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MESSAGE:

I'm working at a private sector restaurant and have educated the restaurant and the other private sector workers about their gifts (tips) which I know are not federally taxable income.

I have done much research on this subject and ask you to share the information with others.

Thank you,
Rhonda

Tax on Tips According to the Internal Revenue Code

What the Code states:

SUBPART C - INFORMATION REGARDING WAGES PAID EMPLOYEES

Sec. 6053. Reporting of tips

a) Reports by employees

Every employee who, in the course of his employment by an employer, receives in any calendar month tips which are wages (as defined in section 3121(a) or section 3401(a)) or which are compensation (as defined in section 3231(e)) shall report all such tips in one or more written statements furnished to his employer on or before the 10th day following such month. Such statements shall be furnished by the employee under such regulations, at such other times before such 10th day, and in such form and manner, as may be prescribed by the Secretary.

According to the IRC (Internal Revenue Code - Title 26 USC) what is to be taxed as tips are two (2) areas: 1 - tips which are wages; and, 2 – tips which are compensation. Lets look at each one separately to see if indeed what a worker is receiving is a tip or a gift.

1 - tips which are wages:

The IRC tells you to look at 3121(a) or 3401(a) for what wages are.

Let's do just that.

Sec. 3121. Definitions

a) Wages - For purposes of this chapter, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash; except that such term shall not include -

b) Employment - For purposes of this chapter, the term "employment" means any service, of whatever nature, performed (A) by an employee for the person employing him, irrespective of the citizenship or residence of either.. (rest of paragraph omitted as irrelevant for our purposes here.)

q) Tips included for both employee and employer taxes - For purposes of this chapter, tips received by an employee in the course of his employment shall be considered remuneration for such employment ... Such remuneration shall be deemed to be paid at the time a written statement including such tips is furnished to the employer pursuant to section 6053(a) (This code section defines what tips are. This is important so that you know so that you know what the employee has to be received in the course of employment to be considered a tip.)

Again, let's look at section 6053(a) the reporting of tips, so that we know what the IRC is asking to be reported.

Sec. 6053. Reporting of tips

a) Reports by employees - Every employee who, in the course of his employment by an employer, receives in any calendar month tips which are wages (as defined in section 3121(a) or section 3401(a)) or which are compensation (as defined in section 3231(e)) shall report all such tips in one or more written statements furnished to his employer...

You see the circular reasoning here. Section 3121 points you to 6053 to understand the definition, 6053 points you to 3121 to understand the meaning (definition) of the section. This is a very common occurrence within the IRC. However, we are not without hope. All of these sections talk about tips as wages or services performed by an employee for his employer which we shall see are called wages.

Therefore, we must look at the definition of wages to know what they are talking about.

Sec. 3401. Definitions

a) Wages - For purposes of this chapter, the term "wages" means all remuneration (other than fees paid to a public official) for services performed by an employee for his employer,...

Wages by definition are what an employer pays an employee. IT IS NOT WHAT A CUSTOMER GIVES AN EMPLOYEE. More on this later.

Let us look at the 2nd part of the definition of wages.

2 - tips which are compensation:

Sec. 3231. Definitions

(e) Compensation -

For purposes of this chapter -

(1) The term "compensation" means any form of money remunerato an individual for services rendered as an employee to one or more employers.

Again, we have services rendered to an employer NOT A CUSTOMER, which service results in a tip (from the employer). This is because anything paid by an employer to an employee are wages [see definition at section 3401(a).] by whatever name you want to call it; like tips for example. A customer has not hired the employee. A customer does not pay the employee; the customer pays the employer - the employee merely acts as an agent for the employer to transport the money to him (the employer).

So what does the employee receive when a customer express his appreciation for the attention given to him? The IRC defines it as a gift, see section 2503.

Sec. 2503. Taxable gifts

a) General definition

The term "taxable gifts" means the total amount of gifts made during the calendar year, less the deductions provided in subchapter C (section 2522 and following).

(b) Exclusions from gifts

(1) In general

In the case of gifts (other than gifts of future interests in property) made to any person by the donor during the calendar year, the first \$10,000 of such gifts to such person shall not, for purposes of subsection (a), be included in the total amount of gifts made during such year.

The IRC excludes from taxable gifts the first \$10,000 received by anyone over the course of a year from each person from whom he received it.

In Summary

As can be seen from the definitions above and many, many others within the IRC tips are only called tips for tax purposes if paid by an employer to his employee(s). Any money paid by a customer would be defined by the IRC as a gift. If any single customer during the calendar year did not pay over \$10,000 to the employee, there would be no reporting requirement on the monies received by the employee. Besides, the employer has no obligation to report other peoples gifts to his employees.

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