

## **SUBJECT: CREDIT FOR EMPLOYEE CASH TIPS – RESTAURANTS ONLY**

**DATE: 02.11.10**

If own a restaurant there is a credit for Social Security taxes you pay on an employee's cash tip income which is treated (for tax purposes) as paid by you to the employee. Note that the credit applies with respect to tips received from customers **in connection with the provision of food or beverages**, regardless of whether the food or beverages are for consumption on or off the premises.

These tips are required to be reported to you by the employee; however, you may still take the credit even if the employee did not report the tips to you.

The credit only applies to the tip income that brings your employee's wages over \$5.15 per hour, which was the minimum wage on Jan. 1, 2007.

It is interesting to note that in 2007 tax legislation that was tied to passage of the increase in the minimum wage, Congress in effect froze the FICA tax credit based on pre-2007 law so that the credit wouldn't be affected by the increase in the minimum wage hourly rate amending the Fair Labor Standards Act of '38 to \$7.25 in three 70-cent increments. The minimum wage increases from \$5.15 to \$5.85 as of July 24, 2007, to \$6.55 as of July 24, 2008, and to \$7.25 as of July 24, 2009. In other words, to the extent the tip income just brings the employee up to the minimum wage level, no credit is available.

Calculations are made on a monthly basis.

*Example:* Felix is a waiter in the ABC Restaurant. He is paid \$2 an hour plus tips. During the month, he works 160 hours for \$320 and receives \$2,000 in cash tips which he reports to his employer. (For purposes of this example, assume a minimum wage rate of \$7.25 an hour.)

Felix's \$2 an hour rate is below the \$5.15 minimum wage rate (as in effect on Jan. 1, 2007) by \$3.15 an hour. Thus, for the 160 hours worked, he is below the minimum rate by \$504 ( $160 \times \$3.15$ ). For Felix therefore, the first \$504 of tip income just brings him up to the minimum rate. The rest of the tip income is \$1,496 ( $\$2,000 - \$504$ ). Felix's employer pays Social Security taxes at the rate of 7.65% for Felix. The employer's credit is thus \$114.44 for the month:  $\$1,496 \times 7.65\%$ .

Social security taxes paid with respect to tip income used to determine the credit cannot also be deducted (but you can elect not to take the credit, in which case you can claim the deduction).

If you have any questions relating to this credit call or email.