



MANUAL TRANSMITTAL

Department of the Treasury
Internal Revenue Service

4.23.7

OCTOBER 1, 2024

EFFECTIVE DATE

(10-01-2024)

PURPOSE

- (1) This transmits a revised IRM 4.23.7, Employment Tax, Employment Tax on Tip Income.

MATERIAL CHANGES

- (1) IRM 4.23.7 was revised to reflect the following changes:

Number	SUBSECTION	MATERIAL CHANGE
1	IRM 4.23.7.1	Added Specialty Examination, Employment Tax Program of the Small Business/Self-Employed Division is the “Primary Stakeholder.”
2	IRM 4.23.7.1.2	Content in paragraph (3) was updated on where to search for delegation orders issued by the Commissioner of the Internal Revenue.
3	IRM 4.23.7.1.6	Updated for clarity and website addresses paragraphs (2), (3), (4) and (5). Added paragraph (6) that provides the responsibility for civil penalty programs is assigned to Office of Servicewide Penalties (OSP). Added paragraph (7) that provides primary resources for TE/GE examiners.
4	IRM 4.23.7.1.7	Added subsection titled “Program Controls” to document the reviews and quality assurance activities associated with the National Tip Reporting Compliance Program.
5	IRM 4.23.7.3.1	Removed subsection regarding Railroad Retirement tax on tip income.
6	IRM 4.23.7.4.1	Updated paragraph (1) for clarification by changing “employees” to “individuals.”
7	IRM 4.23.7.5.1	Updated paragraphs (1) item (d), (3), and (5) for clarification.

Number	SUBSECTION	MATERIAL CHANGE
8	IRM 4.23.7.7	Revised content of paragraph (7) for clarity.
9	IRM 4.23.7.7.2	Revised content of paragraph (2) for clarity.
10	IRM 4.23.7.7.3	Updated paragraphs (6), (8) and (9) language for Form 4668.
11	IRM 4.23.7.7.4	Updated paragraph (12) changing “30 days” to “20 days.” Revised the content in paragraph (14) and (15) for clarity. Added a new note in paragraph (16) item (c) for additional language on the Form 4668.
12	IRM 4.23.7.7.5	Modified language in paragraph (9) since TE/GE no longer uses Form 5599.
13	IRM 4.23.7.9	Removed paragraph (4) and all subsequent paragraphs were re-numbered. Paragraph (4) content was revised.
14	IRM 4.23.7.10.6.2.3	Revised the content of paragraph (3) item (c) for clarity.
15	IRM 4.23.7.10.6.2.5	Added subsection “Updating Established Tip Rates” which clarifies how established tip rates may be updated an ERR or an Addendum.
16	IRM 4.23.7.10.6.2.5.1	Added subsection “Economic Rate Reductions (ERR)” which defines and clarifies procedures for updating establishment tip rates with an ERR.
17	IRM 4.23.7.10.6.2.5.2	Added subsection “Addendum for Existing Outlet/Establishment” that defines and clarifies procedures for updating tip rates for existing outlets or establishments with an addendum.
18	IRM 4.23.7.10.6.2.5.3	Added subsection “Addendum for New Outlet or Establishment” that defines and clarifies procedures for updating tip agreement for new outlets or establishments with an addendum.

Number	SUBSECTION	MATERIAL CHANGE
19	IRM 4.23.7.10.6.3	Updated paragraphs (1) thru (5) for clarification.
20	IRM 4.23.7.10.6.4	Added content to paragraph (4) items (a) thru (c) for clarification.
21	IRM 4.23.7.10.6.5	Added paragraph (2) to clarify instructions and all subsequent paragraphs were renumbered.
22	IRM 4.23.7.10.6.6	Added note to paragraph (5) to clarify that order of the outlets on 4318 must match the list of outlets on Appendix A or Attachment B. Updated paragraph (6) and added paragraph (7) to clarify when Summary may be used as Lead Sheet. All subsequent paragraphs renumbered
23	IRM 4.23.7.10.6.7	Added paragraphs (4) thru (8) to clarify the use of the Rate Review timeline Added Paragraph (9) for authority to use electronic signatures and email.
24	IRM 4.23.7.10.6.7.1	Added paragraphs (3) on approval of tip rates and (4) for requirement to use NTRCP approved templates and assistance with template selection.
25	IRM 4.23.7.10.6.9	Updated entire subsection by adding paragraphs (3) thru (12). Clarifies data required and approval procedures for examiner to provide tip rates for a newly opened property or outlet.
26	IRM 4.23.7.10.6.10	Updated paragraphs (1) and (2) provide procedures for research required during pre-audit phase of Rate Review and documents required to be included in case file.

Number	SUBSECTION	MATERIAL CHANGE
27	IRM 4.23.7.10.6.11	Changed subsection title to “Initial Contact.” Updated paragraphs (1) thru (4) with procedures for initial contact with employer. Added new paragraphs (5) thru (7) for factors to verify during initial contact and subsequent procedures and all subsequent paragraphs were renumbered.
28	IRM 4.23.7.10.6.12	Updated subsection title to “Initial Appointment, Tour and Interviews.”. Added paragraph (1) listing actions to be taken during the initial appointment with the employer and all subsequent paragraphs were renumbered. Updated content of paragraph (2) to include points to document during the tour of the business for each outlet Updated paragraph (3) to clarify sources for interviews and added paragraph (4) to include NTRC Shared Drive Resource file as reference Updated paragraph (5) and items (a) thru (c) to clarify information obtained from various department interviews.
29	IRM 4.23.7.10.6.13	Added new paragraphs (1) and all subsequent paragraphs were renumbered and updated the content in paragraph (2) to provide instruction on information document request (IDR) preparation. Add content to paragraph (3) to clarify procedures to issue IDR 1, General Information. Added new paragraph (4) clarifying the issuance of IDR 2 by department and all subsequent paragraphs were renumbered. Updated content in paragraph (5) and added paragraph (6) to clarify the procedure on additional IDRs. Added new paragraph (6) Added new paragraphs (7) and (9) on the use of IMS for IDRs.

Number	SUBSECTION	MATERIAL CHANGE
30	IRM 4.23.7.10.6.14	Added new paragraphs (1) thru (7) and renumbered all subsequent paragraphs. Clarifies the requirement to use NTRCP customized templates to calculate tip rates. Paragraph (6) and items (a) thru (f) to clarify what data from IDRs and interviews examiners should include in the template. Added (7) to clarify how responses from IDRs and interviews are used in template selection. Updated the content of paragraph (8) to clarify application of Cash Differential and Stiff Rate in tip rate calculation. Updated the content of paragraphs (9) thru (11) to clarify different types of rate review methods
31	IRM 4.23.7.10.6.15	Updated content of paragraphs (1) thru (3) to clarify use of point of sale system in calculating tip rates.
32	IRM 4.23.7.10.6.16	Revised the content of paragraphs (1) thru (5) to clarify factors to consider in a payroll certification.
33	IRM 4.23.7.10.6.17	Updated paragraph (1) to clarify the tip rate of "Actual" and added paragraph (2) how it complies with 6053(a). All subsequent paragraphs are renumbered. Added paragraph (4) to include requirement to use lead sheets and upload all workpapers to IMS.

Number	SUBSECTION	MATERIAL CHANGE
34	IRM 4.23.7.10.6.18	Added paragraph (1) to explain use of “Summary Tab” and revised paragraph (2) to clarify analysis of tip rate calculations. All subsequent paragraphs were renumbered. Added paragraphs (3) and (4) to clarify the procedures for approval of the tip rates by the NTRCP analyst. Added paragraph (5) requiring examiner to share all approved templates with the employer prior to final review.
35	IRM 4.23.7.10.6.19	New subsection “Meet with Employer to Review and Agree to Tip Rates” was added and all subsequent subsections were renumbered. Subsection was added to clarify actions to finalize tip rates.
36	IRM 4.23.7.10.6.20	Updated the title of the subsection to “Issue and Secure the Tip Agreement.” Added paragraphs (1) thru (6) to clarify procedures to prepare the tip agreement and paragraph (7) when an extension may be applicable. Added paragraphs (8) thru (13) to add procedures for NTRCP pre-approval of tip agreement and issuance to employer.
37	IRM 4.23.7.10.6.21	Added paragraphs (1) thru (7) to comply with all IMS case closing procedures
38	IRM 4.23.7.10.6.22	Updated subsection title to “Printed Case File Closing and Assembly.” Removed content and added new content.
39	IRM 4.23.7.10.6.23	Revised paragraphs (3) and (4) from 15 days to 10 days.

Number	SUBSECTION	MATERIAL CHANGE
40	IRM 4.23.7.11	Revised the subsection title to “Mandatory Compliance Reviews on Voluntary Tip Agreements.” Inserted new paragraph (1) to clarify purpose of compliance reviews and all subsequent paragraphs were renumbered. Removed paragraphs (2), (4), (5) and (7). Updated paragraphs (2) and (3) to clarify tip agreement requirements. Moved content of paragraphs (8) to IRM 4.23.7.11.2, (9) to IRM 4.23.7.11.3, (10) to IRM 4.23.7.11.4, (11) to IRM 4.23.7.11.4.1, (12) to IRM 4.23.7.11.4.2, (13) and (14) to IRM 4.23.7.11.4.3, and (15) through 18 to IRM 4.23.7.11.4.4.
41	IRM 4.23.7.11.1	Inserted new subsection “Compliance Review Procedures” that clarifies types of cases and possible outcomes.
42	IRM 4.23.7.11.2	Inserted new subsection “Cases Established on ERCS and IMS.” which provided instructions on the codes to complete Form 5445-NTRC and clarifies IMS requirements. Moved content of paragraph (8) to this subsection.
43	IRM 4.23.7.11.3	Inserted new subsection “Compliance Review Case File.” Added paragraph (1) to clarify documents in the initial case file and (2) advising examiner to reference routing sheet and ETLS Tip Rate Review series 510 lead sheets. Moved content of IRM 4.23.7.11 (9) to this subsection.
44	IRM 4.23.7.11.4	Inserted new subsection “Conducting a Compliance Review.” Moved content of IRM 4.23.7.11 (10) to this subsection.
45	IRM 4.23.7.11.4.1	Inserted new subsection “Precontact Analysis.”. Moved content of IRM 4.23.7.11 (11) to this subsection. Updated content to clarify procedures and analysis.

Number	SUBSECTION	MATERIAL CHANGE
46	IRM 4.23.7.11.4.2	Insert new subsection "Taxpayer Contact." Moved content of IRM 4.23.7.11 (12) to this subsection. Added paragraph (1) to clarify procedures to determine if employer is complying with the tip agreement. Updated paragraph (2) items (a) and (h) to clarify procedures.
47	IRM 4.23.7.11.4.3	Inserted new subsection "Compliance Review." Moved content of IRM 4.23.7.11 (13) and (14) to this subsection. Updated paragraph (1) to clarify analysis and workpapers to include in case file. Updated paragraph (1) item (e) for clarification
48	IRM 4.23.7.11.4.4	Inserted new subsection "Case Summary and Disposition." Moved content of IRM 4.23.7.11 (15) through (18) to this subsection. Updated paragraph (2) for clarification Updated paragraph (3) for clarification Subparagraph titles changed to (a) thru (c). Updated subparagraph (b) for clarification Updated paragraph (4) for clarification
49	IRM 4.23.7.12	Inserted new subsection "Under-reported Employee Tip Income Soft Notice Program" and all subsequent subsections are renumbered. This subsection provides instruction and policy to examiners and NTRCP analyst of the Soft Notice Program.
50	IRM 4.23.7.12.1	Added new subsection "Examples of Taxpayer Issues and Responses." This subsection provides instruction and policy to examiners and NTRCP analyst of taxpayer's responses to the Soft Notice Program inquiries.

Number	SUBSECTION	MATERIAL CHANGE
51	IRM 4.23.7.13	Added new subsection “Form 906 Closing Agreement” and all subsequent subsections are renumbered. This subsection provides instruction and policy to examiners and NTRCP analyst in the preparation of a closing agreement.
52	IRM 4.23.7.13.1	Added new subsection “Form 906 Preparation” This subsection provides instruction and guidance to examiners and NTRCP analyst in the preparation of a closing agreement.
53	IRM 4.23.7.13.2	Added new subsection “Payment Process” This subsection provides instruction and guidance to examiners and NTRCP analyst in processing payments.
54	IRM 4.23.7.13.3	Added new subsection “Post-Payment Monitoring.” This subsection provides instruction and guidance to examiners and NTRCP analyst in the post-payment monitoring of the agreements.
55	Exhibit 4.23.7-2	Letter 3381 is no longer to prepared in duplicate. Added the letter will be mailed by the examiner.
56	Exhibit 4.23.7-3	Corrected number, title, or catalog number of letter, publication, and form when appropriate.

- (2) Changed all references of “Property” to “employer” and “Reviewer” to “examiner” throughout IRM 4.23.7.
- (3) Editorial changes made throughout the IRM for to add clarity, readability, and to eliminate redundancies. Reviewed and updated website addresses, legal references, titles, IRM references, and IRS organization or organization terminology to business unit as necessary.

EFFECT ON OTHER DOCUMENTS

IRM 4.23.7, dated May 10, 2021, is superseded.

AUDIENCE

This section contains instructions and guidelines for all LB&I, TE/GE, and SB/SE employees when dealing with employment tax tip issues.

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4.23.7

Employment Tax on Tip Income

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4.23.7.1
(10-01-2024)
Program Scope and Objectives

- (1) **Purpose:** This section details the basic structure of Tip Examinations and the Tip Rate Review process.
- (2) **Audience:** This section contains instructions and guidelines for all Large Business and International (LB&I), Tax Exempt/Government Entities (TE/GE), and Small Business/Self-Employed (SB/SE) employees dealing with Tip Examinations and Tip Rate Review procedures.
- (3) **Policy Owner:** Director, Specialty Exam Policy of the Small Business/Self-Employed Division.
- (4) **Program Owner:** Program Manager – National Tip Reporting Compliance Program (NTRCP).
- (5) **Stakeholder:** Specialty Examination, Employment Tax Program of the Small Business/Self-Employed Division.

4.23.7.1.1
(05-10-2021)
Background

- (1) The mission of Employment Tax National Tip Reporting Compliance Program (NTRCP) Territory is to develop and implement policies and strategies for tip income filing, payment (withholding), and reporting compliance.
- (2) Tipping has been a historical area of underreporting and is subject to unique laws and regulations. Traditional examinations often are burdensome to both the taxpayer and the IRS. NTRCP has developed voluntary tools, most predominantly tip agreements, which address employer and employee compliance.
- (3) This section provides guidance on general tip examinations and voluntary compliance tools for taxpayers in the tipping industry. Examiners should also refer to tip training materials for additional guidance.

4.23.7.1.2
(10-01-2024)
Authority

- (1) Employment tax provisions are found at Internal Revenue Code Subtitle C:
 - a. Chapter 21, Federal Insurance Contributions Act (FICA)
 - b. Chapter 22, Railroad Retirement Tax Act (RRTA)
 - c. Chapter 23, Federal Unemployment Tax Act (FUTA)
 - d. Chapter 24, Federal Income Tax Withholding (FITW)
 - e. Chapter 25, General Provisions relating to employment taxes and collection of income taxes at source
- (2) NTRCP is governed by Policy Statements and other internal guidance that apply to all IRS personnel regardless of operating division. The Policy Statements found in IRM 1.2.1, *Servicewide Policy Statements*, apply to all employment tax issues and examinations. Reviewers should review these Policy Statements to properly perform their examination duties.
- (3) A website, *IMDD Search Servicewide Delegation Orders*, provides a searchable list of Servicewide Delegation Orders issued by the Commissioner of the Internal Revenue, or on their behalf by the deputy commissioner. Delegation Orders pertaining to each IRS business process can be found in IRM 1.2.2, *Servicewide Delegations of Authority*.
- (4) IRM 4.23.7.10.6, *Gaming Industry Tip Compliance Agreement (GITCA)*, provides Servicewide instructions for all operating divisions with employees involved with tip rate reviews, allowing for improved consistency of tip administration of employment taxes.

4.23.7.1.3
(05-10-2021)
Responsibilities

- (1) Director, Specialty Examination, is the executive responsible for the procedures and updates addressed in this IRM.
- (2) Chief, Employment Tax Examination, is responsible for operational compliance related to tip filing and reporting.

4.23.7.1.4
(05-10-2021)
Program Objectives and Review

- (1) **Program Goals:** The processes and procedures provided in this IRM are consistent with the objectives or goals for National Tip Reporting Compliance. The mission of NTRCP is to establish effective policies and procedures for tip income filing, payment, and reporting compliance. This is accomplished through enforcement and compliance programs such as tip examinations and tip rate reviews.
- (2) **Program Effectiveness:** Adherence to quality standards and attributes are measured by Employment Tax Embedded Quality (EQ) Performance Reports. Progress toward business results is measured by Performance Planning and Analysis (PPA) Exam reports.

4.23.7.1.5
(05-10-2021)
Acronyms

- (1) The following table lists commonly used acronyms and their definitions:

Term	Definition
CCP	Centralized Case Processing
ETLS	Employment Tax Lead Sheets
ET-WSD	Employment Tax - Workload Selection and Delivery unit
EQ	Embedded Quality
FICA	Federal Insurance Contributions Act
FITW	Federal Income Tax Withholding
FUTA	Federal Unemployment Tax Act
GITCA	Gaming Industry Tip Compliance Agreement
IMS	Issue Management System
IRA	Individual Retirement Account
IRM	Internal Revenue Manual
ITG	Indian Tribal Governments
LB&I	Large Business and International
NTRCP	National Tip Reporting Compliance Program
MOU	Memorandum of Understanding
POS	Point of Sale
PPA	Performance Planning and Analysis
RRTA	Railroad Retirement Tax Act
SB/SE	Small Business/Self-Employed

Term	Definition
SERP	Servicewide Electronic Research Program
SRS	Specialist Referral System
SSA	Social Security Administration
TBOR	Taxpayer Bill of Rights
TE/GE	Tax Exempt/Government Entities
TEPA	Tipped Employee Participation Agreement
TRAC	Tip Reporting Alternative Commitment
EmTRAC	Employer-designed Tip Reporting Alternative Commitment
TRD/EP	Tip Rate Determination and Education Program
TRDA	Tip Rate Determination Agreement

4.23.7.1.6
(10-01-2024)

Related Resources

(1) The following table lists the primary sources of guidance:

Source	Title	Description of Guidance
IRM 4.23	Employment Tax IRM	IRM sections, the majority of which are owned by SB/SE - Specialty Examination Policy, provide Servicewide instructions for employees of all operating divisions involved with the correct filing, reporting, and payment of employment taxes. IRM 4.23 serves as the foundation for consistent administration of employment taxes by various IRS operating divisions.

(2) Other helpful information sources include:

- *SB/SE Employment Tax Small Business Knowledge Base Homepage,*
- *Specialist Referral System (SRS) Homepage,*
- *Employment Tax Policy Contacts* provides a list of SB/SE Employment Tax Policy Analysts, their contact information and program assignments, and
- *Program Manager and Analyst Contact List* provides the NTRCP Program Manager and analysts' contact information and program assignment.

(3) The Taxpayer Bill of Rights (TBOR) lists rights that already existed in the IRC, putting them in simple language and grouping them into 10 fundamental rights.

Employees are responsible for being familiar with and acting in accord with taxpayer rights. See IRC 7803(a)(3) . For additional information about the TBOR refer to *Taxpayer Bill of Rights Homepage*.

- (4) The Taxpayer Advocate Service (TAS) is an independent organization within the IRS, led by the National Taxpayer Advocate, that helps taxpayers and protects taxpayer rights. TAS offers free help to taxpayers when a tax problem is causing a financial difficulty, when they've tried and been unable to resolve their issue with the IRS, or when they believe an IRS system, process, or procedure just isn't working as it should. TAS strives to ensure that every taxpayer is treated fairly and knows and understands their rights under the TBOR. TAS has at least one taxpayer advocate office located in every state, the District of Columbia, and Puerto Rico.
- (5) Employment tax examiners should consider the disclosure provisions when preparing agreed and unagreed case reports. For further information, see the *Privacy, Government Liaison and Disclosure (PGLD) knowledge base*.
- (6) Overall responsibility for civil penalty programs is assigned to Office of Service-wide Penalties (OSP). OSP is charged with coordinating policy and procedures concerning the civil penalty program administration, ensuring consistency with the penalty policy statement, reviewing and analyzing penalty information, researching penalty effectiveness on compliance trends, and determining appropriate action necessary to promote voluntary compliance. For further understanding of the civil penalty program and penalty relief refer to the *Penalties Knowledge Base Homepage*.
- (7) TE/GE employees must refer to IRM 4.70.14.2.1.4.5, *TE/GE - Tip Compliance Agreements*, and IRM 4.70.18, *Tip Compliance Agreements*, for guidance and procedures for the TE/GE tip program.

4.23.7.1.7
(10-01-2024)

Program Controls

- (1) All information management systems have safeguard measures in place that address key components of Information Technology (IT) security requirements to restrict access to sensitive data.
- (2) The Employment Tax program has established a separation of duties of users' roles.
 - Policy and procedures – Employment Tax Policy is within SB/SE Specialty Exam Policy
 - Tip policy and procedures – National Tip Reporting Compliance Program is within SB/SE Specialty Examination
 - Tip Field Exam Case Selection – Employment Tax – Workload Selection and Delivery is within SB/SE Examination Case Selection
 - Tip Underreporting Campus Exam Case Selection – National Tip Reporting Compliance Program is within SB/SE Specialty Examination
 - Examination - Employment Tax Examination is within SB/SE Specialty Exam
 - Quality and review - Embedded Quality is within SB/SE Field and Specialty Exam Quality
- (3) The Issue Management System (IMS) is required to be used during employment tax tip cases by examiners assigned to Specialty – Employment Tax Operations.

- (4) Unless instructed otherwise, examiners will use the ETLS - Employment Tax Lead Sheets developed specifically for employment tax tip cases.
- (5) SB/SE ET examiners working ET Large Cases will use Large Case Lead Sheets (LCLS). LCLS are developed specifically for large case employment tax cases. Examiners working ET Large Cases will follow workpaper preparation, specific audit techniques, and case closing procedures unique to these types of audits including tip cases.

4.23.7.2 (01-13-2014) Introduction

- (1) Under Treas. Reg. 31.3102-3, the employer is responsible for deducting and depositing the employee's share of social security and Medicare tax on tips. All tips should be included in a written report furnished by the employee to the employer. The employer must withhold to the extent that collection can be made from the employee's funds on or after the time the written statement is furnished. The employee's funds include wages (exclusive of tips) in the employer's possession and amounts turned over to the employer by the employee.
- (2) If the employee does not provide enough money, the employer will apply the employee's regular pay and any money the employee gives to the employer to the taxes in the following order:
 - a. Social security and Medicare or railroad retirement taxes on the employee's regular wages,
 - b. Federal, state, and local income taxes on the employee's regular wages,
 - c. Social security and Medicare taxes or railroad retirement taxes on the employee's reported tips, and
 - d. Federal, state, and local income taxes on the employee's reported tips.

Any taxes that remain unpaid can be collected by the employer from the employee's next paycheck. If withholding taxes remain uncollected at the end of the year, the employee may be subject to a penalty for underpayment of estimated taxes.

- (3) IRC 3121(q) provides that employers must pay the employer's share of social security and Medicare taxes on tips reported by their employees in the course of employment. The tips are deemed to have been paid at a time a written statement including such tips is furnished by the employee to the employer. If no such statement is furnished (or to the extent the statement is incomplete or inaccurate) the tips will be deemed to be paid on the date on which Section 3121(q) Notice and Demand for the taxes is made to the employer. (See IRM 4.23.7.7.4, *Section 3121(q) Notice and Demand Procedures*, below).
- (4) For income tax purposes, tips are wages that are deemed paid at the time a written statement including such tips is furnished to the employer pursuant to IRC 6053(a) or, if no statement including such tips is so furnished, at the time received. employers are required to withhold federal income tax on tips listed on the employee's written statement.
- (5) The employer is required to furnish a statement to the employee showing the amount of social security and Medicare taxes that could not be collected from the employee's wages. Form W-2, **Wage and Tax Statement**, is the form prescribed for furnishing this statement under Treas. Reg. 31.6053-2(b). Unlike the uncollected portion of the regular (1.45 percent) Medicare tax, the uncollected Additional Medicare Tax (0.9 percent) is not reported on Form W-2. The employer shows the uncollected social security tax, Medicare tax, and Addi-

tional Medicare Tax as a current period adjustment on the employer's employment tax return, (for example, Form 941, *Employer's QUARTERLY Federal Tax Return*).

Note: For tax years beginning after December 31, 2012, a 0.9 percent Additional Medicare Tax applies to Medicare wages, Railroad Retirement Tax Act compensation, and self-employment income over a threshold amount based on the taxpayer's filing status. For more information on Additional Medicare Tax, go to IRS.gov and enter "Additional Medicare Tax" in the search box.

4.23.7.3
(12-18-2012)
Employee Tip Reporting

- (1) IRC 6053(a) requires that the employee provide the written statement of tip income to the employer by the 10th day of the month following employee's receipt of the tips, if reportable. No particular form is required to be used in reporting tip income. Treas. Reg. 31.6053-1 requires that the form used should be signed by the employee and disclose:
 - a. The name, address, and social security number of the employee,
 - b. The name and address of the employer,
 - c. The total amount of tip income, and
 - d. The period for which, and the date on which, the statement is furnished. If the statement is for a calendar month, the month and year should be specified. If the statement is for a period of less than one calendar month, the beginning and ending dates of the period should be shown (for example, Jan. 1 through Jan. 8, 2020).
- (2) Employees may use Form 4070, *Employee's Report of Tips to Employer*, along with Form 4070-A, *Employee's Daily Record of Tips*, for the written statement of tip income. Forms 4070 and 4070-A are included in Publication 1244, *Employee's Daily Record of Tips and Report of Tips to Employer*.

Note: Some employers may require employees to use an employer-provided form.

- (3) In lieu of a separate form for tip reporting, Treas. Reg. 31.6053-1(b)(2)(iii) provides that an employer may prescribe regularly used forms (such as timecards) for use by employees in reporting tips. However, the form must meet the requirements of Treas. Reg. 31.6053-1(b)(1)(iii) and (iv) and must contain identifying information which will assure accurate identification of the employee by the employer.
- (4) An employer may prescribe regularly used electronic forms for use by employees for reporting tips. If an electronic statement is used, the electronic system must ensure that the information received is the information transmitted by the employee. The system must document all occasions of access that result in the transmission of a tip statement. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and transmitting the statement is the employee identified in the statement transmitted. Any electronic statement must include the same information set out above in paragraph (1). An electronic tip statement must be signed by the employee. The electronic signature must identify the employee transmitting the electronic tip statement and must authenticate and verify the transmission. Upon request by the IRS, the employer must supply the IRS with a hard copy of the electronic

tip statement and a statement that, to the best of the employer's knowledge, the electronic tip statement was filed by the named employee. Treas. Reg. 31.6053-1(d).

- (5) If an employee does not report all cash tips (cash tips include tips received from customers), charged tips (credit and debit card charges) distributed to employees by employer, and tips received from other employees (under any tip-sharing arrangement) to the employer in a written statement, the employee may be subject to the penalty imposed by IRC 6652(b), Failure to Report Tips.
- (6) The cash tips to which this provision applies include checks and any other monetary media of exchange. Tips received by an employee in any medium other than cash, such as passes, tickets, or other goods or commodities, do not constitute wages for FICA purposes. See Treas. Reg. 31.3121(a)(12)–1.
- (7) If an employee fails to maintain records, or if the records kept do not accurately reflect the amount of tip income received, the IRS is authorized, under IRC 446(b), to reconstruct income in accordance with any method that in its opinion clearly reflects the amount of tip income received.
- (8) The employee is responsible for reporting **all** tip income on his or her Form 1040, *Individual Income Tax Return*. Tip income includes cash tips (see IRM 4.23.7.3 (3) above) and the value of tips not paid in cash, for example passes, tickets, goods, or services. These non-cash tips are not included in the Form W–2 but must be reported for Federal income tax purposes on the employee's Form 1040.

4.23.7.4 (01-13-2014) **Form 4137 Requirements**

- (1) Form 4137, *Social Security and Medicare Tax on Unreported Tip Income*, is used by an employee to compute the social security and Medicare tax owed on tips not reported to the employer. Unreported tip income, reported on Form 4137, is carried over to Form 8959, *Additional Medicare Tax*, which is used by an employee to compute Additional Medicare Tax owed on tips not reported to the employer. Unreported tips may include allocated tips shown on the employee's Form W-2, Wage and Tax Statement, Box 8, (unless the employee can prove a smaller amount with adequate records). The employee may be subject to a penalty equal to 50 percent of the social security tax, Medicare tax, and Additional Medicare Tax due for failure to report tips to the employer unless reasonable cause exists (IRC 6652(b)). The Form 4137 and Form 8959 are filed with the Form 1040, *Individual Income Tax Return*.

4.23.7.4.1 (10-01-2024) **Form 4137 Compliance Program**

- (1) Form 4137 is designed to be used exclusively by employees to calculate the social security and Medicare taxes on unreported tips. Prior to 2007, Form 4137 was also used by individuals to report Form 1099 income that they believed were wages rather than non-employee compensation. Starting with tax year 2007, Form 8919, *Uncollected Social Security and Medicare Tax on Wages*, is used for that purpose.
- (2) Form 4137 shows the individual EIN(s) and the employee's unreported tips for each of the employers for whom the employee worked for during the year. Form 4137 allows the IRS to aggregate unreported tips reported on Forms 4137 for each employer. This allows the IRS to provide each employer with a Section 3121(q) Notice and Demand for the employer's share of the applicable FICA due on the tips their employees reported to the IRS but did not report to the employer.

- (3) IRC 3121(q) provides the authority for the IRS to issue a Section 3121(q) Notice and Demand to an employer for the employer's share of FICA tax on unreported tips – determined either by tip examination or from Forms 4137 filed by employees. Detailed guidance related to the Section 3121(q) Notice and Demand process for tip exams is covered in IRM 4.23.7.7.4, *Section 3121(q) Notice and Demand Procedures*.
- (4) The Form 4137 Compliance Program is designed to determine the total tips shown as unreported on Form 4137 for each employer and then issue a Section 3121(q) Notice and Demand for the payment of the employer's share of FICA tax on those tips. This program is administered by NTRCP within SB/SE Employment Tax.
- (5) The Section 3121(q) Notice and Demand process related to Form 4137 is not considered an examination. The employer's (taxpayer's) books and records are not examined. The Section 3121(q) Notice and Demand process is a collection program – collecting the employer's share of FICA taxes related to unreported tips shown on the Forms 4137 with each respective employer through a current period liability to the employer's Form 941, *Employer's Quarterly Federal Tax Return*. No specific format is required for the notice and demand, but the IRS has developed correspondence for making the notice and demand.
- (6) Each case is established on AIMS using the following codes:
 - **Project Code 1034:** 4137 Tip Correspondence Contacts
 - **Tracking Code 7887:** 4137 Leads
- (7) Examiners must use Letter 4520-P, *Pre-notice for Employer Share of Tax Based on Form 4137*, to provide the employer with advance notice of the IRC 3121(q) FICA tax liability. Generally, the IRS will send the employer the pre-notice at least thirty days prior to issuing the Section 3121(q) Notice and Demand to allow the employer sufficient time to gather the necessary funds for making a timely tax deposit.

Note: Letter 4520-P emphasizes to the employer that if a payroll service is used, the employer should immediately notify the payroll service of the IRC 3121(q) FICA tax liability. The payroll service provider may need time to work with the employer so the necessary payroll deposit can be made timely and thus reduce or eliminate any interest or deposit penalties.
- (8) There are four attachments to Letter 4520-P:
 - a. **Tax calculation worksheet:** Summarizes the IRC 3121(q) FICA tax liability due,
 - b. **Form 4137 detail spreadsheet:** Lists information from each of the Form(s) 4137 filed under the employer's EIN (employer identification number),
 - c. **Publication 5080 FAQs:** Provide guidance for the most commonly asked questions, and
 - d. **Notice 609:** Informs individuals of their privacy rights in non-criminal cases.

Note: It is recommended that examiners issue the Section 3121(q) Notice and Demand within the first 60 days of the quarter to give the employer sufficient

time to gather the necessary funds to make the tax deposit and to have sufficient time to notify its payroll service, if there is one, to ensure a timely tax deposit.

- (9) In general, no sooner than thirty days after sending Letter 4520-P to the employer, the IRS will send Letter 4520, *Section 3121(q) Notice and Demand*. This letter will explain how the employer should report the IRC 3121(q) FICA tax liability to avoid penalties and interest.
- (10) There are two attachments to Letter 4520 based on Forms 4137:
 - a. **Tax calculation worksheet:** Summarizes the IRC 3121(q), FICA tax liability, and
 - b. **Form 4137 detail spreadsheet:** Lists information from each Form 4137 filed under the employer's EIN (employer identification number).
- (11) The employer must report the IRC 3121(q) FICA tax liability on the Form 941 for the quarter corresponding to the date of the Section 3121(q) Notice and Demand. This Form 941 is referred to as the "reporting Form 941." The date of the Section 3121(q) Notice and Demand will be the last business day of the quarter in which the Letter 4520 is issued, not the mailing date of the letter.
- (12) If the employer fails to report the IRC 3121(q) FICA tax liability on the reporting Form 941, that quarter will be opened for a limited scope examination initiated on the missing IRC 3121(q) FICA tax liability. This limited scope exam will address the non-reporting of the IRC 3121(q) FICA tax liability **only**. The exam group should use the following codes to establish these limited scope exams on AIMS:
 - **Project Code 1118:** Limited Scope Exam – Unreported IRC 3121(q) Tax
 - **Tracking Code 7887:** 4137 Leads

Note: For more information on this Program, contact an NTRCP analyst.

4.23.7.5 (12-18-2012) Information Return Reporting

- (1) Information reporting is a key component in IRS compliance programs. Information reporting also serves to further several key initiatives in the administration of federal income taxes, such as reducing burdens associated with tax return preparation.
- (2) IRC 6041 through IRC 6053 and Title 31 of the United States Code require that taxpayers report various types of payments to both the IRS and the recipients of the payments. These payments include such items as rent, salaries, wages and income paid in the course of a trade or business, and payments such as dividends, interest, and royalties made to another person.
 - a. The term "information return" means any statement, return, form or schedule as described in Treas. Reg. 301.6721-1(g). See IRM 4.10.5.6, *Information Returns*, for details on information returns.
 - b. For large food or beverage establishments, a key information return for tip examinations is Form 8027, *Employer's Annual Information Return of Tip Income and Allocated Tips*, discussed in IRM 4.23.7.5.1, *Form 8027 Requirements*.
 - c. Employers who file Form 8027 and meet the tip allocation rules must report the allocated tip amounts on the affected tipped employee's Form W-2, *Wage and Tax Statement*, Box 8, for the applicable tax year.

4.23.7.5.1
(10-01-2024)
Form 8027
Requirements

- (1) Treas. Reg. 31.6053–3 requires certain large food or beverage establishments to make an information return with respect to tips. The employer is required to file a separate information return for each calendar year in which the employer has employees. The information return will contain the following:
 - The employer's name, address, and employer identification number
 - The establishment's name, address, and identification number
 - The aggregate gross receipts (other than nonallocable receipts) of the establishment from the provision of food or beverages
 - The aggregate charge receipts (defined as charge receipts with charged tips)
 - The aggregate of charged tips on those charge receipts
 - The aggregate of tips reported to the employer by the tipped employees
 - The aggregate amount the employer is required to report under IRC 6051 with respect to service charges of less than ten percent
 - (2) Large food or beverage establishments use Form 8027, to make annual reports to the IRS on its food or beverage operations receipts and employees' reported tips.
 - (3) A "large food or beverage operation" is defined as one which normally employs more than ten employees on a typical business day during the preceding calendar year, food or beverage is consumed on premises, and is an operation in which the tipping of food or beverage employees is customary. See Treas. Reg. 31.6053–3(j)(7).
 - (4) The phrase "more than ten employees on a typical business day" is defined in Treas. Reg. 31.6053–3(j)(9). This test is met if one-half of the sum of the average number of employee hours worked per business day during the calendar month in which the aggregate gross receipts from food or beverage operations were the greatest, plus the average number of employee hours worked per business day during the calendar month in which the aggregate gross receipts from food or beverage operations were the least, is greater than 80 hours. This test includes all employees of a food or beverage operation not only food or beverage employees.
- Note:** Refer to "Worksheet for Determining Whether To File Form 8027" in the Instructions for Form 8027, for additional information.
- (5) A food or beverage employee is an employee who provides services in connection with the provision of food or beverages. Such employees include, but are not limited to; waiters, waitresses, busboys, bartenders, hostesses, maitre d's, dining room captains, wine stewards, cooks, and kitchen help. See Treas. Reg. 31.6053-3(j)(10). Employees who are not food or beverage employees include, but are not limited to, managers, coat check staff, doormen, and parking attendants.
 - (6) A separate Form 8027 must be filed for each location under common ownership or control. If the total hours of all locations exceed the 80 hours computation, then each location must file a separate Form 8027. This is true even if the individual locations, when considered separately, would not exceed the 80 hours test.
 - (7) For information about the requirement to file Forms 8027, see *Instructions for Form 8027* and Pub 1239, *Specifications for Electronic Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips*.

4.23.7.5.2
(01-13-2014)
**Form 8027 Allocated
Tips**

- (1) An employer who operates a large food or beverage establishment is required to allocate among tipped employees an amount equal to the excess of eight percent of the gross receipts of such establishment for the payroll period over the aggregate amount of tips reported by employees at such establishment to the employer. See Treas. Reg. 31.6053-3(d).
- (2) This results in an allocation of a percentage of gross receipts to tipped employees. The individual allocation is entered as an information item on the employee's Form W-2 Box 8. There are no taxes withheld from allocated tips because tips were not reported by the employee to the employer in a written statement. Employees must report the allocated tips from their Form(s) W-2, Box 8, on a Form 4137, *Social Security and Medicare Tax on Unreported Tip Income*, which must be attached to their Form(s) 1040 unless they can establish with adequate records that they received a lesser amount. Employees use Form 4137 to compute their share of social security and Medicare tax on these unreported tips. Employees use Form 8959, *Additional Medicare Tax*, to compute Additional Medicare Tax on these unreported tips. Form 4137 and Form 8959 are filed with Form 1040, **Individual Income Tax Return**.
- (3) The employer is not required to report its share of social security and Medicare taxes on allocated tips because these tips were not reported in a written statement by the employees receiving the allocated tip amounts. However, if unreported tips are determined in the course of a tip audit or through the Form 4137 Compliance Program, the employer is liable for its share of social security and Medicare taxes on the tips that were not reported by employees when notified by the IRS .

Note: Additional Medicare Tax is only imposed on the employee. There is no employer share of Additional Medicare Tax.

- (4) Examiners should consider whether to assert any penalties for an employer's failure to file Form 8027 and/or failure to report tip information on Form W-2 as required. See IRM 20.1.7, *Information Return Penalties*.

4.23.7.6
(12-18-2012)
**Other Information
Reporting Issues to
Review**

- (1) In the area of tip income reporting, employers and business owners at times mis-characterize certain payments. Examiners need to be alert for situations where payments for services are inappropriately structured or incorrectly classified. Mis-classification of payments may result in incorrect information return reporting and/or underpayment of employment taxes.

4.23.7.6.1
(12-18-2012)
**Payments to Drivers of
Taxicabs, Limousines,
Tour Buses, and Other
Modes of Transportation
for Services**

- (1) Certain payments to drivers of taxicabs, limousines, tour buses, and other modes of transportation may have been mis-characterized by employees, employers, or business owners as tips.
- (2) This may occur in situations that involve drivers who are employees of companies engaged in the business of transporting passengers for a fare (for example, limousines and taxicabs). The drivers pick up and transport passengers to their requested destinations. Typically, the driver collects the fares from the passenger. It is customary for the passenger to tip the driver an amount in addition to the fare for the transportation provided. At issue are other payments the driver may receive in addition to the tips from the passenger.

- (3) Some business establishments such as adult entertainment clubs, restaurants, nightclubs, and other service establishments have a practice of making payments to drivers who bring passengers to their establishments.
 - a. Generally, the service establishment's personnel will not render payment to the driver until the passenger first pays a cover charge or otherwise indicates in some manner that they are patrons of the service establishment.
 - b. Payments by establishments to drivers are usually made in cash, although some establishments issue vouchers to the drivers that can be exchanged for cash at a later time.
 - c. The amount of the cash or voucher payment may or may not bear any relationship to the transportation fare, may vary depending upon the number of patrons, and may be far greater than either the fare or the customary tip for the transportation.
 - d. In many situations, one or more passengers are transported from a location such as a hotel directly to the establishment. In some cases, the driver may make agreements with certain hotel personnel so that when a guest wants to go to an establishment (for example, hotel guest informs hotel personnel that they are interested in finding an adult entertainment club), the hotel personnel will summon the driver with whom they have an agreement from the hotel's transportation queue and the driver will split the payment from the establishment with the hotel personnel.
 - e. In some cases, the passenger may not request a particular destination and the driver or hotel personnel will recommend an establishment that will pay the highest amount for delivering the passenger/patron.
 - f. Many establishments advertise in local magazines, specifically targeted at drivers in the transportation industry. The ads indicate that the establishment will pay a "referral fee," "tip," or "incentive" for delivery of passengers/patrons.
- (4) Generally, the drivers do not report the payments to their employer as tips. Thus, the employers are not treating the payments as wages subject to employment taxes. The absence of reporting on either Forms 1099 or Forms W-2 may result in some drivers not reporting the payments as income on their income tax returns.
- (5) Chief Counsel Advisory (IRS CCA 201106010, dated 12-01-2010), provides that under the facts and circumstances described in the CCA (similar to the situations described above), the payments from the establishments to the drivers are not tips received in the course of employment with the transportation company, but are considered payments for services separate and distinct from those the drivers perform for their transportation company employer. In addition, if the payments to one driver equal or exceed \$600 in a calendar year, the business making the payment is required to report these payments on Forms 1099.
- (6) When examining service businesses (such as restaurants, night clubs et al.), examiners need to investigate the existence of payments of this type which are usually paid in cash or by a voucher that can be converted to cash at a later date. Various techniques may be used to identify the existence of and deduction for such payments (including observation of drop-off locations of transportation companies at the establishment and inquiries regarding the establishment's business deductions.)

- (7) The reporting requirements applicable to the payments made by the establishments described above are provided in IRC 6041(a). This section requires all persons engaged in a trade or business and making payment in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other **fixed or determinable** gains, profits, and income of \$600 or more in any taxable year, to file an information return with the IRS and to furnish an information statement to the payee. Payments are fixed when they are paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. Treas. Reg. 1.6041-1(c). Payments that are **fixed or determinable** must be reported on Form 1099. See Treas. Reg. 1.6041-1(a)(2).
- (8) If the payments at issue are for the separate and distinct services of delivering patrons, the service establishments are required under IRC 6041 to file a Form 1099 with the IRS for each person (driver) to whom they paid \$600 or more during the calendar year. If the establishments do not file Form 1099, examiners should consider assertion of penalties under IRC 6721 and IRC 6722. Penalty assertion should be discussed with the examiner's manager.
- (9) Backup withholding should also be considered if the payor fails to secure a Taxpayer Identification Number (TIN) from the service provider individual (in this case, the driver). The payor is required to back-up withhold a percentage on the payment amount (24 percent). If the payor fails to withhold the current applicable backup withholding percentage from the service provider, the payor becomes liable for the backup withholding under IRC 3406. See IRM 4.23.8.13, *IRC 3406 - Backup Withholding*.
- (10) Pub 4904, *How to Report Driver Referral Fees, Incentive Payments, and Other Income You Receive*, can be used to educate business owners of their reporting, filing, and payment obligations on payments for services.

4.23.7.6.2 (01-13-2014)

Tips vs. Service Charges

- (1) Tips are not defined in the IRC or Treasury Regulation. Rev. Rul. 2012-18, 2012-26 I.R.B. 1032, provides criteria for determining whether a payment is a tip or a service charge. Service charges are frequently referred to as "auto-gratuities" in the hospitality industry. Rev. Rul. 2012-18 uses the criteria provided in Rev. Rul. 59-252, 1959 C.B. 215. We rely on Rev. Rul. 2012-18 in making the distinction between a tip and a service charge (or auto-gratuity). Examiners should verify that distributed service charges are properly characterized as wages subject to withholding, and not as tips.
- (2) Rev. Rul. 2012-18 provides specific examples of amounts characterized as tips and service charges to illustrate the application of factors relevant to distinguishing a tip vs. a service charge. Example A in Q and A 1 of Rev. Rul. 2012-18 illustrates a service charge paid by a large party when the menu specifies that a fixed charge will be added to all bills for parties of 6 or more customers. Example B illustrates a tip in a situation where the credit card charge receipt shows sample tip calculations.
- (3) The incorrect characterization impacts the withholding rules and affects a number of forms and credits:
 - Form 8027, *Employer's Annual Information Return of Tip Income and Allocated Tips*,

- Form 8846, *Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips*, for the IRC 45B credit, and
 - Form 3800, *General Business Credit*.
- (4) The criteria of Rev. Rul. 2012-18 should be applied to determine whether the payment made is a tip or a service charge. Q and A 1 of Rev. Rul. 2012-18 provides that the absence of any of the following factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge:
- a. The payment must be made free from compulsion,
 - b. The customer must have the unrestricted right to determine the amount,
 - c. The payment should not be the subject of negotiation or dictated by employer policy, and
 - d. Generally, the customer has the right to determine who receives the payment.
- (5) A contractually fixed gratuity for catering, banquets, weddings, transportation, baggage handling and other events or items is generally considered to be service charges if the amount is distributed or paid to the service staff. A non-contractually fixed gratuity, or “auto-gratuity,” that is the policy of the employer is generally considered to be a service charge. If these amounts are distributed or paid to the employees, then the amounts are non-tip wages subject to withholding. Examples of employer policy driven service charges:
- a. Employer sets a fixed charge or “auto-gratuity” for all purchases in the food or beverage establishment regardless of amount of sale or number of guests.
 - b. Auto gratuity added for a large party of customers.
 - c. Bottle service fees or cork fees in night clubs or restaurants.
 - d. Delivery fees in the pizza industry or other delivery service industries.
- (6) Examinations performed in industries where tipping is customary should include the following:
- a. An evaluation of the employer’s policy for customer gratuities,
 - b. The internal controls for payments received by the establishment or the employee as gratuities,
 - c. The splitting or pooling of gratuities,
 - d. The employee’s reporting of gratuities to the employer under IRC 6053(a), and
 - e. The distribution of gratuities from the employer to the employees.
- (7) The employer’s characterization of a payment as a “tip” is not determinative. The fact that the employee may have reported the payment as a “tip” to the employer is also not determinative. When performing a tip examination, examiners must ensure that distributed service charges are properly characterized as wages subject to withholding and not as tips. Distributed service charges that have been characterized as tips should generally be re-characterized and an adjustment made to the Form 941, **Employer’s Quarterly Federal Tax Return**, under examination and reported on employment tax report Form 4666, *Summary of Employment Tax Examination*, and Form 4668, *Employment Tax Examination Changes Report*.

- (8) Amounts determined to be service charges and not tips are not eligible for the IRC 45B credit claimed on Form 8846, (and thus are not eligible for the General Business Credit claimed on Form 3800.)
- (9) When calculating the amount of unreported tips for an employer-only assessment under IRC 3121(q), examiners must ensure they do not include service charges in the Section 3121(q) Notice and Demand.
- (10) A review of the correct characterization of service charges does not constitute a “tip examination” within the meaning of a voluntary tip agreement. Establishments possessing a tip agreement can be contacted to review the tip vs. service charge issue. The examiner must take caution against making an adjustment for unreported tips and focus on the correct characterization and reporting of service charges.
- (11) A tip rate review of an employer participating in a voluntary tip compliance agreement should also include an evaluation of the items in the preceding paragraph.
 - a. Service charges should not be included in any calculation that arrives at an hourly tip rate, tip rate calculated on a percentage of sales, or any other rate determination method when preparing a voluntary tip compliance agreement.

Note: Examiners must consider if sales with a related service charge must be excluded from the tip rate calculation.
 - b. Examiners should note in their work papers and appendices that service charges were not included in the tip rate computations.
 - c. The tip agreement should also instruct the employer how to account for and report service charges.

Note: The examiner must refer to IRS training course number 28136-B002, *Employment Tax Tip Rate Reviews (Student Guide)* (Catalog Number 93915C), on treatment of service charges and preparation of tip agreement when service charges are imposed by the employer.

4.23.7.7
(10-01-2024)
**Employment Tax Tip
Examination**

- (1) Employment tax tip examinations are regular employment tax cases with tipping identified as a potential issue. Items to consider:
 - a. Review of Form 941, *Employer's Quarterly Federal Tax Return*, shows low or zero tips but the NAICS code indicates an industry where tipping is customary.
 - b. The amount of tips is low compared to the tip related sales.
- (2) Form 8027, *Employer's Annual Information Return of Tip Income and Allocated Tips*, is analyzed and compared to Forms 941 filed by employers to determine the potential for under-reported tips in the food and beverage industry. Factors to consider in a tip examination include if the Form 8027 indicates:
 - Charged tips are greater than or equal to total tips reported,
 - A significant disparity between the charge tip rate and the cash tip rate, and
 - Allocated tips at a rate lower than 8 percent and there is no tip rate reduction determination letter for the taxpayer.

Note: See IRM 4.23.7.14, *Petition for Lower Rate*.

- (3) Examiners may be assigned a case where the taxpayer is under a voluntary tip compliance agreement described in IRM 4.23.7.10, *Tip Rate Determination and Education Program (TRD/EP)*. There may be historical information contained in the case file pertaining to the type of tip agreement and any compliance activity the IRS has employed to improve compliance by the taxpayer. Compliance reviews are not tip examinations and are conducted differently than a case selected for a tip examination. If you receive a case for a compliance review, contact the NTRCP Policy analyst for details on these procedures.
- (4) The terms of the tip agreement generally provide that the IRS will not examine employers under a tip agreement as long as the employer is complying with the terms of the agreement. If a tip examination has been opened in error and the examiner has not reviewed books and records, the examination should be closed using Disposal Code "32," Survey After Assignment. If books and records were reviewed, the examination should be closed using Disposal Code "02," No-Change. If the examiner's manager believes there has been egregious noncompliance or an abusive situation exists, they should contact the SB/SE National Tip Reporting Compliance Program Manager to discuss alternatives and future actions.
- (5) During the initial interview, examiners should clarify with the taxpayer that this is not an income tax examination - it is an employment tax examination. Examiners should explain that they will be gathering information to determine the correct tip income earned by the establishment's employees.
- (6) Examiners must consider expanding the scope of a tip audit when warranted. Tip audits are not limited in scope to tip related issues and examiners are responsible for ensuring the full compliance of the taxpayer under examination.
- (7) Cases classified for a **tip examination** should not be limited in scope to tip related issues. For further information see IRM 4.23.7.7.1, **Scope of Tip Examination**. Issues, such as fringe benefits and unreported or underreported compensation, should be considered and added to the tip audit examination plan when appropriate.
- (8) Examiners must perform the required filing checks to ensure the taxpayer is in compliance with other filing, payment and reporting obligations. To complete the required filing checks, examiners must conduct an analysis of all subsequent returns which are filed or due before the audit is closed and all prior returns which have open statutes, including those not filed. This analysis includes evaluating audit potential through IDRS research to determine whether:
 - a. The taxpayer met their filing, payment and reporting obligations,
 - b. Liens or bankruptcy indicators are present,
 - c. Tip noncompliance identified on the return under audit is likely to be present on the prior and/or subsequent return(s) and if such noncompliance is material, and
 - d. Collectability is a factor.

Note: For more information regarding required filing checks refer to IRM 4.23.3.6.3.1, *Required Filing Checks*.

- (9) If needed to complete the required filing checks, examiners should inspect taxpayer's retained copies or requisition the original returns.
- (10) If the required filing checks result in a determination that the taxpayer is not in compliance with income tax filing requirements, the examiner must complete Form 5346, *Examination Information Report*, and forward it to the SB/SE Employment Tax Workload Selection and Delivery (ET WSD) (per IRM 4.23.3.3.6.1, *SBSE ET-WSD Referrals*).
- (11) Audit steps and findings must be documented in the audit workpapers.

4.23.7.7.1 (05-10-2021) **Scope of Tip Examination**

- (1) Cases classified for a "tip examination" should not be limited in scope to tip related issues only. Examiners should perform the required filing checks to ensure the taxpayer is in compliance with other filing, payment, and reporting obligations. Other common issues such as fringe benefits and unreported or underreported compensation should be considered and added to the examination plan when appropriate.
- (2) Examiners should conduct the examination to a point where the reported employment tax liability is determined to be substantially correct. Examiners must determine whether information returns such as wage and tax statements have been correctly filed and whether all applicable Federal return requirements have been met. See IRM 4.23.3.6.3.2, *Scope of Employment Tax Examination*, for further details.

4.23.7.7.2 (10-01-2024) **Employer Tip Examinations**

- (1) The Supreme Court determined in *U.S. v. Fior d'Italia, Inc.* 122 S.Ct. 2117, the IRS has the authority to assess the employer's share of social security and Medicare taxes due on employees' tip income using an aggregate estimation method. In light of this case, the IRS may generally conduct tip examinations and make assessments for social security and Medicare taxes on employers only, without first examining the tip records of the individual employees.
- (2) As it is critical that examiners meet with the employer to arrive at the correct tip income and to determine the factors affecting how this income is to be reported on the employer's tax returns, the examiner should contact the employer to schedule an appointment. This is done by mailing Letter 3850, *Employment Tax Appointment Letter*, or Letter 3851, *Employment Tax Call-in Appointment Letter*. For more information regarding scheduling an initial appointment refer to IRM 4.23.3.6.4, *Scheduling the Initial Appointment*. The examiner must enclose an Information Document Request (IDR) with the examiner's confirmation/appointment letters. The IDR should be tailored for the particular taxpayer and should be separated by topic and recipient.
- (3) Examiners should establish on AIMS all periods for which books and records are examined, generally all four quarters in a tax year. To ensure proper tracking of audit results, use Project Code "0673" and Activity Code "465" when establishing the employer's returns on AIMS. Refer to the most recent Project/Tracking Code list from Employment Tax Policy to confirm that the appropriate tracking code is used to identify the examination.
- (4) When tip income is an issue, the examiner should determine whether employees are reporting tips to their employer and if the employer is withholding employment taxes as required. The examiner should determine if the amount of tip income reported is reasonably correct. At a minimum, the examiner should consider the following:

- a. **Nature of the establishment.** Employees of fine dining restaurants generally receive more tips than those of less expensive restaurants since tips are generally a percentage of the customer's bill. The same would apply to tips paid to employees of expensive hotels, beauty shops, etc.
 - b. **Method of payment.** Does the establishment accept cash, checks, credit cards, debit cards, or charge accounts? Are all types of payment reported as tip income by the employee?
 - c. **Geographical location of the establishment.** Different areas have varying tipping habits.
- (5) When the examiner determines it is necessary to pursue the unreported tip income issue, the "McQuatters Formula" provides a method of reconstructing tip income that has been accepted by the courts. It specifically addresses factors to be considered in determining a tip rate and the types of items used for making a reduction, such as tip outs and stiff rates. See *McQuatters v. Commissioner*, T.C. Memo, 1973-240. In *McQuatters*, the stiff rate (term used when a customer does not tip the server) was applied to the gross sales. With the increased use of credit cards and debit cards, the volume of charge sales that include a tip have also increased. Therefore, applying a stiff factor to gross sales would not be appropriate. In tip examinations, the examiner should apply the stiff rate only to cash sales and charge sales that did not have a tip added to the bill. The stiff factor should not be applied to charge sales including a tip amount. To obtain an electronic version of the calculation worksheet to use, contact an analyst with NTRCP. However, where the "McQuatters Formula" cannot be applied, the examiner may use any method deemed reasonable to arrive at the correct income. See IRC 446(b).
- Note:** Treas. Regs. 31.6053-3(j) provides that gross receipts include the retail value of certain complimentary food or beverages. See Treas. Regs. 31.6053-3(j)(16).
- (6) In general, for tip examinations, examiners should consider expanding the examination to include the prior and subsequent tax periods.
- (7) If the employer is participating in a tip agreement described in IRM 4.23.7.10 and is complying with the commitments under this agreement, then any social security and Medicare tax assessments made against the employer must mirror those first made from additional tips self-reported by an employee (that is, Form 4137, *Social Security and Medicare Tax on Unreported Tip Income*) or assessed through an audit. Form 14439, *Employee Data Report*, is for collecting the tipped employee information (for both tip examinations and reporting agreement non-participants). Information on audited individual tipped employees come from other exam areas of the IRS, such as Campus Audit. As a general rule, Employment Tax Specialists do not perform the tipped employee Form 1040, **Individual Income Tax Return**, examinations. The information gathered from the Form 14439 of the examined employees is used to determine the employer's social security and Medicare tax assessment. The examination must be in Status 90 prior to sending the NTRCP analyst a copy of the Form 14439. However, if the employer is not in compliance with the commitments under the agreement, then tax assessments may be made against the employer without first examining the tip records of the individual employees, but only if the tip agreement has first been terminated.

Note: Before an examiner can initiate an employer-only examination of an employer who is a party to a tip agreement described in IRM 4.23.7.10, *Tip Rate Determination and Education Program (TRD/EP)*, the agreement must be terminated. Documentation and other evidence in the case file must establish that the employer failed to comply with the terms of the agreement before the IRS can terminate or revoke the agreement. Refer to the Delegation Order 4-34 for GITCAs and Delegation Order 1.23-20 for TRACs and TRDAs for current revocation signatory approvals.

- (8) If the tip examination case resulted from a classification activity, and is a large food or beverage establishment, the case file should contain a simulated Form 8027 for each establishment under the employer's EIN and an IRC 3121(q) Pre-Audit FICA Tax Calculation Worksheet that will provide the examiner with an estimate of the potential IRC 3121(q) liability. It is the examiner's responsibility to review this information and validate the amounts shown on the Form 8027 using the employer's books and records. The examiner will then prepare an Examination IRC 3121(q) FICA Tax Calculation Worksheet that will be included with the Section 3121(q) Pre-Notice and Notice and Demand letters sent to the employer.
- (9) NTRCP has developed worksheets to assist the examiner in arriving at the correct unreported tip amount and correct tax liability. This worksheet is attached to Letter 3264, *Pre-notice for Employer Share of Tax due on Unreported Tips*, as well as the Section 3121(q) Notice and Demand, Letter 3263-E, *Notice and Demand - Employer Only*, or Letter 3263, *Section 3121(q) Notice and Demand*.
- (10) The worksheets accommodate tip computations that may not have been based on the "McQuatters Formula" (for example, Tip per Product) and also allow the examiner to consolidate tip computations from multiple venues or establishments. The worksheet is available in two versions:
 - Single establishment, and
 - Multiple establishments or venues.

Note: The computations on both worksheets are identical, however the multiple establishments/venue worksheets provide a section for listing the individual amounts of underreported tips by establishment/venue. Instructions for completing the worksheet are built into the electronic file. Contact an NTRCP analyst for electronic copies of these worksheets.

4.23.7.7.3
(10-01-2024)
**Report Writing
Procedures for Tip
Examinations**

- (1) There are unique report writing procedures for employment tax examinations where underreported tip income earned by employees is an issue. These examinations are often referred to as IRC 3121(q) cases. These procedures ensure that tip examinations meet the quality standards and conform to general employment tax report writing procedures. See Exhibit 4.23.7-2, *Chart of Tip Report Writing Instructions*, for a summary of scenarios.
- (2) The examination of tip related and other employment tax issues involves inspection of an employer's book and records. The examiner must issue an examination report or no-change letter at the conclusion of each examination. An employment tax liability resulting from a tip examination is considered a current period liability when the notice and demand is issued to the taxpayer.

Taxpayer liabilities generated under the authority of IRC 3121(q) require slight deviations from the common report writing procedures.

- (3) At the conclusion of an employment tax examination, the examiner will issue Form 4666, *Summary of Employment Tax Examination*, to the taxpayer. The Form 4666 should address all examined issues, regardless of determination.
- (4) In addition to report Form 4666, the examiner may need to issue Letter 4840, *Unreported Tips and No Change for Other Examined Issues*. Letter 4840 is used when, in addition to the issue of unreported tips, other employment tax issues were examined, resulting in an adjustment to employment tax due to unreported tips; but no adjustment made to the other examined employment tax issues. In addition, Letter 4840 lets the taxpayer know that while there was no adjustment made to taxes for the year of examination, there is a liability due on the unreported tips to be reported as a current period liability. The letter explains when and how the IRC 3121(q) FICA tax liability must be reported.
- (5) If the only issue examined is unreported tips and no adjustment is warranted, the examiner issues Form 4666 and Letter 3401-A, *Employment Tax No Change Transmittal Letter*. Under these circumstances, no specialized report writing procedures are required. The examiner would follow normal employment tax report writing procedures as discussed under 4.23.10.5, *Notification Letters in No-Change or No-Liability Cases*. The examiner will prepare the final no-change letter, Letter 3381, *No Change Letter for Employment Taxes*. After the manager has signed the letter, the examiner will mail the letter to the taxpayer and the taxpayer's authorized representative and document the activity record with the date sent and to whom. A copy of the letter will be uploaded to the 'Correspondence Letters' section in IMS.
- (6) If the only issue examined is unreported tips and an adjustment to unreported tips **is** warranted, the examiner will prepare Form 4666 and Letter 3264 to be included with the examination report package issued to the taxpayer. The examiner will not enter any dollar amount on Form 4666 under column c. This is because the IRC 3121(q) FICA tax liability owed by the taxpayer is reported on the current Form 941 for the quarter corresponding to the date of the Section 3121(q) Notice and Demand. Letter 3264 gives the taxpayer a brief overview of the process for reporting the IRC 3121(q) FICA tax liability and will include a detailed calculation of the additional taxes that will be shown on the Section 3121(q) Notice and Demand. Form 4666 should include the following when the only issue examined was unreported tips and the taxpayer owes additional tax on these unreported tips:

Example: IRC 3121(q): "The inspection of your books and records resulted in the determination that your employees did not report all of the tips they earned to you, their employer. You owe tax of \$[insert amount] on these unreported tips. Once the IRS issues you a Section 3121(q) Notice and Demand for the social security and Medicare tax due on the unreported tips, you will become liable for the employer's share of the tax under Internal Revenue Code section 3121(q)."

Note: The IRC 3121(q) FICA tax liability is treated as a current tax liability and will be assessed when reported on a current period Form 941 through the Section 3121(q) Notice and Demand process. The examiner should not place these adjustments on Form 4668, *Employment Tax Examination Changes*.

Report. There is no Form 4668 report prepared for examinations limited in scope to unreported tips since the change in tax is a current period liability.

- (7) If there is a determination that all tips were correctly reported but adjustments are warranted to other employment tax issues identified during the course of the examination, the examiner will issue Form 4666 and follow the employment tax report writing and closing procedures in 4.23.10, *Report Writing Guide for Employment Tax Examinations*. Under these circumstances, no specialized tip report writing procedures are required.
- (8) If other employment tax issues in addition to tips were examined but adjustments are warranted only to unreported tips, the examiner should issue Form 4666 and Letter 4840, *Unreported Tips and No Change for Other Examined Issues*. When listing the examined issues on Form 4666, the examiner will not enter any dollar amount for the IRC 3121(q) tips issue. Form 4666 should include the language provided below. Letter 4840 informs the taxpayer that the only examined issue that warranted an adjustment was on the unreported tips. Letter 4840 also informs the taxpayer that Letter 3264 is enclosed with the examination report package. Letter 3264 gives the taxpayer a brief overview of the process for reporting the additional tax and should include a detailed calculation of the additional taxes to be included in the Section 3121(q) Notice and Demand. Add the following language to Form 4666 when, in addition to unreported tips, other employment tax issues were examined but the only issue adjusted is unreported tips:

Example: IRC 3121(q): The inspection of your books and records resulted in the determination that your employees did not report all of the tips they earned to you, their employer. You owe tax of \$[insert amount] on these unreported tips. Once the IRS issues you a Section 3121(q) Notice and Demand for the social security and Medicare tax due on the unreported tips, you will become liable for the employer's share of the tax under Internal Revenue Code section 3121(q).

- (9) If the examination results in adjustments to other employment tax issues and adjustments to unreported tips, the examiner must prepare Forms 4666 and 4668. When listing the examined issues on Form 4666, you will not enter any dollar amount for the IRC 3121(q) tips issue. Form 4666 should include the language provided below in the "Other Information" section. The examiner should also include Letter 3264. Form 4666 gives the taxpayer a brief overview of the process for reporting the additional tax and should include a detailed calculation of the additional taxes to be included in the Section 3121(q) Notice and Demand.

Note: IRC 3121(q): "In addition to the examination changes shown on Form 4668, we also examined tip income. The inspection of your books and records resulted in the determination that your employees did not report all of the tips they earned to you, their employer. You owe tax of \$[insert amount] on these unreported tips. Once the IRS issues you a Section 3121(q) Notice and Demand for the social security and Medicare tax due on the unreported tips, you will become liable for the employer's share of the tax under Internal Revenue Code section 3121(q)."

- (10) If the examination of the taxpayer's books and records did not include the examination for employment tax purposes of whether any individuals should be

treated as employees of the taxpayer for the purposes of Section 530 of the Revenue Act of 1978, as amended, a statement to that effect should be included on any Form 4666 and/or Form 4668 issued to the taxpayer. See IRM 4.23.10.10.3, *Employment Tax No-Change Report*.

- (11) Section 3121(q) Notice and Demand Procedures and Case Closing are discussed in IRM 4.23.7.7.4, *Section 3121(q) Notice and Demand Procedures*.

4.23.7.7.4
(10-01-2024)

**Section 3121(q) Notice
and Demand Procedures**

- (1) When an employee fails to report tips to the employee's employer, the employer is not liable for its share of the social security and Medicare taxes on the unreported tips until the IRS makes notice and demand to the employer. See IRC 3121(q).
- (2) The employer is liable for the employer's share of social security and Medicare taxes for tips even though the employees failed to provide the employer with written statements. The additional tax liability may be based upon the employer's records for the tax year and/or on Form 4137 filed by employees. The additional tax liability is not due until the IRS issues a Section 3121(q) Notice and Demand (even though the tips were paid to employees in prior years).
- (3) No specific form is required for a Section 3121(q) Notice and Demand, but the IRS has developed correspondence. The first letter to be issued is Letter 3264 which is sometimes referred to as a "pre-notice letter."
- (4) Generally, the IRS will send the taxpayer the pre-notice Letter 3264 at least thirty days prior to issuing the Section 3121(q) Notice and Demand to allow the taxpayer sufficient time to gather the necessary funds for making a timely tax deposit. Examiners **must** use Letter 3264, to notify the taxpayer of the IRC 3121(q) FICA tax liability.
 - a. At the time the pre-notice is issued, the examiner should emphasize to the taxpayer that if a payroll service is used, the taxpayer should immediately notify the payroll service of the IRC 3121(q), FICA tax liability. This is to provide the payroll service provider sufficient time to make the necessary payroll deposit and to help reduce or eliminate any interest or deposit penalties.
 - b. It is recommended that examiners issue the Section 3121(q) Notice and Demand within the first 60 days of the quarter to give the taxpayer sufficient time to gather the necessary funds to make the tax deposit and to have sufficient time to notify its payroll service, if there is one, to ensure a timely tax deposit. If the employer reports the IRC 3121(q) FICA tax liability on the line titled "Section 3121(q) Notice and Demand - Tax due on unreported tips" on the Form 941 for the quarter corresponding to the date of the Section 3121(q) Notice and Demand and makes a timely deposit based on the date of the Section 3121(q) Notice and Demand, the tax due on this liability is interest and penalty free.
- (5) Generally, at least thirty days after the Pre-Notice letter is sent to the taxpayer, the IRS will send the Letter 3263, *Section 3121(q) Notice and Demand*. This letter will explain how the employer should report and pay the IRC 3121(q) FICA tax liability to avoid penalties and interest.

- a. The employer must report the IRC 3121(q) FICA tax liability on the Form 941 for the quarter corresponding to the date of the Section 3121(q) Notice and Demand. This Form 941 is referred to as the “reporting Form 941.”
 - b. If the employer fails to report the IRC 3121(q) FICA tax liability on the reporting Form 941, the examiner will initiate an examination of the reporting Form 941 in order to assess the IRC 3121(q) FICA tax liability. This, in essence, constitutes an unagreed report and the examiner then adheres to normal unagreed procedures and reports. Rev. Rul. 2012-18, provides guidelines for IRC 3121 Notice and Demand procedures.
- (6) The examiner must post-date the Section 3121(q) Notice and Demand to account for mailing delays and to provide sufficient time following receipt to allow employers to adjust their deposit amounts accordingly. A Section 3121(q) Notice and Demand should not be issued or dated on a Saturday, Sunday, or federal holiday. Therefore, the date on the Section 3121(q) Notice and Demand should be post dated with the last day of the quarter.

Example: The examiner mails Letter 3263-E to the taxpayer on February 24, 2020. The date of the Section 3121(q) Notice and Demand is March 31, 2020.

- (7) There are two Section 3121(q) Notice and Demand letters for use in employer tip examinations:
- a. Letter 3263-E is used for employer-only examinations where the audit results are not dependent on any audits of the employer’s tipped employees.
 - b. Letter 3263 is used for employer tip examinations where the employer has signed a tip compliance agreement. Any assessment against the employer must mirror that first made against the individually audited tipped employees.
- (8) For assessments based on the results of the employees’ examinations, the examiner may disclose certain information on employee returns in the Section 3121(q) Notice and Demand issued to the employer. This information may be disclosed only if it is necessary to substantiate the employer’s share of social security and Medicare taxes on the unreported tip income. The information may be disclosed because it “directly affects” or “directly relates to” the resolution of an issue and there is a transactional relationship between the employer and the employee. See IRC 6103(h)(4)(B) and IRC 6103(h)(4)(C).
- (9) When the employer’s liability is dependent on the outcome of the tipped employees’ audits, then the examiner should attach a spreadsheet (Form 14439) to the Section 3121(q) Notice and Demand explaining the tax liability. The examiner may also attach this spreadsheet to the Pre-Notice and Demand. The Form 14439 should include information such as the following:
- Employee name, social security number, job position, dollar amount of sales or the number of hours worked,
 - Tip rate used in the calculation,
 - Tips reported by the employee, and
 - Unreported tips by the employee.
- (10) For employer-only audits, there is no requirement to provide a breakdown of the audited employees’ assessments. However, the examiner will attach the *McQuatters* calculations, or other calculation spreadsheet if *McQuatters* was

not used, to the Section 3121(q) Notice and Demand to show how the liability (aggregate assessment) was determined. When examining a casino, the examiner will attach a spreadsheet showing the unreported tip amounts broken down by the tipped occupational categories.

- (11) After the examiner issues the Section 3121(q) Notice and Demand, all quarters examined are closed using Disposal Code "01", No-Change with Adjustment, unless other adjustments were made to the return. This disposal code should be used regardless of the agreement or lack of agreement by the taxpayer to the proposed IRC 3121(q) FICA tax liability.
- (12) The examiner can generally close the exam to the group manager 20 days after the Section 3121(q) Notice and Demand (Letter 3263-E or Letter 3263) was issued to the taxpayer. Once the examiner issues the Section 3121(q) Notice and Demand and the case is ready to be closed, the Form 5344, *Examination Closing Record*, is prepared. See IRM 4.23.7.7.3 , **Report Writing Procedures for Tip Examinations**, for procedures when other employment tax issues warranted adjustments. If other employment tax issues are examined and an adjustment made, use the primary issue disposal code.
- (13) For each quarter examined, complete Form 5344, "Item 418 - 3121(q) Amount," to capture the IRC 3121(q) FICA tax liability. Generally, the IRC 3121(q) FICA tax liability should be spread among all the examined periods in a year in a ratable manner - thus, the amount to enter for each quarter is the social security and Medicare tax amount shown in the Section 3121(q) Notice and Demand divided by the number of quarters examined. For example, if the IRC 3121(q) FICA tax liability is \$4,000 and only one year was examined, you would enter \$1,000 for each of the four quarters examined for the tax year.
 - a. On Form 5344, if case is closed agreed, enter on Line 12 Transaction Code "300" with "0" for the dollar amount.
 - b. "0" is entered because the additional tax is treated as a current period liability.
 - c. The Form 941 quarter to be established for the Unagreed Report is the quarter corresponding to the date of the Section 3121(q) Notice and Demand.

Note: The amount you enter on Line 418 is the IRC 3121(q) FICA tax liability, **NOT** the unreported tip amounts.

- (14) On the Form 3198, *Special Handling Notice for Examination Case Processing*, under "Letter Instructions for CCP," the examiner will check the **Other Instructions** box and notate: "Please validate that the amount on Form 5344, Line 418, matches the amount on the enclosed Section 3121(q) Notice and Demand, Letter 3263." A copy of the Section 3121(q) Notice and Demand (Letter 3263 or Letter 3263-E) will be sent to Centralized Case Processing (CCP) with all other closing documents.
- (15) Each group must monitor the Form 941 for the quarter in which the Section 3121(q) Notice and Demand was dated (also known as the "reporting Form 941") and must maintain a spreadsheet containing details of monitoring activity and time spent monitoring the reporting Form 941. Make the information available to your manager as needed. Time spent monitoring the filing or assisting the taxpayer in the resolution of an incorrect or non-reporting of the IRC 3121(q) FICA tax liability is recorded under Activity Code 575-5XX, depending on the type of tipped industry being examined. For example, time

spent monitoring a restaurant tip case would be recorded as 575-518. (For additional information on applicable time codes see IRM 4.9.1-1, *Definitions of Miscellaneous Examination Activity Codes* and IRM 4.9.1-2, **Direct Examination/ Compliance SSCs**.)

- (16) After the reporting Form 941 has posted, generally within two to six weeks following the close of the quarter, the examiner must check IDRS/BRTVU to confirm that the employer properly reported the IRC 3121(q) FICA tax liability shown in the Section 3121(q) Notice and Demand.

- a. For tax years after December 31, 2010, the IRC 3121(q) FICA tax liability is reported on the reporting Form 941, on the line titled "Section 3121(q) Notice and Demand—Tax due on unreported tips."

Note: For Section 3121(q) Notice and Demands issued during tax years 2009 and 2010, this amount was reported on line 7c - "Current quarter's adjustments for tips and group-term life insurance." For Section 3121(q) Notice and Demands issued during tax years 2005, 2006, 2007, and 2008, the amount was reported on line 7e - "Prior quarter's social security and Medicare taxes."

- b. If IDRS research shows that the amount was accurately reported, no further action is needed.
- c. If the tax was not reported, the examiner will first contact the taxpayer to determine if the non-reporting was simply an oversight. The examiner should instruct the employer to file a Form 941-X, **Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund**, for the quarter of the reporting Form 941 and pay the tax with the form. If the examiner is unable to resolve the reason for the non-reporting then they will establish the reporting Form 941 on AIMS. A limited scope exam, using Project Code "1118", will be conducted to address the non-reporting of the IRC 3121(q) FICA tax liability. Follow normal employment tax unagreed procedures at IRM 4.23.10.16, *Unagreed Employment Tax—Examination Reports*.

Note: Form 4666 should include the following language: "This is a limited scope examination report assessing the IRC 3121(q) Notice and Demand FICA tax amount that [insert name of taxpayer] failed to report."

Note: If an adjustment is made to the "reporting Form 941" for the IRC 3121(q) FICA tax liability, **DO NOT** enter any value on Item 418 of the Form 5344 when that case is closed.

4.23.7.7.5 (10-01-2024) **Employee Tip Examination**

- (1) If unreported tip income is identified as a result of an employer tip examination, then the employee and employer are liable for FICA tax on the unreported tip income. The employee is also liable for income tax on the unreported tip income.
- (2) Generally, examiners will collect employee information in the form of an "employee record layout spreadsheet". The spreadsheet includes pertinent information regarding the employer's tipped employees such as the total tips per examination and the potential unreported tips for each tipped employee. Check with the designated NTRCP analyst to get an electronic copy of the latest version of the employee record layout spreadsheet. The examiner will forward

this information and a copy of the McQuatters formula or other calculation showing how the tip rate was determined to the SBSE NTRCP analyst who will complete the exam referral.

- (3) Indian Tribal Government (ITG) examiners are required to prepare an employee calculation spreadsheet for all tipped employees in each occupational category showing unreported tips. A copy of the spreadsheet should be sent to the ITG tip coordinator at the time the employer tip audit is closed.
- (4) If the examiner initiates the employee examinations, the employee returns will be established on AIMS . Use Activity Codes 530 through 536. To ensure proper tracking of audit results, use the following project codes:
 - 360: Gaming industry employees (all venues, including food and beverage),
 - 364: Food and beverage industry employees, or
 - 672: Barber and cosmetology industry employees.
- (5) Generally, Employment Tax Specialists do not perform the tipped employee Form 1040 examinations. The employee's tax adjustments are made on forms prescribed for individual income tax examinations. Procedures for adjustments to an employee's tax for tips not reported to the employer are discussed in IRM 4.23.10.18, *Procedures for Employee Tax Adjustment on Tip Income Not Reported to Employer*.
- (6) Advance payments received for employment tax cases should be reported in accordance with the taxpayer's instructions. Absent instructions, the payments will be reported first as if they were for income tax and the balance will be reported as social security and Medicare taxes.
- (7) If the case is unagreed, Letter 525, *General 30-Day Letter*, is issued for both the social security and Medicare taxes and income tax. Form 2504-S, *Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment (Employment Tax Adjustments Not Subject to IRC 7436; Worker Classification or Section 530 Issues Not Addressed in this Exam)*, is generated along with the 30-day letter showing the separate computation for the social security and Medicare taxes due. The taxpayer is notified in the report that the social security and Medicare taxes are not included in the deficiency notice and are stated separately on Form 2504-S. If the employee requests an Appeals conference, the employee's case should be forwarded to Appeals using normal procedures.
- (8) If the employee fails to respond to the 30-Day letter, the case should be closed for the issuance of a Statutory Notice of Deficiency on the income tax deficiency and related penalty only. Social security and Medicare taxes, unlike income tax, may be assessed without issuing a Statutory Notice of Deficiency. If a Statutory Notice of Deficiency is to be issued for income tax, the social security and Medicare taxes on the unreported tip income and the related penalty will not be included in the audit report. However, the notice to the taxpayer will include a statement concerning the related social security and Medicare taxes and penalty liability.
- (9) Examiners must remember to properly code the tip audit adjustments on the Form 5344 or for TE/GE, the RCCMS Closing Record tabs. The IRS submits this information electronically to the Social Security Administration. The codes can be found in the AIMS Processing Handbook, IRM 4.4.12, *Examined*

Closings, Surveyed Claims, and Partial Assessments, and IRM 4.5.1, *TE/GE AIMS Processing*. If these codes are not entered properly, the tipped employee's social security and Medicare wages will not show increase in wages due to the adjusted tip income and the employee will not receive social security credit.

4.23.7.8

(05-10-2021)

Statute of Limitations for Tip Examinations

- (1) For employment tax audits where unreported tip income is the sole issue, it is not necessary to extend the statute date on the employer's Form 941, *Employer's Quarterly Federal Tax Return*, for the tax year under examination. The statute of limitations for the IRS to assess the employer's share of the social security and Medicare taxes on unreported tips is determined by the reporting Form 941 (that is, the quarter corresponding to the date of the Section 3121(q) Notice and Demand). Accordingly, the examiner is permitted to conduct a tip examination for the employer's share of the FICA taxes on unreported tips even though the regular statute date could under normal procedures bar the examiner from working that tax period. If a case is assigned to an examiner where the statute date for the tax year under audit causes the system to generate Form 895, *Notice of Statute Expiration*, perform the following procedures:
 - a. Form 895 will be generated based on the month and year of the return's statute just as they do for all returns where the statute is irregular. This feature is an integral part of the statute control process.
 - b. The examiner will complete the Form 895 when the system generates it due to the irregular statute.
 - c. Examiners should follow the procedures in IRM 25.6.1, *Statute of Limitations Processes and Procedures*. Although for an employment tax audit where unreported tip income is the only issue, the statute is governed by the date of the Section 3121(q) Notice and Demand, examiners still need to prepare the Form 895, *Notice of Statute Expiration*, within the specified time frame of 180 days.
 - d. Enter "MM/AD/YYYY" in Section 5.
 - e. In Section 6, place a checkmark on the line "Employment Tax Return Examination Limited to IRC 3121(q) (AD)."
 - f. In Section 7, enter as remarks "Statute for 3121(q) examination year is determined by the date of Section 3121(q) Notice and Demand."
- (2) Once the Section 3121(q) Notice and Demand is issued, the applicable period of limitations is the period of limitations for the employer's Form 941 for the calendar quarter in which notice and demand is made and NOT the period(s) of limitations for the returns for the quarters in which the tips were received. As a general rule, the IRS must assess the employer FICA taxes on the unreported tips within 3 years after April 15th of the calendar year following the year in which the notice and demand is made.

Example: If the Section 3121(q) Notice and Demand is dated December 31, 2020, the liability is required to be reported on Form 941 for the fourth quarter of 2020, due on January 31, 2021. If the employer timely files the Form 941, the period of limitations for assessment ends on April 15, 2024.

- (3) However, if the employer did not file its Form 941 for the fourth quarter of 2020 before April 15 of the succeeding calendar year (April 15, 2021) and instead filed on May 10, 2021, the IRS must assess the employer FICA taxes by May 10, 2024, the date three years after the date the return was filed.

Example: If the employer files a false or fraudulent Form 941 for the quarter in which the adjustment is required to be made or fails to file Form 941 for that quarter, the additional employer FICA taxes on the unreported tips can be assessed at any time.

- (4) If it is necessary to extend the statute, use *Form SS-10, Consent to Extend the Time to Assess Employment Taxes*, to extend the statute of limitations for assessing against the employer additional FICA tax on the unreported tip income. The IRS may assess the employer's share of FICA on the unreported tip income even if it is barred by the statute of limitations from assessing the employee's share of FICA tax.

4.23.7.8.1
(01-13-2014)
**Extending Statute of
Limitations for Tip
Examinations of
Employees (Form 1040)**

- (1) Form 1040 is a multi-purpose tax return reporting both income and FICA taxes (that is, social security tax, Medicare tax, and Additional Medicare Tax). If the employee:
- Did not report any FICA taxes on the return (that is, the employee did not attach Form 4137 and make an entry on Form 1040 to report FICA tax (Line 23 for 2022 Form 1040)), or
 - Did not attach Form 8919, *Uncollected Social Security and Medicare Tax on Wages*, and make an entry on Form 1040 to report FICA tax (Line 23 for 2022 Form 1040), or
 - Did not attach Form 8589, *Additional Medicare Tax*, and make an entry on Form 1040 to report FICA tax (Line 23 for 2022 Form 1040).
- (2) The period of limitations does not begin to run and an assessment of FICA taxes may be made at any time. Therefore, social security tax, Medicare tax, and Additional Medicare Tax on unreported tips can be assessed even if the statute of limitations has expired for the assessment of income taxes. (See Rev. Rul. 79-39).
- a. Form 872, *Consent to Extend the Time to Assess Tax*, or Form 872-A, *Special Consent to Extend the Time to Assess Tax*, is used to extend the statute for assessing FICA taxes on tips if those forms specify that they relate to those specific taxes. Thus, the kind of tax to specify on the consent is "Social Security and Medicare tax on tips." If Additional Medicare Tax applies, specify "Social Security tax, Medicare tax, and Additional Medicare Tax on tips" on the consent
 - b. If income tax and FICA taxes were reported on the same return, the statute for assessment of additional FICA taxes is the same as the statute for the income tax.
 - c. If FICA taxes were not reported on the return, there is no statute on the assessment of FICA taxes and an extension is not necessary in order to assess FICA taxes. See Rev. Rul. 79-39.
- (3) Use Form 872 (or Form 872-A) to extend the statute for assessing both income tax and FICA taxes on the employee's unreported tip income if the tipped employee reported any FICA taxes on the employee's Form 1040 and the assessment statute of limitations must be extended. See IRM 25.6.22.6.10.2, *FICA Tax on Tips Not Reported to Employer*. For additional details on employee tip examinations and statute extensions, see IRM 4.19.15.26, *Correspondence Exam Tip Program*.

4.23.7.9

(10-01-2024)

IRC Section 45B Credit

- (1) The IRC 45B credit applies to employers who operate a food or beverage establishment where tipping is customary and where food or beverages are served for either on- or off-premises consumption. IRC 45B allows an income tax credit to food and beverage businesses for the share of employer's FICA taxes paid with respect to certain employees' tip wages. The employer can claim the income tax credit whether or not the employee reports the tip wages to the employer. Form 8846, *Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips*, is used to compute the credit.

Note: Additional Medicare Tax is only imposed on the employee. There is no employer share of Additional Medicare Tax. Thus, Additional Medicare Tax has no effect on an employer's IRC 45B credit.

- (2) The taxpayer entitled to the credit is the employee's employer. This is generally the employer under the common law rules, unless there is another entity that has control of the payment of the wages (for example, an IRC 3401(d)(1) employer). The application of the common law rules is a factual determination. Furthermore, the determination of whether an entity is an IRC 3401(d)(1) employer is also a question of fact. See, for example, TAM 201347020, which held that a professional employer organization (PEO), was not eligible to claim the IRC 45B credit on tips received by its clients' employees because it was not in control of the payment of wages to the employees within the meaning of IRC 3401(d)(1).
- (3) PEOs (also commonly known as employee leasing companies) may designate themselves as the employer. A number of court cases have found that a PEO is neither the common law employer nor the IRC 3401(d)(1) employer. Thus, the examiner must first determine, through an examination, who is the employee's common law employer or the IRC 3401(d)(1) employer before the examiner can determine who is entitled to the credit.
- (4) IRC 45B credit is allowed to be used to offset the alternative minimum tax (AMT) liability. The amount of the credit is based on the amount of tips in excess of those treated as wages for purposes of the Fair Labor Standards Act as in effect on January 1, 2007 (that is, the tip credit is determined based on a minimum wage of \$5.15 per hour). Therefore, if the amount of the minimum wage increases, the amount of the tip credit will not be reduced.
- (5) If the employer pays additional tax as a result of an employment tax examination on unreported tips, the employer may be entitled to an additional IRC 45B credit. If so, the IRC 45B credit is available to the employer in the year the IRC 3121(q) FICA tax liability is paid and not the year in which the unreported tips were received by the employee.

4.23.7.10

(05-10-2021)

Tip Rate Determination and Education Program (TRD/EP)

- (1) The Tip Rate Determination and Education Program (TRD/EP) was designed to promote compliance by industry employers and employees with the provisions of the Internal Revenue Code relating to tip income and to reduce disputes under IRC 3121(q). The TRD/EP was established in the early 1990's. Tip Agreements were designed to enhance administration of the tip program by both the employer and the IRS and to facilitate and promote the use of current financial information technology in the tip reporting process. Tip Compliance Agreements offer the following:
 - Taxpayer education, and
 - Voluntary Tip Compliance Agreements.

- (2) The IRS initiated the TRD/EP for various reasons, including:
 - a. **Education:** To help tipped employees and their employers improve their understanding of the laws regarding the federal tax treatment of tips and enhance tax compliance using voluntary tip compliance agreements,
 - b. **Simplification:** To make it easier for tipped employees to calculate their tips, report their tips, and pay their taxes, and
 - c. **Burden Reduction:** To reduce the likelihood of a tip examination and ease the financial burdens associated with a tip examination.
- (3) Voluntary tip agreements are generally available to employers in industries where tipping is customary. Employers interested in these programs must be substantially compliant with their tax filings and demonstrate solid internal controls for tip reporting. Agreements offered to employers are signed by both parties. The employer commits to satisfy certain obligations set forth under the particular agreement. If employers and employees remain in compliance with the tip agreement, they are generally afforded tip audit protection. Current TRD/EP agreements include:
 - Tip Rate Determination Agreement (TRDA),
 - Tip Reporting Alternative Commitment (TRAC),
 - Employer-designed TRAC (EmTRAC), and
 - Gaming Industry Tip Compliance Agreement (GITCA).
- (4) These voluntary tip compliance agreements help reduce taxpayer burden ordinarily associated with the IRS assessments of additional FICA taxes on unreported tip income. The IRS, through outreach and education, helps business owners and their tipped employees understand the tax laws related to tip income reporting so that they can more accurately meet their reporting and filing obligations.
- (5) The employer can choose not to enter into the program, but instead, institute its own program or actions to bring itself and its employees into compliance.
- (6) The TRD/EP is a voluntary program for both the employer and the IRS. Employers are screened for suitability. Screenings do not increase the likelihood of an audit. Employers can request a tip agreement or choose not to participate in the program at all. An employer who participates can only have one agreement at a time.

4.23.7.10.1
(01-22-2010)
**Tip Compliance
Agreements**

- (1) There are specific tip compliance agreements for the food and beverage, cosmetology and barber, and gaming (casino) industries. There are also generic tip agreements that permit all other tipping industries to participate in the program. The TRDA and TRAC agreements are available to employers in all industries, including restaurants and bars, salons and barber shops, taxicab and limousine companies, airport skycap companies, car wash operations, and tour guide companies. The GITCA is available only to employers in the gaming industry. The EmTRAC is available only to food and beverage employers.
- (2) Some employers will find one agreement more beneficial, some will prefer another agreement, and some will choose not to participate in the program at all. As this is a voluntary program, employers do not have to participate. Those who choose to participate may participate in only one agreement at a time.

4.23.7.10.2
(05-10-2021)

Solicitation of Tip Compliance Agreements

- (1) IRS employees will under no circumstances use or imply the threat of an audit when soliciting participants to sign up for any tip compliance agreement. Section 3414 of the IRS Restructuring and Reform Act of 1998 specifically prohibits the threat of an audit to coerce taxpayers into signing a TRAC agreement.
- (2) The mission of the IRS is to provide taxpayers with top quality service by helping them understand and meet their tax responsibilities and to apply the tax law with integrity and fairness to all. The purpose of a tip compliance agreement is to educate employers in industries where tipping is customary on their tip income reporting responsibilities, and to promote tip reporting compliance among their tipped employees.
- (3) There are pre-qualification procedures to follow before the agreement can be approved:
 - a. When assigned a tip agreement request, read the entire agreement and understand the commitments specified for the IRS and for the employer.
 - b. Contact the employer and review the "Employer Commitment" sections of the agreement. The employer needs to demonstrate that everything is in place to satisfy these commitments, before the IRS will approve the agreement.
 - c. Evaluate the employer's level of compliance and ensure that all federal reporting, filing, and payment compliance are current.
 - d. If the employer is a large food or beverage establishment, request the most currently filed Form 8027, *Employer's Annual Information Return of Tip Income and Allocated Tips*.
 - e. If the employer is not a food or beverage establishment, request the previous tax year's report for charged sales and tips and cash sales and tips. Compare to tips reported by employees through the W-3 filing to determine substantial tip reporting compliance.
- (4) After the analysis of the information, if the IRS representative determines that the request cannot be approved, contact the taxpayer to explain why. Follow up the telephone contact with Letter 4761, *Agreement Request Denial*. Letter 4761 explains to the taxpayer why the request to participate in a tip compliance agreement is not being approved. The letter will give the reason or reasons.
- (5) With the consent of the IRS, any tip employer may participate in a tip agreement. Either the IRS or an employer may suggest the employer's potential participation in the program. The IRS's decision to refuse participation by any employer in this program is not subject to review.
- (6) The person designated by the employer to sign a tip agreement must have the authority to legally bind the company. The person is also responsible to ensure all internally affected employees are notified of the agreement and the requirements.
- (7) If a taxpayer expresses an interest to enter into a voluntary tip compliance agreement during the course of an ongoing examination, the examination must first be completed prior to discussing participation in the program. The taxpayer must understand that where the tax has been determined, a tip agreement will not eliminate any balance due. At the conclusion of the exami-

nation, examiners can begin the process of implementing the tip agreement. Note that time on the case for securing an agreement is documented separately.

- (8) Once the audit has been finalized, the tip agreement request can be referred to NTRCP for review and consideration.
- (9) **Activity Codes:**
 - a. Employment tax examiners should use activity code "551" and Project Code "0985" to report time spent soliciting tip agreements with Source Code "99" and MFT "C0" (C zero).
 - b. The Tracking Code will depend on the market segment. Contact an NTRCP analyst for the list of Tracking Codes.
 - c. For tip agreement addendums, use Activity Code "551" and Project Code "0986".
 - d. For time spent performing compliance reviews on agreement participants, use Activity Code "551" and Project Code "1104".
 - e. Compliance reviews are discussed later.
- (10) The authority to approve a Tip Reporting Alternative Commitment (TRAC) agreement or a Tip Rate Determination Agreement (TRDA) is found in SB/SE Delegation Order No. 1-23-20. The Authority to approve a Gaming Industry Tip Compliance Agreement (GITCA) is found in Order No. 4-34 (rev. 1).
- (11) For tribal agreements, ITG group managers are authorized to sign the tip agreements under Delegation Order 4-34 (rev. 1).

4.23.7.10.3
(01-22-2010)
**Tip Rate Determination
Agreement (TRDA)**

- (1) A TRDA requires the employer to work with the IRS to arrive at a tip rate for the various worker occupations in the establishment.
- (2) At least 75 percent of tipped employees must agree to participate by signing a Tipped Employee Participation Agreement (TEPA) with the employer.
- (3) Participating employees comply by reporting tips at or above the rate determined in the agreement for their job category. However, if the employee keeps an actual log of tips, the employee is then only required to report the actual tips received.
- (4) If employees fail to report tips at or above the determined rate, the IRS may audit those employees' tax returns.
- (5) The TRDA does not have any specific education requirement, but the IRS provides assistance to help employees understand their tax responsibilities and emphasizes benefits for complying.
- (6) TRDA is available for all industries where tipping is customary.

4.23.7.10.3.1
(01-22-2010)
**Revoking TRDA
Agreements**

- (1) Revoking any tip agreement requires timely historical documentation on the actions the IRS took to help the employer and its employees come into compliance once a decline in reported tips was identified. If a tip agreement is to be terminated, a request for approval must be sent to the Director of Specialty Examination, prior to notifying the taxpayer (employer) through the NTRCP Program Manager. The NTRCP office will review the request to terminate the agreement and forward to the Director of Specialty Examination for written approval. Examples include:

- a. When, at the end of two consecutive calendar quarters, fewer than 75 percent of the employees in the occupational categories are participating under the agreement,
 - b. When the employer fails to file the necessary tax returns,
 - c. When the employer fails to pay and deposit taxes, or
 - d. When the employer fails to maintain records or to make the required records available to the IRS or the IRS or other federal agency pursues an administrative or judicial action, examination, investigation, or proceeding involving the employer or related party.
- (2) Request for approval to terminate a tribal agreement should be sent to the ITG Tip Compliance Coordinator. The Director of ITG must approve all terminations on any ITG tip agreement.
 - (3) After written approval is received, the NTRC Program Manager must sign the letter notifying the taxpayer of the termination and state the reasons for the termination. Field offices should use Letter 3346, *Tip Program Participation Termination Letter*, for this notification.
 - (4) An employer may terminate a TRDA at any time.
 - (5) If the employer is otherwise complying with the TRDA, the agreement should not be revoked. As a general rule, individual tip examinations will be initiated on the most egregious noncompliant employees.
 - (6) For tribal agreements, after written approval is received from the designated ITG official, the authorized ITG group manager must sign the letter notifying the taxpayer of the termination and state the reasons for the termination. For tribal tip agreements, the designated ITG official may prospectively revoke or terminate a TRDA.

4.23.7.10.4
(01-22-2010)

**Tip Reporting Alternative
Commitment (TRAC)**

- (1) Under the Tip Reporting Alternative Commitment (TRAC) agreement, the employer agrees to institute and maintain an employee educational training program with respect to their tip reporting obligations. Unlike a TRDA, a TRAC agreement does not require that the employer work with the IRS to arrive at a tip rate for any of the worker occupations in the establishment. However, during the meeting with the employer to discuss the agreement, the IRS representative responsible for executing the agreement, should jointly review the employer's books and records to identify the average tip rates for cash and charged tips being received by the tipped employees. This includes a discussion with the directly tipped employees to arrive at tip out percentages (tips shared with other workers) and stiffies (term used when a customer does not leave a tip). This will show the employer and the employees if the employees are reporting their tips accurately. Inform the employer and employees that the IRS will monitor tip reporting on the Form 941, *Employer's Quarterly Federal Tax Return* and on Form 8027 if pertaining to a food or beverage business. A TRAC requires employers to:
 - Establish a reasonable procedure for accurate tip reporting by all tipped employees,
 - Institute a training program to educate employees of their tax reporting obligations as they relate to tips, and
 - Comply with all federal tax requirements regarding the filing of returns, paying and making tax deposits, and maintaining required records.

- (2) TRAC's were originally offered to the food and beverage industry but have now been extended to all industries where tipping is customary. A specific TRAC agreement is available for the cosmetology and barbering industry containing characteristics unique to this industry.
- (3) A TRAC affects all employees. As long as both the employer and employees are complying with the requirements under the agreement and all tips are being reported accurately, no tip audits will be initiated on either the employer or the employees. The IRS will only terminate a TRAC agreement if the employer fails to meet the terms of its commitment.
- (4) To qualify for a TRAC agreement, the business must have charge receipts that show a charged tip. That is, a reasonable amount of the business's gross receipts must be from charged receipts that included a charged tip. There is no set percentage - as long as the amount of charged receipts with a charged tip is sufficient to determine the average charged tip rate.
- (5) If the reporting of tip wages by tipped employees has not improved after six months from securing the TRAC agreement, the employer will be notified. Specific taxpayer correspondence will notify the employer of any shortfalls in satisfying the agreement commitments and remind the employer about tip reporting obligations and the consequences for failing to comply with the law.
- (6) If the underreporting occurs because of the employer's system, the employer will be offered suggestions for improvements or changes needed to be made to the procedures. If, after a reasonable period the employer has not corrected the procedures, the employer may be referred for a tip examination and/or the agreement may be terminated. Implementation of these follow-up procedures allows the establishments to gauge how well their education requirement is being fulfilled and whether the employees are complying with their tip reporting requirements.

4.23.7.10.4.1
(05-10-2021)
**Revoking TRAC
Agreements**

- (1) Revoking any tip agreement requires the case file to have timely historical documentation on the actions the IRS took to help the employer and its employees come into compliance once the decline in reported tips was identified. If a tip agreement is to be terminated, a request for approval must be sent to the Director of Specialty Examination, prior to notifying the taxpayer (employer), through the NTRC Program Manager. Examples include:
 - a. When the employer fails to file the necessary tax returns,
 - b. When the employer fails to pay and deposit taxes.
 - c. When the employer fails to maintain records,
 - d. When the employer fails to make the required records available to the IRS,
 - e. When the employer fails to substantially comply with the educational program or the tip reporting requirements,
 - f. When the employer fails to maintain records or to make the required records available to the IRS, or
 - g. When the IRS or other federal agency pursues an administrative or judicial action, examination, investigation, or proceeding involving the employer or related party.
- (2) An employer may revoke a TRAC agreement at any time.
- (3) In the case of an employer with establishments in more than one key area and where one or more establishments are not complying with the requirements

under an agreement, the IRS, through the controlling office, will notify the employer corporate headquarters. The IRS will allow the corporate headquarters a reasonable amount of time to get these establishments into compliance (for example, 90-days). If the noncompliant unit or units do not come into compliance, the Program Manager may request approval to revoke the entire agreement. The TRAC employer needs to understand that internal controls must be consistent for all establishments to ensure the Agreement as a whole complies with accurate tip income reporting.

- (4) If the employer is otherwise complying with the TRAC agreement, the agreement should not be revoked. As a general rule, individual tip examinations should be initiated on the substantially noncompliant employees.

4.23.7.10.5
(01-22-2010)
**EmTRAC –
(Employer-designed
TRAC) Program**

- (1) The Employer-designed TRAC (EmTRAC) program retains many of the provisions available under the TRAC agreement. The employer must establish an educational program that trains employees that the law requires them to report all their cash and charged tips to their employer. Education must be furnished for newly hired employees and quarterly for existing employees. The EmTRAC program provides an employer with considerable latitude in designing its educational program and tip reporting procedures, which the employer may combine.
- (2) The EmTRAC program is available only to employers in the food and beverage industry.
- (3) Procedural and other information regarding the EmTRAC program can be found in Notice 2001-1.
- (4) Rules for terminating or revoking an EmTRAC are the same as for a TRAC agreement.

4.23.7.10.6
(12-18-2012)
**Gaming Industry Tip
Compliance Agreement
(GITCA)**

- (1) The Gaming Industry Tip Compliance Agreement (GITCA) Program was designed to promote compliance by gaming industry employers and employees with the provisions of the Internal Revenue Code relating to tip income and to reduce disputes under Section 3121(q). The Gaming Industry Tip Compliance Agreement Program was established in May of 2003 by Rev. Proc. 2003-35, 2003-20 I.R.B. 919. The model GITCA used by the IRS and gaming industry employers was updated in 2007 and is now administered under Rev. Proc. 2007-32, 2007-22 I.R.B. 1322, and Rev. Proc. 2020-47, 2020-48 I.R.B. 1121. The new model GITCA agreement was revised to enhance administration of the GITCA program by both the employer and the IRS and to facilitate and promote the use of current financial information technology in the tip reporting process. Please see Rev. Proc. 2020-47 for an update to potentially lengthen the term of the initial rate review agreement to up to five years.
- (2) The Gaming Industry Tip Compliance Agreement offers the following:
 - a. A two-tiered participation requirement,
 - b. Safe harbor from tip-related examinations for participating tipped employees and employer,
 - c. Electronic filing of Form 8027 or substitute form used to provide the Form 8027 required data,
 - d. No allocated tip requirement for participating employees,
 - e. Flexibility due to economic considerations, and

- f. A self-certification option which reduces the burden of reporting individual payroll and tip information.
- (3) The gaming industry offers many unique occupations and terminology. For more information on gaming occupations, see the following Bureau of Labor Statistics website: *Bureau of Labor Statistics*
 - 1. Select "Occupational Outlook Handbook" (under Publications)
 - 2. Select "A-Z Index"
 - 3. Select (G) "Gaming Services Occupations"

4.23.7.10.6.1
(12-18-2012)
GITCA Background

- (1) The GITCA, like all other tip agreements, is voluntary. However, once an agreement is entered into by the gaming establishment, the tipped employees will have to decide whether to participate in the program or not starting with the tip agreement effective date. Participation in the program means that the employee will report at or above the established tip rate for their particular worker category. If the employee decides to participate in the program, generally, the employer will automatically calculate the tip income reported for the employee and include that amount on the employee's Form W-2, *Wage and Tax Statement*, at the end of the year.
- (2) Under the GITCA Program, a gaming industry employer and the Internal Revenue Service work together to reach an agreement that establishes minimum tip rates for tipped employees in specified occupational categories, prescribes a threshold level of participation by the employer's employees, and reduces compliance burdens for the employer and enforcement burdens for the IRS.
- (3) With the consent of the IRS, all employers operating a gaming establishment may participate in the GITCA Program. Either the IRS or an employer may suggest the employer's potential participation in the program. The IRS's decision to refuse participation by any employer in this program is not subject to review.
- (4) An employer who complies with the reporting requirements of Section V of its GITCA, and participating employees of the employer who report in accordance with the agreement, will be deemed to be in compliance with the reporting requirements of IRC 6053 for the taxable periods during which the agreement remains in effect.
- (5) Rev. Proc. 2007-32 superseded Rev. Proc. 2003-35. All GITCAs executed pursuant to Rev. Proc. 2003-35 will remain in effect until the expiration date set forth in that Agreement, unless superseded by the execution of a Gaming Industry Tip Compliance Agreement under section 4.02 of Rev. Proc. 2007-32 and Rev. Proc. 2020-47.

4.23.7.10.6.2
(12-18-2012)
GITCA Benefits and Responsibilities

- (1) The GITCA is an enforceable agreement that must be signed by the employer's designated representative and the IRS designated official. The person designated by the employer to sign the GITCA must have the authority to legally bind the company/casino. Employees who choose to become participants in the program must sign the Appendix C, "Gaming Employee Tip Reporting Agreement," or similar document and also assume certain responsibilities to maintain their status as participating employees. The similar document can be an agreement that contains similar wording outlined by the

employer. Section IV, Employee Participation of the GITCA, discusses the employees' responsibilities as an eligible and participating employee.

- (2) Generally, the IRS and the employer work together to establish tip rates for tipped employees in specified occupational categories. These rates are determined using methodologies in accordance with generally accepted accounting principles.

4.23.7.10.6.2.1
(12-18-2012)

Employer's Benefits and Responsibilities

- (1) The employer agrees to encourage eligible employees to become participants in the program and sign the Appendix C, Gaming Employee Tip Reporting Agreement. In addition, the employer agrees to maintain the Gaming Employee Tip Reporting Agreements for the applicable period (statute of limitation on employment tax assessment) and make the agreements available to the IRS upon request. See Section V, Paragraph A of the GITCA.
- (2) The employer agrees to make tax withholding based upon tips reported and include all reported tips in the employee's Wage and Tax Statement, Form W-2. See Section V, Paragraphs B and C, of the GITCA.
- (3) The employer agrees to maintain the following records for at least 4 years after April 15 following the calendar year to which the records relate, and to make those records available to the IRS upon request:
 - a. Employee records. See Section V, Paragraph E(1) of the GITCA for the specific employee information required to be maintained.
 - b. Appropriate gaming establishment records. These records are used in the determination of the tip rates for each specific occupational category. See Section V, Paragraph E(2) of the GITCA for additional information.
 - c. Food and beverage operations records. For each food and beverage venue, the employer will maintain gross receipts subject to food or beverage tipping and aggregate receipts showing charged tips. See Section V, Paragraph E(3) of the GITCA for additional information.
- (4) The employer agrees to furnish the following to the IRS:
 - a. An annual report showing each non-participant. This report is due on or before March 31 for the preceding calendar year. See Section V, Paragraph F(1) of the GITCA for more information. An additional annual report providing the same information about participants is required if the employer is not self-certified. See Section V, Paragraph F(2) of the GITCA for additional information.
 - b. Specific records pertaining to large food or beverage establishments. The report is due on or before the Form 8027 filing date. See Section V, Paragraph F(3) of the GITCA to determine what information is required. If the records show that allocated tips are required to be reported, the employer should report them on Forms W-2 issued to nonparticipating employees tips allocated pursuant to Section 6053 of the Code. The employer is not required to report allocated tips on Forms W-2 issued to participating employees. In addition, the employer is not required to complete the portion of Form 8027 related to tip allocations to participating employees. See Section V, Paragraph F(4) of the GITCA for additional information.
 - c. For each calendar year, the employer will provide a report generated from the employer's time-and-attendance system or payroll processing system that evidences the tip rates utilized by the employer in the prepa-

ration of the Forms W-2 and to implement this agreement. This report will contain information showing the tip rates for each occupational category, shift, and outlet. The report will include the total number of the employer's eligible employees as of December 31. The report is due on or before March 31 of the year after the calendar year, or any portion thereof, during which this agreement was in effect.

- (5) The employer receives the following benefits when entering into a GITCA:
 - a. Implements its own tip income reporting program for employees,
 - b. Improves knowledge of operations and costs of employees and activities,
 - c. Incurs no contingent liability, except for taxes on non-participating employees' tip income, and
 - d. Is relieved of any employer tip examinations.

4.23.7.10.6.2.2
(05-10-2021)

Employee's Benefits and Responsibilities

- (1) All eligible employees may become participating employees if they agree in writing to adhere to certain requirements outlined in the agreement and in the Appendix C, Gaming Employee Tip Reporting Agreement, of the GITCA. For purposes of the agreement, a "nonparticipating" employee is any eligible employee who does not meet the definition of a participating employee, as defined in part IV. F of the GITCA.
- (2) An eligible employee means an individual who performs a job function in an occupational category described in Appendix A, Occupational Categories, Outlets, Shifts, and Tip Rates, of the GITCA and regularly and routinely receives tips, directly or indirectly, of at least \$20 per month.
- (3) A participating employee is an eligible employee who fulfills specific requirements. See Section IV, Paragraphs B, C, and E of the GITCA for additional information.
- (4) A participating employee who revokes the election under the Gaming Employee Tip Reporting Agreement will be treated as a nonparticipating employee for the entire taxable year in which the revocation occurred. The employee may not enter into a new Gaming Employee Tip Reporting Agreement with the employer until January 1 of the following taxable year.
- (5) If a participating employee reports tips to their employer in an amount below the tip rate set forth in Section VIII of the agreement, the employee will be deemed to have revoked their election under the Gaming Employee Tip Reporting Agreement and will be treated as a nonparticipating employee. The employee may not enter into a new Gaming Employee Tip Reporting Agreement with the employer until January 1 of the following taxable year. See Section IV, Paragraph D of the GITCA for additional information.
- (6) An employee may report tips on the employee's federal income tax return below the tip rates if the employee can substantiate, with adequate books and records, that the employee earned less tip income than would be determined by applying the tip rates. As indicated in Section IV, Paragraph D of the GITCA, this employee would be considered a nonparticipating employee.
- (7) Employees who pool tips or their group representatives (example: token committee) must give the employer a listing of the actual share of pooled tips received by or given to each employee. This listing must reconcile to the tips presented to the employer's cage for cashing. See Section VIII, Paragraph A(1) of the GITCA for additional information.

- (8) Employees receive the following benefits when they participate in the GITCA:
- a. Increased unemployment compensation coverage,
 - b. Increased retirement – social security or 401K additions by the employee and employer in a matching situation,
 - c. Increased ability to secure loans – mortgage, car, etc. (qualifying),
 - d. Increased worker compensation coverage, and
 - e. Protection from tip income examination and related liabilities and penalties.

4.23.7.10.6.2.3
(10-01-2024)
**IRS Benefits and
Responsibilities**

- (1) The IRS will work with the employer throughout the agreement process to establish reasonable tip rates and to educate the employer concerning its rights and responsibilities as provided for in the agreement.
- (2) The employer has the primary responsibility for administering the terms and rates of the agreement once it is signed. However, the IRS is available to assist the employer with questions regarding the administration of the agreement and the employer's related reporting requirements.
- (3) The IRS may not examine a participating employee's tip income for any taxable year that ends after the effective date of the agreement, as long as the participating employee fulfills their responsibilities as provided in the agreement and Gaming Employee Tip Reporting Agreement.
- (4) The IRS may not examine the tip income of a participating employee for any taxable year that ends on or before the effective date of the agreement provided that during that prior period the employee was:
 - a. A participant under a predecessor agreement (such as a Tip Rate Determination Agreement (TRDA)) and satisfied all the terms and conditions of that agreement,
 - b. A participating employee under another employer who had a GITCA or predecessor agreement and satisfied all the terms of that agreement, or
 - c. Employed at a workplace not covered by a tip agreement and had no opportunity to participate.
- (5) The IRS may continue any ongoing examination of any employees of the employer begun by the IRS before the effective date of the agreement.
- (6) A nonparticipating employee is subject to the full range of compliance and enforcement procedures of the IRS at any time.
- (7) During any taxable year that the agreement is in effect, the IRS may not assess additional tax against the employer pursuant to IRC 3121(q) with respect to the tip income of participating employees unless the participating employee reports additional tip income on their federal income tax return. The IRS may assert a liability against the employer pursuant to IRC 3121(q) based on tips received by a nonparticipating employee if the asserted liability is based upon the final results of an audit or agreement of the nonparticipating employee or the reporting of additional tip income by an employee.
- (8) If there is a material breach by the employer of its obligation to maintain or provide the information (reports and documents) listed in the agreement, the IRS will send the employer a notice of demand for the information. If the breach continues, then the IRS is no longer bound by the restrictions on additional assessments.

- (9) The burden to examine tip income will be less for the IRS because of executed tip agreements and employee participation.
- (10) The IRS will receive a more consistent stream of revenue generated from tax filings of employers and employees.

4.23.7.10.6.2.4
(12-18-2012)
**Mutual Responsibilities
between the Employer
and the IRS**

- (1) The employer and the IRS agree to meet to discuss the cause of a decline in participation if employee participation is below 75 percent of eligible employees.
- (2) The IRS and the employer agree to start discussions as to any appropriate revisions needed to the agreement no later than six months prior to the termination date.
- (3) The agreement can be terminated upon the joint agreement of the employer and the IRS, without the consent of any participating employee.

4.23.7.10.6.2.5
(10-01-2024)
**for Updating Established
Tip Rates**

- (1) Employers who participate in a GITCA or a TRDA have established hourly tip rates or percentage of sales rates. Tip Rates for GITCA Agreements are effective for the initial term of the agreement and may be extended. Extensions are generally for one-year terms.
- (2) After an agreement is implemented, if it is determined that adjustments to the established rates are necessary, the established rates may be updated by either an:
 - Economic Rate Reduction – Applicable to all impacted hourly tip rates; or
 - Addendum – Applicable to changes to a specific existing or new outlet or establishment.

4.23.7.10.6.2.5.1
(10-01-2024)
**Economic Rate
Reductions (ERR)**

- (1) Defined. An ERR generally applies a percentage reduction to all impacted hourly participant tip rates of a tip agreement due to tipping practices being adversely impacted by external factors beyond the establishment's control.
- (2) Substantiation. The percentage reduction is calculated using the employer's current financial and payroll data. Subjective factors may be revised based on changes to the customer base and customer tipping practices.
- (3) The employer must substantiate the reason for the downturn. Such conditions may include, but are not limited to, economic downturns, new competition, FEMA Disasters, and major construction in the area limiting customer access.
- (4) The employer must substantiate the adverse impact of the downturn. All requests for an ERR must be accompanied by the:
 - a. Analysis with supporting financial documentation based on the most recent 60 days of monthly revenue and payroll hours as compared to the prior year.
 - b. Percentage change in monthly gaming revenues, hotel occupancy, admissions, closures (restaurants, casino floor, amenity services) from prior year, if applicable.
 - c. Third party sources to substantiate the current/upcoming impact in the competitive area such as local plant closing, pandemic, major highway construction.

- d. Projected time period of impact including the basis used to determine the projected time period.
- (5) Request for Modification. Upon the occurrence of one of the following events:
 - a. A significant change in the nature of the business (or segment thereof) related to or impacting tips,
 - b. A significant decrease in the employer's gross monthly revenue as compared to the same month of the previous year that materially affects consumer tipping, or
 - c. A significant drop in the participation rate, the employer may request a modification in the relevant hourly tip rates of the affected participating employees.
- (6) Term. If approved, the temporary reduction will be effective for no more than three months. Extensions can be requested and will be based on updated factors and circumstances.
- (7) Requestor. The GITCA and TRDA Tip Agreements are between the employer and the IRS, and the tip rates are calculated based on the employer's current financial data. Therefore, requests for an Economic Rate Reduction must be initiated by the employer.
- (8) Process. The employer may initiate an ERR request by contacting the NTRCP Territory tip coordinator, group manager or analysts. The process established in IRM 4.23.7.10.6.2.5.1, *Economic Rate Reductions*, for the revision of tip rates upon the occurrence of specific events in no way limits the circumstances that may give rise to a request for revision of tip rates under the mutual agreement process.
- (9) Approver. All ERR requests are forwarded to the NTRCP analyst for final determination. National or regional ERR requests require NTRC Program Manager approval. Employers will receive notification of the determination. If approved, employers are notified of the reduction percentage and the time period covered.

4.23.7.10.6.2.5.2
(10-01-2024)

**Addendum for Existing
Outlet/Establishment**

- (1) Defined. An Addendum is used to add or remove tipped positions, update titles and/or tip rates of an outlet within a casino or standalone establishment under a tip agreement.
- (2) Substantiation. Tip rates for an existing tip agreement are calculated based on the employer's financial and payroll data and subjective factors based on the customer base and customer tipping practices. The employer must substantiate the:
 - a. Reason for the Change. Such conditions may include, but are not limited to, changes in employee positions or tip sharing policies, rebranding, or major construction specific to that outlet within a casino or a standalone establishment.
 - b. Impact of the Change. All requests for changes in tip rates must be accompanied by the analysis with supporting financial documentation based on the most recent 60 days of monthly revenue and payroll hours compared to the prior year and/or specific changes to tipped positions, titles, and tip sharing policies.
- (3) Request for Modification. Upon the occurrence of one of the following events:

- a. A significant change in the nature of the business (or segment thereof) which impacts tipping (for example, employer replaces or rebrands an existing outlet),
 - b. A decrease in the employer's gross monthly revenue as compared to the same month of the previous year at the outlet/establishment that materially affects consumer tipping,
 - c. A significant drop in the participation rate of any Occupational Category as of the participation measurement date, or
 - d. Request for modification of the relevant hourly tip rates of the affected Participating Employees within an occupation Category (for example, an outlet or shift).
- (4) Term. An Addendum to adjust tip rates due to changes in daily operations will be effective through the term of the tip agreement plus any applicable extensions. An Addendum to modify tip rates specific to an outlet or establishment due to temporary situations such as construction will be effective for no more than three months. Requests for extensions will be based on updated factors and may be granted by the IRS.
 - (5) Requestor. The GITCA and TRDA Tip Agreements are between the employer and the IRS, and the tip rates are calculated based on the employer's financial data. Requests for an Addendum may be initiated by either the employer or the IRS.
 - (6) Process. The employer may initiate an Addendum request by contacting the NTRCP Territory tip coordinator, group manager or analysts.
 - (7) Approver. Addendum requests for changes in tip rates are reviewed and approved by the NTRCP analyst.

4.23.7.10.6.2.5.3
(10-01-2024)

**Addendum for New
Outlet or Establishment**

- (1) Defined. When an employer under a tip agreement opens a new outlet or establishment, the employer does not have prior year or historical financial data to calculate tip rates. An Addendum will be used to provide tip rates for both directly and indirectly tipped positions for the new outlet using "comparable rates." Comparable rates are based on averages from similar outlets at similar casinos or restaurants currently under a tip agreement.
- (2) Substantiation. A request to add a new outlet to a tip agreement based on comparable rates must include, but is not limited to:
 - Projected Opening Date,
 - Type of Outlet,
 - Hours of operation,
 - Menu and/or average check,
 - Directly and indirectly tipped positions,
 - Standard of tipping including tip out policies,
 - One rate or shift rates for each position,
 - Similar outlets or establishments within the casino or competitive casinos/restaurants nearby, or
 - Tip rates for the same establishment at sister casinos/restaurants with similar sales and tipping expectations.
- (3) Term. An Addendum to provide tip rates based on comparable rates will generally be effective for a 12 to 18 month period, that is the remainder of the current year plus the subsequent year with an expiration of December 31 of

the following year. This time period allows the employer six months to resolve fluctuations in start-up operations and then another 12 months of data to calculate their tip rates.

- (4) Requestor. The GITCA and TRDA Tip Agreements are between the employer and the IRS, and the tip rates are calculated based on the employer's financial data. Requests for an Addendum may be initiated by either the employer or the IRS. The employer may initiate an Addendum request by contacting the NTRCP revenue agent, Territory tip coordinator, group manager or analysts.
- (5) Process. The examiner will forward all data collected to the Territory tip coordinator who will provide the comparable rates. The assignment of the Territory tip coordinator is determined based on the physical location of the establishment.
- (6) Approver. All comparable tip rates must be approved by the NTRCP analyst.

4.23.7.10.6.3
(10-01-2024)
**Tip Rate Review
Background**

- (1) IRM 4.23.7.10, *Tip Rate Determination and Education Program (TRD-EP)*, is a compilation of various subsections from IRM 4.23.1, *Employment Tax - Employment Tax Objectives, Organization*, and IRM 4.23.2, *Employment Tax Responsibilities and Coordination with other Functions*, to provide a consolidated overview of tip rate reviews.
- (2) Definitions for the purposes of this section, IRM 4.23.7.10, are as follows:
 - Employer: The Taxpayer
 - Establishment: Physical location of employer's casino or standalone place of business
 - Examiner: Reference for a revenue agent who conducts rate reviews
 - Outlet: A specific venue located within an establishment
 - Project Team: Group assembled by the employer to work in cooperation with the examiner; this may include employees from the following departments: Finance, Program analysts, Payroll, Human Resources, Food and Beverage, Gaming Managers and Front Services Managers (if applicable).
- (3) All Tip Agreements are voluntary between the IRS and an employer. Once an agreement is entered into by the employer, the tipped employees will elect to decide whether to participate in the program or not. Employers may require mandatory participation conditional upon the state's Department of Labor laws. Participation in the program means that the employee will report at or above the established tip rate for their particular worker category. If the employee elects to participate in the program, generally, the employer will apply the tip rate by outlet, position and/or shift for each hour the employee is clocked in and available to receive tips, and include that amount on the employee's Form W-2 at the end of the year.
- (4) Under the Tip Compliance Program, the IRS and an employer work together to reach an agreement that establishes minimum tip rates for tipped employees in specified outlets, occupational categories, and shifts, prescribes a threshold level of participation by the employer's employees, and reduces compliance burdens for the employer and enforcement burdens for the IRS. With the consent of the IRS, all employers operating an Establishment whose employees earn tip income may participate in the Tip Compliance Program. Either the IRS or an employer may propose the Establishment's potential par-

ticipation in the program. The IRS's decision to refuse participation by any employer in this program is not subject to review.

- (5) An employer who complies with the reporting requirements will be deemed to be in compliance with the reporting requirements of IRC 6053 for the taxable periods during which the agreement remains in effect.

4.23.7.10.6.4
(10-01-2024)

Control of Cases and Establishment of Cases

- (1) Most employment tax rate reviews of SB/SE and LB&I employers are established by NTRCP. If established by another Employment Tax territory: East, Mid-States, West, Large Case, the activities are coordinated with a Territory tip coordinator, NTRCP analyst or NTRCP group manager. NTRCP analyst completes the final review of tip rates prior to the tip agreement being sent to the employer.
- (2) Cases originating in Classification will have the project and tracking code on the controls prior to receipt in the group. See Exhibit 4.23.7-1, *Codes to Complete Form 5345-NTRC*, for a listing of these codes.
- (3) If an examiner is assigned a rate review case not previously established on ERCS or expands an open rate review to include additional establishments, the examiner will complete the Form 5345-NTRC, *NTRC Request for ERCS Examination Non AIMS DET Item* and submit to their manager for approval and ERCS input. Rate review cases are not established on AIMS. The Form 5345-NTRC will include:
 - a. Contact Person including title, phone number and email of the person the examiner will be in contact for the rate review.
 - b. Tax period which is the current Year and Month the rate review case is established in.
 - c. Special project and tracking codes have been established for rate review cases since they are established on ERCS, but not on AIMS. See Exhibit 4.23.7-1, *Codes to Complete Form 5345-NTRC*, for a listing of these codes.

4.23.7.10.6.5
(10-01-2024)

Issue Management System (IMS)

- (1) All examiners trained in the use of the Issue Management System (IMS) are required to use IMS for all case management, regardless of the type of case being worked. See IRM 4.23.4.5, *Guide for Examiners Using Issue Management Systems (IMS)*, and subsequent sections.

Note: ET case files must contain the Employment Tax Lead Sheets (ETLS) mandatory leadsheets.

- (2) All workpapers that contribute to the development of the case and support the audit trail must be included in IMS and uploaded to the appropriate Standard Audit Index Number (SAIN). See IRM 4.23.4.2.2, *Workpaper Preparation: General*. All uploaded documents must follow the naming convention described in IRM 4.23.4.5.5, *File Naming Convention*.
- (3) Inputting Time into IMS: Reviewers who are required to input technical time must use IMS for time input. See IRM 4.23.4.5.4, *Charging Time on Cases/Returns and Issues*, and IRM 4.9.1.7.2, *Time Input on ERCS and IMS*, for more details.

4.23.7.10.6.6
(10-01-2024)
**Tip Rate Review
Employment Tax Lead
Sheets (ETLS)**

- (1) The work paper system is designed to facilitate consistent organization of case files and eliminate duplication. NTRCP Tip Rate Review ETLS is a workbook similar to the SB/SE ETLS but modified to be specific to Rate Review cases.
- (2) Examiners must use the administrative and issue lead sheets on the Knowledge Management (KM) website under Tips. Check the KM for the latest version of the Tip Rate Review ETLS.
- (3) Administrative lead sheets address the administrative items requiring comment by the examiner. They are also used as a guide to assist the examiner with properly completing the Tip Rate Review case.
- (4) The administrative lead sheets listed below are mandatory for examiners and are generally applicable to all Tip Rate Review cases:

Reference Number	Title/Document Description
100	Form 9984, <i>Examining Officer's Activity Record</i>
105	Administrative Lead Sheet
120	Initial Contact Lead Sheet
125	Interview Questions and Notes
125-2	Summary of Interview
125-3	Tour of Business
130	Related Properties and Leased Outlets
200	Employer-Computed Tip Reporting Process Certification
300	Tip Rate Approval

- (5) The sections of the Form 4318 are arranged by specific purpose:

Note: The layout of the outlets or gaming departments and positions on the final Appendix A / Attachment B will match the NTRCP approved outlet order found on Form 4318 in the Tip Rate Review ETLS.

Reference Number	Title/Document Description
400 through 460	Tipped Outlet Lead Sheets
505	Employer Meetings
506	Employee Meetings
610	Information Document Requests
910	Correspondence
920	Current Rates/Agreements - This is the section which the final Agreement signed by both the authorized signatory of the employer and the NTRC Program Manager is stored.

Reference Number	Title/Document Description
930	Prior Rates/Addendums/Extension - This section is only applicable for employers that had a previous agreement with the IRS
935	Form 8027 Analysis
940	Memorandum of Understanding (MOU) for Secure Email
950	Case Building Materials
950	IDRS Research

- (6) An issue leadsheet is required for each Tipped Outlet. For the gaming Section 400, if an average hourly rate is calculated, the “Summary” tab may be used as the lead sheet. However, the examiner must address the actions to be considered on the related ETLs lead sheet.
- (7) For the Sections 410-460, the examiner will use an approved NTRCP template Summary tab as the lead sheet when an average hourly tip rate is calculated. The examiner will complete all sections of the Summary tab.

Reference Number	Title/Document Description
400	Gaming Outlet Lead Sheets
410	Food Outlet Lead Sheets
420	Beverage Outlet Lead Sheets
430	Front Service Outlet Lead Sheets
440	Transportation Outlet Lead Sheets
450	Spa Outlet Lead Sheets
460	Golf Outlet Lead Sheets

- (8) Workpapers support the information included on the lead sheets. Each Tipped Outlet requires the inclusion of supporting documentation for each rate calculation including but not limited to rate calculation worksheets, Point of Sale (POS) and financial reports, tip sharing policies, interview notes, and payroll reports.

Note: See IRM 4.23.4.2, *Workpapers*, and subsequent sections for guidance on general workpaper preparation. See IRM 4.23.4.5.5, *File Naming Convention*, and subsections for guidance on naming files uploaded to IMS. See IRM 4.23.4-4, *Mandatory Items and Standard Naming Convention Location for ET Tip Agreement Program*, for guidance on naming files and file location. For additional Lead Sheet guidance, see IRM 4.10.9.7, *Lead Sheets*.

4.23.7.10.6.7
(10-01-2024)
Rate Review Procedures

- (1) The IRS’s goal is to reduce the tip reporting tax gap and decrease taxpayer burden through employer and employee participation in TRD/EP. See IRM 4.23.7.1, *Program Scope and Objectives*.

- (2) The Streamline Method for rate reviews and the Traditional Method for rate reviews use the same process to arrive at tip rates, including calculation methods, objective factors, and subjective factors. There are some differences between the Streamline Method and the Traditional Method for conducting rate reviews.
- (3) The IRS is always looking for methods to reduce internal administrative burden and external compliance burden. The Streamline Method for rate reviews is the preferred process that:
 - a. Modernizes the rate review process by leveraging electronic data,
 - b. Engages participants to better understand the voluntary program,
 - c. Provides consistency through a uniform approach, and
 - d. Reduces rate review cycle time through collaboration and increased participation.
- (4) All rate reviews in a competitive area must be completed timely before the current tip agreement expires to ensure participating employers and their employees can continue in the tip program without disruption. All tip agreements in a region or competitive area are completed timely to ensure a level playing field and fair tax administration.
- (5) To assist examiners in the timely completion of rate review work, at the beginning of each rate review period NTRCP analysts issue a Timeline of Actions for each type of tip agreement.
 - Employer Timeline for TRDA
 - Examiner Timeline for TRDA
 - Employer Timeline for GITCA
 - Examiner Timeline for GITCA
- (6) Because all tip agreements in a competitive area must be implemented simultaneously, (for example January 1, 20XX), the rate review period may exceed 12 months or a calendar year.
- (7) Each Timeline outlines the roles and responsibilities of both the examiner and the employer's management team.
- (8) Each Timeline establishes actions and due dates to ensure all rate reviews in the competitive area and the assigned rate reviews for that tax year are completed timely. In general, the examiner will complete the following actions for rate reviews:

Month(s)	Action
Month 1	Research the establishment under the Tip Agreement (IRM 4.23.7.10.6.10, <i>Pre-Contact Analysis and Research For Tip Agreements</i>)
Month 2	Make Initial Contact, schedule Initial Meeting and Issue IDR 1 (IRM 4.23.7.10.6.11, <i>Initial Contact</i>)
Months 3-5	Conduct Initial Meeting, Interviews, Tour of Business and Issue IDR 2 (IRM 4.23.7.10.6.12, <i>Initial Appointment, Tour, and Interview</i> and IRM 4.23.7.10.6.13, <i>Information Document Requests</i>)
Months 5-11	Hourly tip rates calculated; internal control for positions on actual verified; payroll and timekeeping capabilities verified; all rates approved by NTRCP analyst

Month(s)	Action
Month 12	All tip rates agreed to and approved by NTRCP analyst
Months 13-14	Issue Mock Appendix A/Attachment B, assist with employee education, complete payroll certification, issue tip agreement, secure countersigned tip agreement; employer updates systems with new rates
Month 15 (January 1)	Effective Date of new agreement

(9) The examiner will review the Timeline of Actions and become familiar with the timing of the steps to be taken during the rate review.

(10) For the use of electronic signatures and encrypted email the examiner may:

- a. Accept images of signatures and digital signatures on documents related to the determination or collection of a tax liability or to the resolution of tax controversies,

Caution: For further information refer to IRM 10.10.1.6.1, *Accepting Images of Signatures and Digital Signatures in Certain Taxpayer Interactions*.

- b. Receive and transmit documents using email with encryption when working person-to-person with IRS personnel.

Note: Refer to IRM 4.23.7.10.6.11 (10) for additional information on the use of secure email.

Caution: For further guidance on the use of secure email refer to Interim Guidance Memorandum PGLD-10-1023-0002, which provides for the receipt and transmission of documents through October 31, 2025, using email with encryption when working person-to-person to address compliance. This guidance should remain in effect until the IRS fully implements long-term solutions for secure electronic communication channels with taxpayers as alternatives to encrypted email.

4.23.7.10.6.7.1 (10-01-2024)

Completion of the Templates

- (1) Traditional Method: Templates completed by the IRS
- (2) Streamline Method: Templates completed by the employer (preferable method) with guidance and assistance from the IRS. Streamline engages the employer more in the rate calculation process:
 - a. The employer calculates the initial rate providing early opportunities to identify errors,
 - b. Rate calculations also provide the employer with an understanding of rate changes or fluctuations,
 - c. The employer determines the appropriate staff and amount of their involvement in the calculation process, as to not impede their business, and
 - d. The IRS is "on site" less frequently, the rate review is less intrusive to the operation of the business
- (3) Regardless of method used, all tip rates must be approved by the NTRCP analyst to ensure consistency in the competitive area under review.

- (4) Examiners must use NTRCP approved templates for all tip rate calculations. See *Food and Beverage Template Selection Guide* in NTRCP Shared Drive for assistance in selecting template for a food or beverage establishment.

4.23.7.10.6.8
(05-10-2021)

Criteria to be Considered Tip Income

- (1) Payments must meet the following criteria to be considered as tips:
 - a. The payment must be made free from compulsion,;
 - b. The customer must have the unrestricted right to determine the amount,
 - c. The payment should not be the subject of negotiations or dictated by employer policy, and,
 - d. Generally, the customer should have the right to determine who receives the payment.

Note: If any of the above factors are missing, there is doubt that the payment is a tip. Rev. Rul. 2012-18 provides specific examples of amounts characterized as tips and service charges to illustrate the application of these factors.

- (2) If a business adds service charges (such as “auto-gratuities”) to customers’ bills which it distributes to employees, the business should characterize the distributed service charges as non-tip wages, not as tips.
- (3) The facts and circumstances around a payment are the determinative factors in the proper treatment of a payment, not the employer’s or employee’s characterization or treatment.
- (4) Rev. Rul. 2012-18 (Auto Gratuities/Service Charges) and H.R.5180 - Tip Income Protection (TIP) Act of 2018 (Supervisors and Tips) should be discussed and provided to the employer.
- (5) Tip-Sharing, the sharing of tips with non-directly tipped employees, is not allowed in all states. The Reviewer will need to research the applicable law for each state dependent upon the location of the employer.

4.23.7.10.6.9
(10-01-2024)

Working Newly Opened Outlets and Newly Opened Establishments

- (1) When assigned a tip agreement request, the examiner must first become very familiar with the agreement. Take the time to read the entire agreement and understand the benefits and responsibilities specified for the IRS, for the employer and for the employee. It is important for the examiner to assess the employer’s overall operations and tax compliance for suitability to participate in the tip program. Any noted deficiencies must be shared with the group manager or NTRCP analyst prior to commencing development of tip rates.
- (2) Newly Opened Outlet or Establishment: When an employer under a tip agreement opens a new outlet or when a new gaming related establishment opens, the employer does not have prior year or historical financial data to calculate tip rates. In both situations, the assigned tip coordinator for the territory will establish tip rates for both directly and indirectly tipped positions using “comparable rates.”
- (3) The examiner must notify both the group manager and Territory tip coordinator of the request for new tip rates. This is especially important for employers under a current tip agreement. The employer will need new tip rates in place when the new outlet opens to ensure consistency in employees’ pay with their other surrounding outlets.

- (4) If the examiner is notified of a new outlet opening, while conducting a rate review, they may be asked to gather the following information:
- Type of Outlet(s),
 - Hours of operation,
 - Menu and/or average check,
 - Directly and indirectly tipped positions,
 - Standard of tipping including tip out policies,
 - One rate or shift rates for each position,
 - Similar outlets within their property or competitive properties nearby, or
 - Tip rates for the same establishment at related properties with similar sales and tipping expectations.
- (5) The examiner will forward all data collected to the Territory tip coordinator who will provide tip rates based on averages from similar outlets at properties currently under a tip agreement. These rates are also known as “comparables.” The assignment of the Territory tip coordinator is determined based on the physical location of the establishment. All comparable rates must be approved by the NTRCP analyst.
- (6) Once the tip coordinator provides the comparable rates for the new outlet or establishment to the examiner, the examiner will share with the employer the proposed rates for each position. The examiner will not provide the actual calculations or disclose the establishments that were used to prepare the comparable rates.
- (7) The examiner will work with the Territory tip coordinator to prepare an Addendum to the tip agreement to add the new tip rates. The comparable tip rates are usually established for a 12-18 month period, that is the remainder of the current year plus the subsequent year with an expiration of December 31, 20xx.
- (8) An examiner may be assigned a rate review to calculate tip rates using historical data:
- a. Update comparable tip rates for an existing agreement set to expire within 12-18 months.
 - b. Calculate tip rates for an existing establishment that wants to join the tip program.
 - c. Calculate tip rates for an existing establishment with expiring comparable rates that wants to remain in the tip program.
- (9) Tip rates are calculated for employers with at least 12 months of financial data. The examiner will calculate tip rates based on the most current set of calendar year financial data to execute a new tip agreement.
- Example:** A tip agreement, expiring on December 31, 2022, will have tip rates calculated using 2021 financial data and a new tip agreement implemented on January 1, 2023.
- (10) The examiner will conduct interviews with the establishment’s management staff knowledgeable of the tipping operations to determine:
- The business operations, including locations and competitors,
 - Type of Point of Sale (POS), payroll and timekeeping system capabilities, and

- Standard tipping and tip out practices.

(11) The examiner will request:

- Financial data such as POS reports to document sales by type and tipping practices.
- Payroll records to document tipped positions and hours worked.
- Forms 8027 to establish their current tip reporting if they are a large food and beverage establishment
- Documentation of the number of drinks, checks, valet tickets, bell runs, or room occupancy to calculate the tip rates for non-food and tips based on service provided.
- Documented subjective data such as the average tip per drink, cash tip rate and stiff rate should be compared and consideration given to using consistent factors among employers in the same competitive area and of a similar type. NTRCP analyst has suggested parameters for the subjective factors.

(12) When multiple tip agreements are being updated in the same competitive area, tip rates will be reviewed by the group manager and approved by the NTRCP analyst to ensure subjective factors used in the tip rates are consistent within the competitive area.

Reminder: Tip rates are not negotiated they are calculated. Refer to *Employment Tax Tip Rate Reviews (Student Guide)* training material ITM 28136-B002, Catalog Number 93915C for more information on the calculation of tip rates.

4.23.7.10.6.10
(10-01-2024)

**Pre-Contact Analysis
and Research For Tip
Agreements**

(1) The employers requesting any tip agreement must show readiness or compliance to implement the agreement. Examiners will conduct and document a pre-contact analysis which will include some or all the following.

- Verify the employer's tax filings. If the employer has not been compliant in all their filing requirements, for the year under review plus two prior tax years, contact the group manager and NTRCP analyst before proceeding with the pre-contact.
- Research the employer's internet sites and document the types of services offered, hours of operation, menus, and other information useful in determining customer base and tipping practices. The website document must be saved in IMS and indexed as a Section 950 workpaper. The website document will provide a general idea of new outlets, outlets that may have closed, and the volume of tip rates to be calculated during the rate review.
- Research IDRS to determine the employer's filing and payment compliance and to secure reported wages and tips and gross receipts for the current and prior two years.
- Research the NTRCP Shared Drive to determine reporting requirements of employers under an existing tip agreement. Employer annual year-end documents within this folder are listed by calendar year and then by employer d/b/a.
- Verify and copy to the case the employer's most current Tip Agreement, Extensions for most current agreement, and subsequent Addenda that provide a list of titles for all outlets, positions and shifts with the corresponding tip rates. Copy the most current Excel version of Appendix A / Attachment B and verify the applicable addendums match the most

current GITCA / TRDA on the NTRCP Shared Drive. Reconcile the Appendix A / Attachment B outlet names to the prepared website document and notate discrepancies. Any discrepancies must be discussed during the initial meeting with the employer.

- f. Secure and review Form 8027, Form 14439, Employee Data Report and List of Tip Rates from the NTRCP Shared Drive. If the documents are not filed and the employer appears to be a required filer, discuss with the employer and secure the document(s).

Reminder: See IRM 4.23.7.11, *Mandatory Compliance Reviews on Voluntary Tip Agreements*, for additional pre-contact analysis.

- (2) Verify if the employer has a Secure Email MOU with the IRS. Determine if the IRS can communicate via secure e-mail with the employer. If so, secure a list of approved establishments and contacts covered by the Memorandum of Understanding (MOU). The examiner should copy the:

- Most Current MOU, and
- MOU Addenda with subsequent date.

Note: Refer to IRM 4.23.7.10.6.7 (10) for additional information on secure email.

4.23.7.10.6.11 (10-01-2024) Initial Contact

- (1) Schedule the initial appointment with the appropriate executive to meet at the establishment to conduct interviews and tour the business.
- (2) **New Employer:** Letter 5327, *GITCA Invitation*, is used to contact and invite a new property into the Tip Compliance Program on behalf of the NTRC Program Manager; employers have 14 days to respond to the letter
- (3) Existing employer (established relationship): The examiner will either issue Letter 5243, *Rate Review Initial Contact Letter*, or contact the employer by phone (the tip agreement contract establishes an ongoing relationship); employers have 14 days to respond and commit to continue in the Tip Agreement Program process.

Note: The current GITCA Appendix F or TRDA Contact List at the end of the tip agreement will include the employer's contact name, address, and phone number. If there are issues with the contact information, the examiner should reach out to the NTRCP analyst for assistance. NTRCP analyst may have the most current name, title, and contact data.

- (4) Prior to contacting the employer, the examiner will become familiar with the NTRCP issued Examiner Timeline of Actions for the competitive area as it will outline the due dates and actions required to ensure a timely rate review process. Each section of the timeline correlates with the steps in the rate review process and provides issues or actions required. A delay in one of the sections means the employer and examiner must make up the time during one of the next steps. Otherwise, the current tip agreement may lapse without a new tip agreement in place, creating a disruption in the employer's operations.
- (5) During the initial call with the employer, the examiner will reference Steps 1 and 2 of the Examiner Timeline of Actions to ensure important factors are verified during the initial call with the employer. See *Employment Tax Tip Rate Reviews (Student Guide)* training material ITM 28136-B002 (Catalog Number 93915C) for examples of Examiner Timeline of Actions.

- (6) When the initial contact is concluded, the examiner will customize the examiner and employer's Timeline of Actions and prepare IDR 1, General Information. The IDR and Employer Timeline must be issued to the employer with Letter 5243-A, **Rate Review – Confirmation of Appointment**, with the date, time, and location of the initial appointment.

Note: For additional information regarding IDRs see IRM 4.23.7.10.6.13, *Information Document Requests*.

- (7) The examiner will document all actions taken on Form 9984.
- (8) For large businesses, NTRCP utilizes the Memorandum of Understanding (MOU) – Agreement to Use Secure Email, to reduce taxpayer burden, cycle time, and costs associated with delivery from voluminous tip related financial data.
- (9) The NTRCP is engaged in a process with SBSE Business Systems Planning, Security Program Management Office, to incorporate the Secure Enterprise Message System (SEMS).
- (10) To communicate by secure E-Mail, the following procedures must be used.
 - a. Request and secure Memorandum of Understanding (MOU) with Letter 5873, *Request Secure Email Memorandum of Understanding*.
 - b. Employer identifies their employees to include in the MOU as participants.
 - c. IRS identifies IRS employees to include in the MOU as participants.
 - d. MOU is signed and approved by the employer and IRS.
 - e. Current MOUs are effective indefinitely; however, many certificates expire after one year, and up-to-date certificates are required.
 - f. MOU can be amended to add or remove employees.
 - g. MOU will be retained by the NTRCP analyst.
 - h. Digital certificates exchanged by all authorized employees for the employer and the IRS.
 - i. Test messages are sent to ensure digital signatures were properly shared.
 - j. Subject lines and attachment names will not be encrypted so IRS personnel must remain disclosure vigilant in these areas.

Caution: For further guidance refer to Interim Guidance Memorandum PGLD-10-1023-0002, which provides for the receipt and transmission of documents through October 31, 2025, using email with encryption when working person-to-person to address compliance or resolve issues in ongoing or follow-up authenticated interactions. This guidance should remain in effect until the IRS fully implements long-term solutions for secure electronic communication channels with taxpayers as alternatives to encrypted email.

4.23.7.10.6.12
(10-01-2024)
**Initial Appointment,
Tour, and Interview**

- (1) The purpose of the initial appointment is to educate the employer and management team on the rate review process and obtain their commitment to the timeline. The examiner will:
 - a. Refer to Step 3, Initial Meeting of the NTRCP issued Timeline of Actions for the rate review period; customize timeline based on beginning and

- implementation dates. The timeline serves as an opportunity to obtain employer commitment to the process and to establish an estimated closure date.
- b. Prepare the timeline based on the mutually agreed upon date to begin the rate review process (generally within 30 days but no more than 60 days from initial appointment).
 - c. Determine a time period covered that will provide the most recent, completed financial data—A twelve-month period is generally required in order to incorporate busy, slow, and average business seasons. Rates should never be calculated based on data selected only from the busiest or slowest times of year as that will not reflect a true average.
 - d. Review and document responses to IDR 1, *Initial IDR*.
 - e. Determine available resources to prepare the initial templates and confirm mutually agreed upon date to begin the Traditional or Streamlined Method (generally within 30 days but no more than 60 days from initial appointment).
 - f. Conduct tour of business.
 - g. Conduct interviews of financial, payroll and human resource managers.
 - h. Conduct or schedule appointments with department directors and/or manager interviews with food and beverage, front and guest services, and gaming departments.
 - i. Conduct or schedule training session on template preparation, if applicable.
- (2) A tour of the business is required. The tour should be done both virtually and physically if possible. The virtual tour is completed during pre-audit or initial contact phases of the Rate Review. This will help the examiner determine the size and scope of the Rate Review. The examiner will document research completed during the virtual tour and update this document with information obtained during a physical walk-through such as:
- Size, location, and customer base,
 - Map of layout (as well a location of outlets, service bars, etc. and any barriers that impact employee tips),
 - Type of Tipping Outlets and how customers leave charged or cash tip,
 - Types of outlets segregate by Fast Food Restaurants, High End Restaurants; Sports Bars, Retail Bars, Casino Floor, VIP Lounges, Front Services, Guest Services, Entertainment/Shows, Slot and Table Games,
 - Hours of Operation noting any recent or upcoming changes/modifications,
 - Menus,
 - Customer tipping preferences, and
 - Press Releases announcing upcoming changes in operations.
- (3) There are multiple websites that may be consulted for additional information. See *Employment Tax Tip Rate Reviews (Student Guide)* training material ITM 28136-B002, Catalog Number 93915C for more information on conducting a tip rate review. See IRM 4.10.3.4, *Interviews: Authority and Purpose*, for authority and purpose for conducting interviews.
- (4) The examiner must also refer to the NTRCP Shared Drive Resource folder for examples of Timelines, IDRs, and interview questions that will assist in meeting with the employer, touring the business and conducting various interviews

- (5) Interviews are used to develop information and establish facts. Interviews should always be held with the person(s) with the most knowledge of the type of information required. The examiner can refer to the NTRCP Shared Drive Resource folder for an outline of topics to be considered and interview questions. Below are examples of the type of information that can be obtained from the various departments.
 - a. Financial/Payroll/Human Resources/IT—the individuals from these areas are responsible for the implementation and administration of the program at the Establishment. This group of individuals will provide responses to questions in IDR 1 on ownership, year-end reporting compliance, types of Point of Sales (POS), timekeeping and payroll systems and shift times, types of POS and payroll reports, capabilities of their time and attendance system to track hours and apply tip rates, and internal controls to move employees to a second shift or outlet.
 - b. The managers of the specific outlets will discuss the details of the daily operations, upcoming operational changes, unique aspects of their POS system, staffing schedules, and policies on employee's sharing their tips. If the particular outlet has a rate of "ACTUAL" then the manager must provide a copy of the Internal Control procedures.
 - c. At the completion of the interviews, the examiner will issue IDR 2 to the specific departments (Food and Beverage, Front and Guest Services, and Gaming). IDR 2 will list the financial data and the templates required to prepare the initial tip rate calculations and prepare the updated Timeline for the Employer.

4.23.7.10.6.13
(10-01-2024)
**Information Document
Requests**

- (1) Form 4564, "Information Document Request", will be used to request information from the employer. All requests for information will be specific, clear, and concise.
- (2) Prior to issuing an Information Document Request (IDR), the examiner will discuss the specific information that is needed with the employer to determine the type of information available such as report titles to secure required payroll, financial and other supporting data for the selected time period covered. Pro-forma examples of the IDRs are in the NTRCP Shared Drive Resource folder.
- (3) IDR 1 - General Information is the initial IDR tailored to the employer and type of tipping establishment to verify general information about their operations and system capabilities. This IDR will be sent with the confirmation of appointment letter along with a copy of the MOU for Secure Email if applicable.
- (4) IDR 2 – Tip Rate Calculations will list the financial data and/or the templates required to prepare the initial tip rates and include the updated Employer Timeline for the establishment. The examiner should issue separate IDRs for each department to obtain requested information. The order of issuing the IDRs for preparation of the templates for each department can be adjusted according to available resources. Examples of IDR 2 by department are:
 - Restaurant or Retail Bar Templates,
 - Combo/Comp Bars, Buffets, Counter Service Templates, or
 - Front Services, Guest Services and Gaming Templates.
- (5) Additional IDRs are sent to request issue specific information needed to calculate tip rates or establish internal controls.

- a. POS Reports; log of bell runs or occupancy information; number of tickets issued by valet; number of hands dealt for Poker—all information broken down by occupational category and shift if applicable.
 - b. Payroll hours worked that are subject to tipping by outlet, occupational category and shift.
 - c. Current one-week staffing schedule is recommended when shift rates are requested.
 - d. Documents used to identify, track, and verify that there are adequate internal controls for outlets and occupational categories to be on “actual” rates. See IRM 4.23.7.10.6.17, *Review of Internal Controls*.
- (6) A separate IDR should be submitted for each topic, each outlet, and each department manager.

Example: If the examiner has questions regarding the Steakhouse and the casino floor, separate IDRs should be developed and issued.

- (7) All examiners will prepare and complete IDRs within IMS, including annotating the Form 4564 as appropriate (for example, Date IDR Issued, Date Information due by). If an IDR is created outside IMS, it can be attached to the IMS IDR to fulfil the requirement to create the IDR in IMS. Examiners must update the IDR status and date fields via the ‘View/Modify Form Status’ icon on the IDR tool bar in IMS.

Note: IDRs must be created and maintained in the ‘IDRs’ section in IMS and not uploaded as a workpaper. See IRM 4.23.4.5.3, *Mandatory Requirements for Information Document Requests (IDRs)*.

- (8) Original employer IDR responses must be uploaded to the ‘IDR Responses’ section in IMS. Original responses from the employer must not be modified. A copy of the employer’s response can be modified and uploaded as a workpaper in IMS to support the audit trail.

4.23.7.10.6.14
(10-01-2024)
**Templates and
Parameters**

- (1) To ensure that tips rates for an establishment are calculated consistently nationwide, NTRCP developed customized templates for every type of tipping outlet or establishment. The templates allow tips received at an outlet to be customized based on the employer’s operations and financial data, and also ensures the IRS is using the same methodology (type of data and formulas) to calculate tips received at the same type of establishment no matter the location.
- (2) IRS uses two methodologies to calculate tips:
- a. McQuatters Formula – Tips received are based on the price of the check with a minimum volume of charged tips and can be used to calculate rates as a percentage of sales or tips by hour.
 - b. Tip per Service/Product – Tips received are based on number of services or products delivered, such as bags delivered, cars parked, etc. This template is also used when tipping is based on the price of a check but the outlet or establishment has low charged tips and customers primarily tip in cash.
- (3) The completed customized templates calculate total tips received by the outlet, direct tips by position, and shift rates, if applicable. The templates also calculate reductions for differences in tipping practices such as when

customers leave a cash tip or leave no tip at all, as well adjustments to the tip pool for tips shared with other employees.

- (4) The templates are segregated by type:
 - Restaurant/Retail Bars
 - Combo and Comp Bars
 - Front Services
 - Guest Services
 - Gaming
- (5) Each template includes a Summary Tab that provides an overview of the data included on each tab of the template and includes an analysis of the factors used to calculate the tip rates for each position. For purposes of a rate review, the Summary Tab may satisfy the Tip Rate Review ETLs lead sheet requirements. However, employees may reference lead sheets for assistance in calculating tip rates based on customer tipping practices.
- (6) Examiners are required to include in the template the employer's IDR and interview responses for a specific outlet or establishment. Examples of required information:
 - Current hours of operation, type of establishment and customer tipping practices,
 - Payroll shifts, type of clock, employees per shift and staffing schedule, if shift rates are required,
 - Explanation of any auto gratuities and services charges imposed and if they are correctly treated as wages (not tips) when distributed,
 - Written Tip Out Policies. If employer has no written policy or states they do not know how the employees share their tips, the examiner must explain that this information is required to calculate the tip rates. Investigative techniques may be employed, such as floor manager and employee interviews, observations, etc.,
 - Average charged tip rate. How customers leave a cash tip (table or tip jar), and
 - Volume of comped sales and number or percentage of customers that leave no tip.
- (7) Examiners will use the responses from their IDRs and interviews to select the template for each establishment that best represents the type of establishment, tipped positions, rates, and customer tipping practices. See *Food and Beverage Template Selection Guide* in NTRCP Shared Drive Resource folder.
- (8) Parameters, or subjective factors, determines the Cash Differential and Stiff Rate used in the templates. The Cash Differential is the difference between cash and charge tip rates. In general, the Cash Differential is usually between 1 percent and 5 percent less than the charge tip rate depending on the type of restaurant, composition of tender, clientele, and customer tipping practices. The Stiff Factor is referred to as a percentage of customers who leave no tip. The stiff factor and the cash differential are established during the initial or subsequent interviews with outlet manager(s). The examiner may reference the parameters to determine if the stiff factor and cash differential are within the normal range for that type of outlet.

Note: The stiff factor is applied only to "cash receipts." Cash receipts include receipts paid in cash, or charge receipts that did not leave a tip (comp sales

are also treated as receipts paid in cash and may be subject to a cash differential and stiff factor). Charged receipts with a charged tip have a definite tip, so the stiff would not be applied to these receipts.

- (9) In the Streamline Method, the employer completes the template and provides requested documentation to the examiner to test the accuracy of the computation. Examiners will request the basis for subjective factors if they exceed the parameter guidelines. For example, the examiner will ask the employer to explain or substantiate how the stiff rate was determined. If the basis does not appear reasonable, the examiner may need to develop additional observations and test the impact of the Stiff Factor on the average tip rate to verify the accuracy of the subjective factors.
- (10) Examiners will provide NTRCP approved templates with instructions and assistance on how to complete the templates to the employer for Streamlined Method. See NTRCP Shared Drive Resource folder for electronic templates.
- (11) In the Traditional Method, the examiner completes the templates based on POS Reports, payroll information and notes from interviews.

Reminder: Comments must be included on the calculations to aid the group manager in the review and NTRCP analysts in approval of rates. See IRM 4.23.7.10.6.14 (6) for examples of comments.

4.23.7.10.6.15 (10-01-2024)

Point of Sales Reports

- (1) POS systems used by employers generate reports that provide details regarding revenue, including gross and net sales, cash, credit card, complimentary sales, the breakdown of sales by composition, job occupation, charge tip information, auto gratuities imposed by the employer, and product mix or breakdown of sales by menu item.
- (2) Report titles and formats of POS Reports vary depending upon the system being utilized by the employer. Even if the employer does not have a common POS system, the general information required to calculate tip rates can be requested and obtained from sales data. The examiner must ask the employer to explain their POS system's tracking of sales and to provide examples of the reports their system can generate.
- (3) Examiners are required to include in the template all POS reports used to calculate the tip rate(s).
- (4) Some POS systems provide a report that includes the charged sales that had a charged tip that is necessary to calculate the charged tip rate for the McQuatters template. There are two issues that require further testing using a credit card sample:
 - a. When the charged tip rate seems low or high for the type of establishment, and
 - b. When there is a high volume of comped sales which can artificially inflate the charged tip rate.

Note: If the *McQuatters* template requires a credit card sample, see *Employment Tax Tip Rate Reviews (Student Guide)* training material ITM 28136-B002, Catalog Number 93915C for information on the templates, POS systems, and a credit card sample.

4.23.7.10.6.16
(10-01-2024)
Payroll Requests and Certification

- (1) It is the responsibility of the examiner to test the capabilities of the payroll system and to verify that the employer can track and apply the calculated tip rates accurately.
- (2) Staffing information and payroll reports provide details regarding hours worked by position for the period being reviewed. Examiners will verify true “tipped hours” excluding administrative, vacation, or other non-tipped hours.
- (3) The examiner will test the payroll tracking system, documenting how the time and attendance system and payroll software system work to accurately apply the specified rate according to each outlet, occupational category, and shift.
- (4) The examiner must sample employees’ time and attendance cards or payroll records and verify the proper rates were used for each shift, occupation, and position to calculate the employees’ tax liability as reported on their paychecks.
- (5) The examiner will determine if the employer imposes Service Charges / Auto Gratuities / Contracted Charges / Bottle Charges (hereinafter “Service Charges”) and how Service Charges are currently handled (or will be handled if a new employer or outlet). The examiner will verify the policies and procedures of both new and existing employers, to ensure service charges distributed to employees are accurately tracked in their POS system and treated as regular wages in payroll. If Service Charges are not appropriately treated as regular wages, the examiner must educate the employer on the correct handling of auto gratuities per Rev. Rul. 2012-18 and advise the employer that they must implement procedures to treat the auto gratuities as wages or discontinue imposing auto gratuities. Either option must be verified during the payroll certification.
- (6) Payroll certifications only apply to a GITCA agreement. If the employer can demonstrate tracking the participants’ hours, applying the correct participant tip rates, accurately tracking and reporting service charges, and reporting the participants’ tips on the paycheck and Form W-2 regularly without error, the examiner with managerial approval and NTRCP analyst concurrence may execute the Appendix E, Employer-Computed Tip Reporting Process Certification, certifying the employer’s payroll. If the employer’s payroll is certified, the employer will only report the Non-Participants on the Year-End Report (Form 14439).

4.23.7.10.6.17
(10-01-2024)
Review of Internal Controls

- (1) The examiner must review the internal control procedures that are used to report tips to payroll, particularly in outlets that pool and split their tips (for example, pit dealers). The tip rate for these positions is **Actual**. Positions with a tip rate of Actual means the IRS reviewed the employer’s ability to capture 100 percent of the tips received and approved the internal controls in place to report the actual tips earned through payroll.
- (2) In satisfaction of their tip reporting obligations under IRC 6053(a) with respect to employees who pool tips, these employees or their employee group representatives (for example, the token committee) shall present to the employer a listing of the actual share of pooled tips received by or given to each employee. This listing must reconcile to the tips presented to the employer’s cage for cashing. The tip rate for these employees will be listed as Actual on the Appendix A or Attachment B of the tip agreement.
- (3) The examiner will document the standard operating procedures from the inception of the tip received from the guest by the employee, to the placement

of the tip in a designated token box and eventually reported on a form supplied to payroll once the count and distribution is completed. Payroll then reports the tips on each employee's checks. Forms should be requested, reviewed, and tracked for verification. Place documents given in the case file under appropriate section with other work papers.

- (4) The examiner will refer to the Tip Rate Review ETL (series 400) lead sheets for additional guidance and will number and upload all workpapers to IMS.

4.23.7.10.6.18
(10-01-2024)

**Analysis and Approval
of Calculated Rates**

- (1) The Summary Tab for each template allows the examiner to analyze the tip rates. The data in the Summary tab is auto-populated data from the various tabs within the template. The examiner reviews and verifies the accuracy of the following:

- Reconciliation of template sales to POS reports,
- Allocation of sales by position and shift; Sales by hour by position,
- Allocation of staffing hours by position and number of Full Time Employees (FTE),
- Position titles of directly and indirectly tipped positions,
- Composition of Sales; Tip Rate by Tender; Number of Products; Average Tip,
- Applicability of reductions when customers leave a cash tip or no tip, and
- Employee tip sharing totals are within industry norms.

- (2) The examiner must also:

- Reconcile tip rate calculations to POS reports,
- Review the source documents to validate rate computations,
- Include the Interview Notes pertinent to the preparation of the tip rate calculation in each template and use them to analyze the accuracy of the tip rate allocations,
- Check for reasonableness of the information. Test the staffing, charge, cash, and comp tip rates, number of drinks served, etc., for each template,
- Verify the math/formula and accuracy of the computation.

Note: Errors do happen, even if the calculation was done on a pre-formulated calculation sheet. Use the most current rate calculation templates.

- Request the basis for subjective factors, and
- Validate how shift rates are applied if the employee clocks in on one shift but works hours into the next shift.

Example: Does the same rate apply or would a different rate apply to the hours for each shift worked?

- (3) If the examiner has questions after analyzing the tip rates, the examiner will:

- Prepare a separate IDR for each department or outlet,
- List questions and request documentation required to resolve any discrepancies noted during the validation of the tip rates,
- Update outlet template with any new information,
- Place IDR responses in Notes tab, and

- Include explanation for material disparity in current and new tip rates in the template.
- (4) Summary Tab will show all objective and subjective data and analysis used to calculate the tip rate for each template. Once the information is verified as accurate and reasonable, and the subjective factors are within the parameters, the examiner will present the calculated tip rates for review and approval as follows. The examiner will:
- a. Verify that the Occupational Category, Outlet and Shift titles exactly match the system used to prepare Form 14439 and verify/update template titles to match.
 - b. Confirm all naming conventions used in the Occupational Category, Outlet and Shift columns of the Appendix A / Attachment B comply with IRM 4.23.4.5.5.3, *Mandatory Standard Naming Convention for ET Tip Agreement Program*, for each tip rate calculation template.
 - c. Use the Summary of Tip Rates on the Summary Tab of each template to prepare a Mock Appendix A or Attachment B listing the employer's position, outlet, and shift titles to be used on the year-end report and the participant and non-participant tip rate for each position. The examiner should refer to *Employment Tax Tip Rate Reviews (Student Guide)* training material ITM 28136-B002 (Catalog Number 93915C) for additional guidance on the preparation and layout of the Appendix A / Attachment B.
 - d. Include comments in the Notes tab or the Daily Operations tab to aid in approval of the tip rates. Examples of comments to include are the type of establishment, the hours of operation, the menu, the types and prices of entrees, the type of payroll system, shift times and length, description of daily operations, and responses from employers that verify any factors that are outside of the norm.
 - e. Once the information is verified as accurate and reasonable, and the subjective factors are substantiated, obtain the first level approval from the group manager or territory tip coordinator with the permission from the group manager.
 - f. E-mail the rate calculations, the Appendix A or Attachment B, to the group manager for review.
 - g. Once the group manager's review is completed, they will forward to the NTRCP analyst for approval.
- (5) Once approved by the NTRCP analyst, the examiner must meet with the employer to review the IRS approved tip rates. Prior to the meeting, the examiner will send all templates and Appendix A's or Attachment B's with the list of tip rates to the employer.

Note: The examiner must follow the Timeline of Actions to ensure the due dates for completion of ALL templates are met. See IRM 4.23.7.10.6.7, *Rate Review Procedures*.

4.23.7.10.6.19
(10-01-2024)

Meet with Employer to Review and Agree to Tip Rates

- (1) By following the Timeline of Actions, the employer will have new tip rates implemented by January 1 of the following calendar year.
- (2) The examiner must review and finalize tip rates no later than September when updating rates for an existing tip agreement.

- (3) The examiner must verify the implementation date of the new tip rates which should be either:
 - a. First day of the payroll period for the next calendar year with an agreement date of January 1, 20XX for GITCA and Gaming TRDA, or
Note: A Gaming TRDA is a leased venue that is located within the four walls of a casino.
 - b. First day of the first calendar quarter following the date the TRDA is signed by the IRS.
- (4) The examiner must be prepared to explain to the employer any material changes to the tip rates:
 - a. Use Form 8027 to compare the total tips reported to the charged tips to determine level of cash tips reported based on current rates.
 - b. Use Form 14439 to address participation levels for employers under a tip agreement and the impact on current tip reporting.
 - c. Use the Tip Rate Calculation Summary Tab to explain the updated tip rate. The Summary includes analysis of allocations of sales and staffing by position and shift.
- (5) The examiner must request the employer verify the titles on Appendix A or Attachment B match the titles used on Form 14439 and verify:
 - a. Employer Name, EIN, Authorized Signatory Name and Title to be listed on the tip agreement.
 - b. Occupational Category (position) titles, Outlet titles, and Shift titles match the titles used to prepare the Form 14439.
 - c. Non-participant and participant tip rates.
 - d. Coverage Adjustment in Column A to calculate the participant tip rate and code in Column B to note if the outlet imposes auto gratuities or not.
 - e. Compare the Participant and Non-Participant rate columns of the Appendix A/Attachment B to the agreed template(s) to verify accuracy of listed rates per shift.

Note: Per Timeline of Actions the Effective Date must allow the employer time to share the tip rates with the employees and secure participation elections; update and test payroll system before running a live payroll. It is imperative then for the final tip rates to be shared with the employer well before the January 1st agreement date. Contact NTRCP analyst for additional guidance.
- (6) The examiner must elevate employer unresolved tip rates to NTRCP analyst for resolution and schedule follow up meeting with employer, if required.
- (7) Once the employer agrees with all tip rates and all tip rates have been approved by the NTRCP analyst, the examiner will issue the tip agreement per the procedures addressed in IRM 4.23.7.10.6.20, *Issue and Secure the Tip Agreement*.
- (8) The examiner will schedule a meeting to complete certification of payroll system (if applicable).
- (9) The examiner will discuss educational options for rolling out the new tip rates for employees and management.

4.23.7.10.6.20
(10-01-2024)

Issue and Secure the Tip Agreement

- (1) Once the tip rates have been reviewed and agreed to by the employer and approved by the NTRCP analyst, the examiner is ready to prepare and issue the tip agreement per the following procedures. All documents must be approved by NTRCP analyst prior to issuance to employer.
- (2) The examiner will use the data from the employer approved Mock Appendix A / Attachment B to prepare the final Appendix A / Attachment B by listing the approved tip rates on the Appendix A or Attachment B tab and completing the Agreement Information Tab (see *Employment Tax Tip Rate Reviews (Student Guide)* training material ITM 28136-B002, (Catalog Number 93915C)).
- (3) The examiner will verify that all approved template titles match the Outlet title (position and shift, if applicable) used on the Appendix A / Attachment B, comply with the naming conventions per IRM 4.23.4.5.5.3, *Mandatory Standard Naming Convention for ET Tip Agreement Program*, and substantiate the tip rates listed on the Appendix A / Attachment B.
- (4) The examiner will prepare the tip agreement. Except for selected pages that are discussed below that require customization, the examiner must never alter the content of the tip agreement. See *Employment Tax Tip Rate Reviews (Student Guide)* training course 28136-B002 (catalog number 93915C) for guidance.
- (5) The following pages of the GITCA must be customized based on the employer under review:

Page	Description
Page 1	Parties to the Agreement – Entity Information
Page 10	Term of the Agreement – Effective and Expiration Date; Renewal Date
Page 12	Entire Agreement – Signature Page
Page 13	Replace this page with Excel version of Appendix A
Page 14	Appendix C
Page 19	Appendix E
Page 20	Appendix F

- (6) The following pages of the TRDA must be customized based on the employer under review:

Page	Description
Page 1	Section I. Definitions and Attachments – Entity Information
Page 8	Section IX. Signatures – Signature Page
Page 9	Attachment A – Establishments
Page 10	Appendix B, Occupational Categories and Initial Tip Rates – Replace this page with Excel version of Attachment B
Page 14	TRDA Contact List

- (7) For the GITCA, if there is an unforeseen delay with the tip rates and there will be a break in coverage between the termination date of the current tip agreement and the implementation date of the new agreement, the examiner must prepare an Appendix D Extension to bridge that time period. The examiner will issue the Appendix D for signature along with the new tip agreement.
- (8) The examiner prepares and e-mails the Routing Sheet (Form 14179, 14180, or 14515), the tip agreement, the Appendix A/Attachment B, and with approved template(s) to NTRCP analyst for approval PRIOR to sending to the employer for signature.
- (9) NTRCP analyst reviews the agreement, initials every page of the Appendix A / Attachment B, and returns the approved documents in pdf format with Routing Sheet to the examiner.
- (10) The examiner will follow IRM 4.23.7.10.6.7 (10) for the use of electronic signatures and encrypted email, if applicable. To issue the agreement for electronic signature, the agreement including the signed Appendix A/Attachment B must be issued in pdf format.
- (11) The examiner will:
 - a. Verify the agreement contains the analyst's initials on every page of the Appendix A/Attachment B of the agreement.
 - b. Issue one copy of the tip agreement to the employer in pdf format preferably by secure or encrypted email, with Letter 5697, *Document Signature Request*.
 - c. Email the Routing Sheet and employer signed agreement to NTRCP analyst to log and forward to Program Manager for countersignature.
 - d. Receive one copy of the countersigned agreement from the NTRCP analyst.
- (12) The examiner will verify the countersigned agreement contains the analyst's initials on every page of the Appendix A/Attachment B; return one copy to the employer, along with Letter 5724, *Return Signed Document*, preferably by secure or encrypted email, and retain one copy of both documents for the case file.

Note: For manually signed tip agreements, the NTRCP analyst will return two countersigned tip agreements to the examiner. The examiner will prepare a separate hardcopy case file that includes the printed Form 14179, 14180 or 14515, Form(s) 9984 and one original countersigned agreement and mail the case file to:

Internal Revenue Service
 Attn: NTRCP Program analyst
 110 City Parkway
 Las Vegas, NV 89106

- (13) Once the countersigned tip agreement is returned to the employer, the examiner will begin case closing procedures.

4.23.7.10.6.21
 (10-01-2024)

Electronic Case Closing

- (1) After the Rate Review process is completed with the employer, the examiner will reference the following IRMs to organize and index the rate review case file in IMS and close the case file:

- a. IRM 4.23.4.5, *Guide for Examiners Using Issue Management System (IMS)* - All examiners are required to use IMS for all case management, regardless of the type of case being worked, including ET Tip Agreement.
- b. IRM 4.23.4.5.5, *File Naming Convention* – All required forms and documents that would otherwise be required in a paper case file per IRM 4.23.4, *Employment Tax – General Procedures and Workpapers* and IRM 4.10.9, *Workpaper System and Case File Assembly*, must be uploaded to IMS.

Note: The mandatory standard naming convention for examiners conducting rate reviews is explained in IRM 4.23.4.5.5.3, *Mandatory Standard Naming Convention for ET Tip Agreement Program* and IRM 4.23.4-4, *Mandatory Items and Standard Naming Convention Location for ET Tip Agreement Program*.

- (2) The examiner is responsible for verifying that all required workpapers are uploaded into IMS before closing the case to the group manager. The examiner must number and upload a pdf of the countersigned tip agreement to the IMS case file.
- (3) Issue specific workpapers will be uploaded in IMS to the specific issue Standard Audit Index Number (SAIN). The SAIN for a tip rate review is ET985 with a Uniform Issue List (UIL) of 06053.00-00. The examiner **must not** use ET080-Administrative Procedures SAIN.
- (4) Tip Review ETLs must be contemporaneously uploaded to IMS in Excel format. Lead sheets included in the ETLs must not be printed and indexed separately. Form 4318, *Examination Workpaper Index*, must serve as the index for the case file workpapers in IMS.
- (5) The examiner will perform the following procedures to close the case:
 - a. Verifies, numbers, and uploads all required documents/workpapers to IMS.
 - b. Updates Form 9984 and Routing Sheet (Form 14179, 14180, or 14181) with date the case file was closed off IMS. Prints ALL activity records to pdf and uploads to IMS following the naming conventions per IRM 4.23.4.5.5.3, *Mandatory Standard Naming Convention for ET Tip Agreement Program* and IRM 4.23.4-4, *Mandatory Items and Standard Naming Convention Location for ET Tip Agreement Program*.
 - c. Updates IMS closed date.
 - d. Notifies group manager via encrypted email with Subject Line “Rate Review case ready for closure” that all documents are uploaded to IMS and the tip review case file is ready for closure and requests the status of case to be updated from Status 12 to Status 90.
 - e. Receives email from group manager that verifies the case is in Status 90 and notifies examiner to close the case off IMS.
 - f. Closes case off IMS.

4.23.7.10.6.22
(10-01-2024)
**Printed Case File
Assembly**

- (1) Once the tip agreement (GITCA/TRDA) is countersigned by the NTRC Program Manager and a copy returned to the employer using Letter 5724, the examiner can begin case closing procedures. There are several steps the examiner must take which include:
 - Printing Physical Case File,

- Assembling Case File,
 - Completing Forms 14179, 14180 and/or 14181,
 - Notifying group manager case is ready to be reviewed, and
 - Sending case file to Las Vegas.
- (2) The examiner must consult with their manager for any special instructions they require regarding closing the case. For example, not all the workpapers which have been uploaded to IMS are required to be printed out. See Exhibit 16-12, “Specialty Examination, Employment Tax Program of the Small Business/Self-Employed Division Tip Review Physical Case Printing Requirements,” in *Employment Tax Tip Rate Reviews (Student Guide)* training course 28136-B002 (catalog number 93915C) for guidance on specific documents that are required to be printed.
- (3) Proper assembly of a case file minimizes delays, administrative problems, and procedural errors.
- a. Attached to the front of the case file are the applicable routing sheets, Forms 14179, 14180, 14181, 14515.
 - b. Attached to the left inside of the folder is Form 5345-NTRC.
 - c. All workpapers follow sections of the Tip Review ETL Form 4318 in numerical order.
- (4) The examiner will not send the physical rate review case file to their group manager. Once the examiner has completed all sections of Forms 14179, 14180 and/or 14181 and uploaded in IMS, they will send an encrypted email notifying their manager all documents are uploaded to IMS, and the tip review case file is ready for closure. Subject line of email must read, **Rate Review case ready for closure**. The body of email will have the employers name and EIN for the manager’s reference.
- (5) After the group manager completes the case review, and makes any additional case comments, the manager will update the case from Status 12 to Status 90 and sign the Form 14179/14180. The manager will then send an email along with the initialed Form 14179/14180 to the examiner stating the case is ready for closure in IMS.
- (6) The examiner must generate the group manager’s 9984 reflecting all case comments made during the rate review, number the document and add to the IMS file.
- (7) The examiner will also number and upload Forms 14179, 14180, and/or 14181 to IMS.
- (8) The examiner will verify that the case is in status 90.
- (9) The examiner will use Form 3210, *Document Transmittal*, to mail the closed case to:
Internal Revenue Service
Attn: NTRCP Program Analyst
110 City Parkway
Las Vegas, NV 89106
- (10) The examiner will make final updates to Form 9984 to indicate the date they closed rate review off IMS and the date file was sent Las Vegas and upload Form 9984 to IMS.

4.23.7.10.6.23

(10-01-2024)

GITCA Renewal Without Full Rate Review

- (11) The examiner will close rate review off IMS and send the group manager an email indicating they have actions to take in IMS. The manager will access the Team website to notate case closing concurrence of the rate review case

- (1) An examiner can make a recommendation to renew an agreement without a full rate review if it is evident the participating employer is following the terms of their agreement, is not on comparable rates, has reported substantially all tip income and is in compliance with their payment and reporting responsibilities
- (2) To make this determination, the examiner will complete and document the following actions:
 - a. Review the current GITCA (for example, addenda, prior extensions, economic rate reductions) to determine if renewal is appropriate.
 - b. Perform IDRS research to confirm the employer's filing compliance.
 - c. Perform Form 8027 analysis. See IRS training course number 28136-B002, *Employment Tax Tip Rate Reviews (Student Guide)*, (Catalog Number 93915C), lesson on Conducting a Compliance Review for examples of analysis, and determine if reported tips are reasonable. Review the current GITCA (for example, addenda, prior extensions, economic rate reductions) to determine if renewal is appropriate.
 - d. Review the GITCA Year-End reports filed by the taxpayer for the full-term of the current GITCA agreement. Compare a sample of the participant rates and hours with the tip income reported. If a Form 8027 is filed, also compare the volume and type of non-participants by outlet.
 - e. Contact the designated employer's representative to secure insights from managers and/or employees to determine if the tip rates are appropriate.
 - f. Perform internet research and review the employer's website to identify new outlets, establishment expansions, and changes in economic conditions, competition, or ownership.
 - g. Conduct a virtual walk-through of the business to reconcile the GITCA Appendix A/Attachment B to outlets observed on the employer's website.
- (3) If the examiner determines the employer to be a candidate for GITCA renewal without a full rate review, the examiner will prepare and submit a recommendation containing a summary of findings to the group manager within 10 business days of making the determination. The recommendation will include a brief overview of the establishment, such as the size of the business along with the number of gaming features, restaurants, and hotels at the establishment.
- (4) The group manager has 10 business days from the day the recommendation is received to review and forward the approved recommendation to the NTRCP analyst with a copy to the tip coordinator. The NTRCP analyst will consult with the tip coordinator, group manager and examiner as needed.
- (5) If the NTRCP analyst concurs, the analyst will forward the recommendation to the NTRC Program Manager within 20 business days from the day they received the recommendation.
- (6) The NTRC Program Manager is responsible for reviewing the summary findings and making the final decision whether to renew an agreement without a full rate review. In making this determination, the NTRC Program Manager should consider the facts in the recommendation, as well as resource availability and workload needs.

- a. If the NTRC Program Manager determines the employer is a candidate for GITCA renewal without a full rate review, such concurrence will be documented in the case file, and the examiner will be given approval to offer a GITCA renewal without a full rate review. Examiners will follow procedures starting at IRM 4.23.7.10.6.19, *Meet with Employer to Review and Agree to Tip Rates*.
- b. If the NTRC Program Manager determines the employer is not a candidate for GITCA renewal without a full rate review, the case file will be documented to indicate the basis for that determination. Reviewers will pursue a renewed GITCA, including a full rate review, following procedures starting at IRM 4.23.7.10.6.7, *Rate Review Procedures*.

4.23.7.11
(10-01-2024)
**Mandatory Compliance
Reviews on Voluntary
Tip Agreements**

- (1) The purpose of tip agreements is to improve employer and employee tip reporting in the various types of tipping industries. Because the term of the tip agreement may be three to five years, it is imperative that the IRS monitor the tip reporting of the employer and their employees to ensure they are complying with the terms of their tip agreement. NTRCP monitors tip agreements for compliance on an annual basis to determine if the employer is complying with the obligations of the tip agreement. The terms of the tip agreement are determined by type.
- (2) Under the terms of the TRDA and GITCA, tip rates are established for the various worker categories in the establishment and require a threshold level of employee participation. At least seventy-five percent of the employees must sign an agreement and agree to report tips at or above the established tip rate for their job category. The employer agrees to apply the tip rate to the hours worked through payroll for participating employees.
- (3) The terms of the TRAC and EmTRAC do not require any tip rates to be established. However, employer's must educate new employees on the tax laws to report tips, require employees to record tips received and have procedures for employees to report tips to their employer. Employers must also re-educate all employees on a quarterly basis. TRAC also requires the employer to establish a reporting system and to file and pay taxes properly. The examiner must reference Tip Review ETLs Compliance Review Lead Sheet (Series 510) for additional guidance.

4.23.7.11.1
(10-01-2024)
**Compliance Review
Procedures**

- (1) This subsection of the IRM provides procedures to perform a tip agreement Compliance Review.
- (2) Examiners may be assigned cases to conduct a compliance review to determine if the employer is meeting the terms of the tip agreement and, for GITCA/TRDAs, applying the correct tip rates or, for TRACs, capturing and reporting all tips received.
- (3) Examiners will provide recommendations based on the results of the compliance review. The recommendations will either be:
 - No Change of the tip agreement,
 - Change the tip agreement, or
 - Revocation of the tip agreement.

4.23.7.11.2
(10-01-2024)
**Cases Established on
ERCS and IMS**

- (1) All compliance reviews must be established on ERCS and set up in the IMS. Form 5345-NTRC, *NTRC Request for ERCS Examination Non-AIMS DET Item*, must be completed for a case to be input on ERCS. Use the following codes to document time spent on these compliance reviews:
 - MFT "C0"(C zero)
 - Source Code "99"
 - Project Code "1104"
 - Activity Code "551"
- (2) All compliance review case files will be set up in IMS and workpapers uploaded to IMS per IRM 4.23.4.5, *Guide for Examiners Using Issue Management System (IMS)*. For the list of mandatory items to be uploaded into IMS see IRM 4.23.4-4, *Mandatory Items and Standard Naming Convention Location for ET Tip Agreement Program*.

4.23.7.11.3
(10-01-2024)
**Compliance Review
Case File**

- (1) If potential non-compliance is identified and the examiner is assigned a compliance review, the case will include:
 - Form 8027, *Employer's Annual Information Return of Tips and Allocated Tips*, for the current and two prior years,
 - Annual and Quarterly Employee Reports, and
 - Time and Attendance Reports.
- (2) In addition to the electronic case file, the examiner must also refer to Form 14515, *Compliance Review Routing Checksheet* and the Tip ETLS Compliance Review Lead Sheet (Series 510).

4.23.7.11.4
(10-01-2024)
**Conducting a
Compliance Review**

- (1) The compliance review will be assigned to an examiner to conduct the review which consists of the following phases:
 - Pre-Contact Analysis,
 - Taxpayer Contact,
 - Compliance Review, and
 - Case Summary and Disposition.

4.23.7.11.4.1
(10-01-2024)
Pre-Contact Analysis

- (1) Prior to contacting the employer, the examiner will conduct and document a pre-contact analysis which will include some or all of the following:
 - a. Review of the tip agreement, including any addenda, prior extensions and economic rate reductions to gain familiarity with the existing agreement.
 - b. Research the internet to determine if the employer has any change in business ownership, locations, branding and/or types of business activities or workers. If the employer has a website, compare the outlet names shown on the website to the outlet titles listed on the tip agreement Appendix A or Attachment B.
 - c. Research IDRS to determine the employer's filing and payment compliance and to secure reported wages and tips and gross receipts for the current and prior two years.
 - d. Analyze the information secured to determine if the current and two prior years of reported tips are reasonable and consistent.
- (2) The examiner should refer to IRS training course number 28136-B002, *Employment Tax Tip Rate Reviews (Student Guide)* (Catalog Number 93915C),

for guidance on analysis. Following are some examples of situations where the analysis may indicate non-compliance with the tip agreement.

- a. Material change in sales, but minimal change in reported tips.
- b. Non-tippable sales on business tax returns not consistent with industry standards.
- c. Minimal change in sales, but material change in charged tips or number of employees on Forms 8027.
- d. Tip rate calculated using Form 8027 data is inconsistent with tip rates on current tip agreement.
- e. Discrepancies between Total Tips reported on Form 8027 and Total Medicare and Social Security Tip Wages reported on Form 941, *Employer's Quarterly Federal Tax Return*.
- f. Questionable allocation of tips on Form 8027.

4.23.7.11.4.2
(10-01-2024)

Taxpayer Contact

- (1) After completing the pre-contact analysis, the examiner will notify the employer that the IRS will be conducting a compliance review to ensure they are complying with the commitments the employer agreed to when they entered into the voluntary compliance agreement. The examiner will issue Letter 4730, *Compliance Review Appointment Notification*, with the initial IDR to the Contact Person listed on Appendix F or TRDA Contact List of the Tip Agreement. The examiner must contact the employer by phone after 10 days to schedule an on-site visit or initial appointment. The examiner will issue Letter 4730 to confirm the appointment date and include IDR Form 4564. There is a Sample Initial IDR for Compliance Reviews included in IRS training course number 28136-B002, *Employment Tax Tip Rate Reviews (Student Guide)*. The examiner will refer to Tip Review ETLs Compliance Review Lead Sheet (Series 510) for additional guidance. There are separate compliance review lead sheets for GITCA, TRAC, and TRDA agreements.
- (2) The examiner's goal is to verify that the employer is accurately reporting their tips:
 - a. Review the employer's written procedures on how both directly and indirectly tipped employees' tips are reported.
 - b. Document the frequency, content, and how the employer educates their employees on their TRAC tip reporting obligations.
 - c. Evaluate the employer's payroll systems and procedures to ensure all tips are accurately reported on Forms W-2 and 941.
 - d. Verify establishments that are covered under the TRAC tip agreement.
 - e. Document any discrepancies between outlet titles and positions listed in their GITCA or TRDA tip agreement and those currently being used.
 - f. Review the employer's procedures to track and apply tip rates through payroll per their TRDA or GITCA tip agreement by outlet, position, and shift, if applicable.
 - g. Document the system's ability to apply a tip rate for both a primary and secondary job code for a TRDA or GITCA tip agreement.
 - h. Review the overall participation rate to determine if the 75 percent threshold is met for a TRDA or GITCA tip agreement.

4.23.7.11.4.3
(10-01-2024)
Compliance Review

- (1) The examiner will refer to the IRS training course number 28136-B002, *Employment Tax Tip Rate Reviews (Student Guide)* (Catalog Number 93915C), for guidance in conducting the compliance review. The course also has the “Compliance Review Sample Initial Interview Questions” that may be customized based on the examiner’s pre-contact analysis. The case file for the compliance review must clearly reflect the steps taken to developing the final recommendation for the employer’s continued participation in the tip program. The workpapers must document the steps taken during the review process and include supporting documents requested, interview(s) and tour notes, sampling of the payroll system and internal controls, as well as any comparative analysis performed. The course material includes issues that should be addressed in the workpapers. They are:
 - Reviewing Internal Controls,
 - Calculating Participation Level,
 - Evaluating payroll procedures,
 - Determining if tip agreement requires modification, and
 - Determining if the employer is complying with the tip agreement commitments such as tracking hours and applying tip rates.
- (2) Fact patterns which may warrant revocation of the tip agreement include:
 - a. The employer has failed or refuses to establish and maintain an Employer-Computed Tip Reporting Process per Section V, paragraph J of the GITCA Tip Agreement.
 - b. Analysis of GITCA or TRDA year-end reports indicates a substantial underreporting of tips for two consecutive years and or the employer has failed or refuses to implement the procedures to timely and accurately report the required data.
 - c. A large food and beverage employer’s failure to file Forms 8027 for two or more years after NTRCP has sent them annual reminders via certified mail/return receipt.
 - d. Comparative analysis of three-years of tax return data shows stable gross sales and wages, but tips reported on Form 941 and/or Form 8027 decreased substantially, and a review of external source information gathered through employer contact indicates the business activity has not changed significantly.

4.23.7.11.4.4
(10-01-2024)
Case Summary and Disposition

- (1) The examiner will prepare Form 14354, *Summary of Compliance Review Findings and Recommendations*, and forward the form to the group manager for review and approval. The examiner must obtain managerial approval and NTRCP analyst concurrence of the recommended disposition before notifying the employer of the review outcome. All recommendations must include NTRCP Analyst concurrence. There are three potential outcomes for a compliance review: no change, change and revocation.
- (2) **Recommended “No Change” to tip agreement:** If no weaknesses or deficiencies were found, the examiner will recommend a “No Change” to the tip agreement. The examiner will submit Form 14354 to the group manager for review and approval. After the group manager has approved the recommendation and documented the activity record, the examiner will notify the employer of the results by issuing Form 14354. The examiner will close the case to the group manager within 10 days. The group manager will forward the case to the NTRCP analyst within 10 days.

- (3) **Recommended “Change” to tip agreement:** If weaknesses and deficiencies were found, the examiner will recommend a “Change” to the tip agreement. The examiner will prepare Form 14354-A, *Compliance Review Acceptance Statement*. The examiner will submit Form 14354 and Form 14354-A to the group manager for review and approval. After the group manager has approved the recommendation(s) and documented the case file activity record, the examiner will notify the employer of the results by issuing Forms 14354 and 14354-A.
- If the employer accepts the recommendations, signs and returns the Form 14354-A, and implements the necessary changes by the corrective action due date, the examiner will notify the group manager within 15 days that the case is ready to close.
 - If the employer accepts the recommendations but is unable to implement the necessary change(s) by the corrective action due date, up to an additional 90 days may be granted with the group manager’s approval. Group manager’s approval must be documented in the case file. Form 14354 will be revised with the new corrective action due date. The examiner will reissue Form 14354 and Form 14354-A with the revised date and secure the employer’s signature. Place the case in suspense (Status 15). The examiner will hold the case at the group level to monitor and verify the employer implemented the corrective actions by the agreed upon due date on the Form 14354-A. The examiner will close the case to the group manager within 10 days of determining the corrective actions have been implemented.
 - If the employer fails to address the corrective actions by the response due date or does not accept the recommendations, the examiner will recommend revocation of the tip agreement.
- (4) **Recommended “Revocation” of tip agreement:** The examiner will prepare Form 886-A, *Explanation of Items*, documenting deficiencies. The examiner will submit Form 14354 and Form 886-A to the group manager for review and approval. After the group manager has approved the recommendation and documented the activity record, the examiner will notify the employer of the results by issuing Forms 14354 and Form 886-A. The examiner will offer the employer an informal conference. If the employer declines to participate or if there is no resolution from the informal conference, the examiner will close the case to the group manager within 10 days. The group manager will forward it to the NTRCP analyst within 10 days to finalize the revocation.

4.23.7.12
(10-01-2024)
**Underreported Employee
Tip Income Soft Notice
Program**

- (1) As part of the compliance monitoring program, GITCA and TRDA employers provide Form 14439, *Employee Data Report*, annually for their non-participating tipped employees. In addition, NTRCP receives similar information from employer tip examinations. NTRCP analyst reviews this information to identify potential employee tip underreporting. This program allows tip employee taxpayers to either substantiate their reported tip amount or amend their tip reporting on their federal tax return, avoiding a potential tip audit.

Note: For purposes of IRM 4.23.7.12, *Underreported Employee Tip Income Soft Notice Program*, “taxpayer” means “tipped employee.”

- (2) NTRCP analyst receives, reviews, analyzes, and perfects the non-participating employee information.

- (3) The inventory list is on an Excel spreadsheet and contains the following: case number, tax year, employer name, taxpayer name, Social Security Number (SSN), taxpayer street address, city, state, and zip address, employee's occupation(s), outlet shift(s), hours worked, sales (if applicable), non-participant tip rate, the calculation of tips based on IRS tip rates, the amount of tips that were reported, the calculated underreported tip amount, and any notes such as the joint (spousal) SSN where the tax return was filed.
- (4) The inventory Excel spreadsheet contains the following tabs:
 - Master Report,
 - Batch submission with date,
 - Second letter,
 - Third letter, and
 - Additional tabs for the number of IRS examiners working the inventory.

Note: The Master Report tab contains information for each taxpayer along with seven columns of information for the IRS examiners to complete as they are working their cases.

- (5) NTRCP analyst forwards the inventory Excel spreadsheet to the CETO department manager.
- (6) Each examiner will receive a spreadsheet with their case information. Examiners update the tabs. The Master Report tab is updated with the following information: assignment date, the assigned IRS examiner, and their manager. This spreadsheet will be used to document taxpayer contacts made along with any substantive comments from any discussions.
- (7) The examiner will prepare Form 14352, *Employee Non-Participant Data Form*, based on the information that was submitted by the NTRCP analyst.
- (8) For each series of letters, the department manager or group manager may determine each mail date.
- (9) The examiner will prepare a mail merge for the taxpayers in their inventory. The examiner will use a Word document of Letter 4884, *Non Participant Soft Notice*, to generate the letters for mailing. The examiner will associate Form 14352, Notice 609, *Privacy Act Notice*, and an envelope to each letter. The letters will be mailed no later than the date shown at the top of each letter. The taxpayer has 60 days to respond.
- (10) When the examiner receives a response from the taxpayer, the examiner will update Form 9984, *Examining Officer's Activity Record*, and their spreadsheet with the contact date, telephone number (if provided), and comments about what the taxpayer said or wrote.

4.23.7.12.1
(10-01-2024)
**Examples of Taxpayer
Issues and Responses**

- (1) The examiner needs to address the taxpayer (tipped employee) issue and update the comments section for that taxpayer.
- (2) If the examiner receives a Form 1040-X, *Amended U.S. Individual Income Tax Return*, the examiner will review and ensure that the amended tax return is correct.
 - a. If the amended return is not correct, the examiner will provide the taxpayer with an opportunity to revise. The examiner will copy the Form

1040-X for the case file, mail the form back to the taxpayer with Letter 5237, *Tipped Employee Soft Notice Final Letter*, and advise the taxpayer that the Form 1040-X is incomplete along with actions needed to correct the form. The taxpayer sends the corrected Form 1040-X back to the examiner.

- b. If the Form 1040-X is correct, the examiner will make a copy of the tax return for their case and mail the Form 1040-X with Form 3210, *Document Transmittal*, to the Fresno Service Center. If the taxpayer sent a payment, the examiner will prepare Form 3244, *Payment Processing*, and submit with the payment to the IRS teller as soon as possible. Copies of Forms 3210 and 3244 along with the check must be added to the case file. The examiner will close their case file, update the spreadsheet with the Form 1040-X information, and date the case was closed.
- (3) If the taxpayer calls the examiner in response to Letter 4884 the examiner will answer any questions and provide details on information needed. The examiner will update their inventory list with the necessary information including a summary of the discussion. The examiner will mail Letter 5237 by adding information or documentation needed in the "Other" section of the letter.
- (4) If the taxpayer sends correspondence, the examiner will determine what course of action needs to be taken. The examiner will update their inventory list with any comments and send Letter 5237 and add information needed in the "Other" section of the letter.
- (5) Examiner questions for unresolved case issues should be submitted first to the lead or group manager. If the lead or group manager cannot answer the questions, the information will be forwarded to the NTRCP analyst for resolution.
- (6) If the taxpayer mails an original tip diary to the IRS, the employee must make a copy of the tip diary for the case file. The employee will add the total tips from the tip diary and compare that amount to the amount reported by the taxpayer to determine if there are any discrepancies. The examiner will ensure that the tip diary is complete and appears to have been kept on a contemporaneous basis.
- (7) If the tip diary is not complete or does not appear to be accurate, the examiner will send the original tip diary back to the taxpayer with Letter 5237 explaining the reasons the IRS is not accepting the tip diary and provide detailed information needed to assist the taxpayer. This letter must be sent by certified mail as these are original documents being returned to the taxpayer.
- (8) If the review of the tip diary shows that the information appears to be correct, the examiner will mail the original tip diary back to the taxpayer with Letter 6561, *Tipped Employee – Soft Notice Accepted Documents*. This letter **must** be sent certified to the taxpayer.
- (9) When the taxpayer does not respond to Letter 4884, the examiner will use a Word document of Letter 5244, *Soft Notice Follow-Up*, to generate the letters for mailing. The examiner will use the mail merge process to mail second letters with the enclosures Form 14352, Notice 609, and a return envelope. IRS generally allows 75 days after the date on Letter 4884 to provide a reasonable opportunity for the taxpayer to respond. The examiner will update their inventory spreadsheet for all actions taken.

- (10) If the taxpayer responds to Letter 5244, the examiner will follow the same steps in IRM 4.23.7.12 (10) and IRM 4.23.7.12.1 (1) thru 4.23.7.12.1 (8).
- (11) If the taxpayer does not respond to Letter 5244, the examiner will use a Word document to prepare Letter 5237 through the mail merge process to issue the final letters with no enclosures to the taxpayers. Letter 5237 requests the taxpayer to respond within 15 days. IRS generally allows 45 days after the date on Letter 5244 to provide a reasonable opportunity for the taxpayer to respond. If the taxpayer does not respond, the employee will update their inventory list and close their case to the group manager.
- (12) If the taxpayer responds to Letter 5237 timely or prior to closing the case to the group manager, the examiner will follow the same steps in IRM 4.23.7.12.1 (10) and (11). The examiner will allow the taxpayer to respond to a letter if additional information is needed. The examiner will keep the case open until the issue is resolved as long as the taxpayer remains actively engaged.
- (13) If the taxpayer responds to Letter 5237 after the case is closed, the examiner will document Form 9984 and the inventory spreadsheet with details about what was received and what actions were taken. The examiner will add any documentation to the case file. The case file should remain closed as the taxpayer was mailed three letters requesting information which was not received until after the case was closed. The examiner will send a letter advising the taxpayer what is needed to resolve the issue.
- (14) The examiner will ensure that all case files contain copies of each letter mailed to the taxpayer along with a copy of Form 14352, correspondence sent by the taxpayer, Form 9984 that has been updated with all actions taken by the examiner, and any other necessary documentation received or associated with the case file. The case file will be closed to the group manager.

4.23.7.13
(10-01-2024)
**Form 906 Closing
Agreement**

- (1) During the tip agreement monitoring process, it may become evident that the employer has not applied the correct tip rate for position(s). Under the terms of the GITCA or TRDA, the employee is deemed a non-participant when an incorrect tip rate is applied and may be subject to a tip audit. Employers are often interested in correcting their payroll errors to make the employee whole (and not subject to audit) and to maintain their overall compliance and continued participation in the tip agreement using a closing agreement. To remedy the issue, the employer is paying both the employee and employer FICA and the employee federal income tax withholding.
- (2) IRM 8.13.1.2.4.1, *Delegation Order 8-3, Closing Agreements Concerning Internal Revenue Tax Liability, as Revised*, explains the authority for the Commissioner to enter into and approve closing agreements.
- (3) A Form 906, *Closing Agreement on Final Determination Covering Specific Matters*, is required for the employer to pay any taxes on participant rates that should have been paid if the correct tip rates were applied.
- (4) To determine if a Form 906 is warranted, the examiner collects enough documentation from the employer to satisfy verifying and calculating the underreporting and additional tax due amounts.
- (5) If a Closing Agreement is required, the examiner will discuss with their manager and work with Counsel.

- (6) The Closing Agreement process will consist of the following phases:

Phase	IRM Subsection
Form 906 Preparation	IRM 4.23.7.13.1
Payment Process	IRM 4.23.7.13.2
Post-Payment Monitoring	IRM 4.23.7.13.3

4.23.7.13.1
(10-01-2024)
Form 906 Preparation

- (1) IRM 8.13.1.3.4, *Guidelines for Preparing Closing Agreements*, provides specific guidelines for preparing a Form 906 including identification of parties, arrangement of content, and the effective date. IRM 8.13.1.3.5, *Execution By Taxpayer*, provides the specific guidelines for the signature page.
- (2) The corrected tax liability calculation must be approved by the examiner's manager and a NTRCP analyst.
- (3) Form 4222, *Closing Agreement Checklist*, must accompany any closing agreement to Tech Services.
- (4) Documented approval from Counsel of the Closing Agreement wording must be provided to Tech Services with the agreement and checklist.
- (5) The examiner that executes the Closing Agreement is the "Receiving Official."
- (6) The guidance on electronic digital signatures applies to the Form 906.
- (7) The Tech Services office for Employment Tax Closing Agreement is Cincinnati. Contact the NTRCP analyst for the most current contact information.

4.23.7.13.2
(10-01-2024)
Payment Process

- (1) Examiners will follow IRM 4.23.25.10, *Procedures for Processing Payments for Barred Years*.
- (2) Inform CCP of any closing agreements related to tipping agreements as this unique situation is not on AIMS, has an MFT "C0", and the payment is not an assessment.
- (3) Depending on the amount of check, the payment is processed using the Form 3244-A, *Payment Posting Voucher - Examination*, for each tax period (per the instructions in IRM 4.20.1.3.1.2, *Complete Form 3244-A, Payment Posting Voucher*, the amounts are posted to the last quarter of each tax year affected). Enter the dollar amount for each tax period next to TC 670, subsequent payment (with a 99 DPC).
- (4) A Form 3210, *Document Transmittal*, is sent with the check and payment posting voucher(s).
- (5) Payment Mailing Address are the following.
 - Remittances less than \$100,000 are sent to:
Internal Revenue Service
Mail Stop 1999
1973 North Rulon White Blvd.
Ogden, UT 84201

Note: Inside envelope label address will include “Attn: Receipt & Control Operations Manager”

- Single remittances of \$100,000 or greater are sent to:
Internal Revenue Service
Mail Stop 2003
1973 North Rulon White Blvd.
Ogden, UT 84201

Note: Inside envelope label address will include “Attn: Receipt & Control Operations Manager”.

Note: When a remittance of \$100,000 or greater is sent an email notification is sent to **&CTR ODN Ogden Tellers**.

- (6) Copies of the check, Form 3210, and Form 3244-A will be sent to Tech Services along with the signed copy of the closing agreement and Form 4222, *Closing Agreement Checklist*.

4.23.7.13.3 (10-01-2024) Post-Payment Monitoring

- (1) If the taxpayer concurs with the terms of the Form 906 closing agreement, the examiner will notify CCP to adjust the taxpayer’s account.
 - a. The examiner will follow IRM 4.23.25.10, *Processing Payments for Barred Years*.
 - b. Email is sent to CCP program analyst notifying them that the unique submission has been requested.
 - c. The examiner will monitor the posting of the TC 670 and TC 570 transaction codes indicating that the money is a subsequent payment for the Taxpayer and that the money is to be frozen on the module and not refunded.
 - d. Once the payment has posted, the examiner will notify CCP by preparing a Form 3870, *Request for Adjustment*, to adjust the employer’s account. The examiner will include the following instructions on the Form 3870: “The payment was agreed to as part of a form 906 closing agreement. The TC 670 posted on (date) in the amount of (\$XX.XX) should be moved to excess collection.”
 - e. Once the Form 3870 has been sent, the examiner will email CCP program analyst notifying them that the unique submission has been requested.
 - f. A Form 3870 must be completed for the last quarter of the tax year affected.
- (2) If the employer is unwilling to remedy the underpayment, revocation of the agreement must be considered and discussed with management.

4.23.7.14 (05-10-2021) Petition for Lower Rate

- (1) IRC 6053(c)(3)(A) requires a large food and beverage employer to allocate tips among its tipped employees if the total tips reported to the employer during any payroll period are less than 8 percent (or the approved lower rate) of the establishment’s gross receipts for that period. The amount to be allocated is generally the difference between the amount reported and the 8 percent. Certain receipts not ordinarily subject to tipping (known as non-allocable receipts) are not considered for this allocation. IRM 4.23.7.5, *Information Return Reporting*.

- (2) Rev. Proc. 86–21, 1986–1 C.B. 560, provides guidelines for employers and employees who wish to petition the IRS to have the percentage of gross receipts required to be allocated as tips reduced from 8 percent to a lower percentage (not below 2 percent). Petitions should be sent to the National Tip Reporting Compliance Program Manager. The address and instructions for requesting a reduction in the tip rate are provided in the Instructions for Form 8027, *Employer's Annual Information Return of Tip Income and Allocated Tips*. The Program Manager's secretary will forward the petition to the office where the taxpayer is located.
- (3) The petition must contain sufficient information to allow the IRS to estimate with reasonable accuracy the actual tip rate of the establishment. Burden of proof rests with the petitioner (taxpayer).
- (4) The user fee may change from year to year. The fee is posted in the first revenue procedure of each calendar year, for example, for 2024 that would be Rev. Proc. 2024-1, 2024-1 I.R.B. 1. This revenue procedure is updated annually to reflect the new fee, posted under Appendix A. Since the petitioner is requesting a letter ruling determination, the payment for the user fee must be submitted along with the petition for the rate reduction.
- (5) This section provides guidelines to NTRCP field office personnel in determining whether the information submitted with rate reduction petitions supports the granting of such a reduction.
- (6) If the field office receives the user fee directly from the petitioner/taxpayer, Form 3244–A, *Payment Posting Voucher - Examination*, must be completed and forwarded with the user fee to the remittance processing area. The user fee and original Form 3244–A need to be transmitted no later than the next working day after receipt. Payments will be forwarded using Form 3210, *Document Transmittal*. Keep a copy of all the paperwork as evidence that a user fee was collected.
- (7) User fees are credited to the general fund revenue account and not to a taxpayer module. Do not enter a form number, MFT, or a tax period on the Form 3244–A. The following must be included on the form:
 - a. SSN/EIN,
 - b. Transaction date (date user fee received),
 - c. Taxpayer name, address, and zip code,
 - d. Total user fees received,
 - e. In the "Remarks" section, write "USER FEE- DO NOT POST TO MASTER FILE," and
 - f. Prepared by (name and symbols).

4.23.7.14.1
(12-18-2012)

**Procedures for Tip Rate
Reduction Petitions**

- (1) It is important to note that the information being reviewed is to be evaluated only in terms of granting a rate reduction below 8 percent and the burden of demonstrating the need for such a reduction is on the petitioner/taxpayer. This is strictly a discretionary area and mechanical formulas using point systems should not be used as the only criteria in making these determinations. Employment Tax personnel reviewing rate reduction petitions should not hesitate to request further information from the petitioner/taxpayer, if needed. If the examiner is unfamiliar with the area or wants to observe the petitioner/taxpayer's operation, a visit to the establishment should be considered.

- (2) If an examiner determines that a rate less than 8 percent is applicable, a determination letter must be sent to the taxpayer. Letters to be used for notifying the taxpayer are:
- Letter 8027-A, *Determination Letter for Approved Tip Allocation Rate Reduction - less than 10 Employees*
 - Letter 8027-B, *Determination Letter Approving Specified Lower Rate*
 - Letter 8027-C, *Determination Letter when Business Meets Cafeteria Style Establishment*
 - Letter 8027-D, *Tip Rate Reduction Request Denied*
- Generally, the period covered by the determination letter is not to exceed three years. At the end of this period, if the employer believes that the circumstances still warrant the use of an allocation percentage of less than eight percent, the employer will have to submit another petition.
- (3) Employers requesting tip rate reductions are required to submit certain information, as described in Rev. Proc. 86-21, if applicable, with their tip rate reduction request to the address given in the Instructions for Form 8027. Studies indicate that a tipping rate of 8 percent is low for most types of restaurants and bars, and the need for any reduction below 8 percent allocation rate must be fully supported by the information submitted.
- (4) The following are guidelines reviewers may use in evaluating tip rate reduction petitions (the sections refer to Rev. Proc. 86-21 sections).
- a. Sections 3.01(a) through 3.01(c)(5), section 3.01(c)(7), and section 3.01(d) of Rev. Proc. 86-21 request a basic description of the establishment and its operations. This description gives information on items that can affect the tipping rate. In establishments where less than full table service is provided, such as self-service or cafeteria type of establishments, the tipping rate may be very low. Another major consideration is the establishment's location and type of clientele. Establishments near college campuses, for instance, may have mostly student customers who may tip at a lower rate. Other factors that may affect the tipping rate include rural versus urban location, full menu versus specialty (such as pizza parlors), and open for lunch only versus open for all meals.
 - b. Section 3.01(c)(6) requests financial information about the establishment that may be useful for determining the actual tip rate. For instance, the total sales subject to tipping can be computed by taking the gross sales and deducting carry-out sales and sales with a service charge. Dividing the total sales subject to tipping into the total tips reported to the employer by the employees will provide the tip rate reported by the employees. The total charge tips divided by the total charge receipts with charge tips may give a more reasonable estimate of the establishment's tip rate.
- (5) The Instructions for Form 8027, *Employer's Annual Information Return of Tip Income and Allocated Tips*, give specific details on the information the taxpayer must submit with the written petition for the tip rate reduction. If the taxpayer has not submitted this information, contact the taxpayer and reference the Instructions for Form 8027 for the information that must be submitted.
- (6) The NTRCP Program Manager will assign the case to an NTRCP field group. The case will include a routing checksheet for processing the request.

- (7) Time for processing a tip rate reduction petition is applied to Activity Code “551” and Tracking Code “6451”. The routing checksheet provides additional details.

4.23.7.15
(01-22-2010)

**Employment Tax
Monitoring Unit**

- (1) Employment Tax Operations will designate specialized resources to monitor the various employment tax programs. One of their duties will be to monitor the agreement inventory to ensure that employers and their employees continue to report their tip income accurately and that the agreement commitments are being satisfied. Follow-up procedures for establishments participating in a tip agreement include a review of the employer’s Forms 941, *Employer’s Quarterly Federal Tax Return*.
- (2) In general, monitoring the agreements should be done at least annually. If the employer has entered into a tip agreement that requires tip rates, these rates should be reviewed according to the agreement requirements. For GITCAs, this may be every five years per Rev. Proc. 2020-47. A determination whether or not the rates should be adjusted will be made at that time.

Exhibit 4.23.7-1 (05-10-2021)

Codes to Complete Form 5345-NTRC

MFT: C0 (zero)

Source Code: 99

Activity Code: 551

Project Codes: Required to identify the type of review. This information will be used to compile various data reports.

Project Codes	Definition
0985	Rate Reviews
0986	Addendums
1104	Compliance Reviews

Tracking Codes: Required to identify the type of business. This information will be used to compile various data reports.

Tracking Codes	Definition
6455	Hotels
6456	Valet
6457	Other Transportation Companies
7944	Casino (includes all venues owned by the casino)
7945	Racino
7946	Boats to Nowhere
7947	Restaurant (non-casino owned)
7948	Spa (non-casino owned)
7949	Golf Course
7950	Sky Caps
7951	Taxi
7952	Slot Bar
7953	Night Club
7954	Card Room
7955	Cosmetology
7956	Establishment - Initial Agreement (Comparable Rates)
7957	Agreement Enforcement Compliance Activities

Exhibit 4.23.7-1 (Cont. 1) (05-10-2021)
Codes to Complete Form 5345-NTRC

Tracking Codes	Definition
7958	Other Tip Positions

Exhibit 4.23.7-2 (10-01-2024)

Chart of Tip Report Writing Instructions

If	Then	Issue Report	Issue Letter(s)
Tips is the only issue examined and there is no Section 3121(q) liability	Follow normal Employment Tax (ET) procedures. Prepare Form 4666* and issue Letter 3401-A, <i>Employment Tax No Change Transmittal Letter</i> .	Form 4666*, <i>Summary of Employment Tax Examination</i> . See IRM 4.23.10.6, <i>Notification Letters in No-Change or No-Liability Cases</i> .	Letter 3401-A. In addition, undated Letter 3381, <i>No Change Letter for Employment Taxes</i> , is to be prepared and signed by the manager. The examiner will mail the letter to the taxpayer and their authorized representative and document the activity record with the date sent and to whom.
Tips is the only issue examined and a tip adjustment is warranted (there is a Section 3121(q) liability).	Prepare Form 4666*. Letter 3264, <i>Pre-notice for Employer Share of Tax due on Unreported Tips</i> , with the report form.	Form 4666*. Special language goes on Form 4666. See IRM 4.23.7.7.3(6)	Letter 3264, sent with the Form 4666 and Letter 3263, <i>Section 3121(q) Notice and Demand</i> , will be issued at a later date.
Tips and other ET issues were examined and the tips were reported correctly (no Section 3121(q) liability), but adjustments made to other examined ET issues.	Examiner follows normal ET exam report procedures. See IRM 4.23.7.7.3(7)	Normal ET exam report procedures. See IRM 4.23.10, <i>Employment Tax Report Writing Guide</i>	Normal ET exam report procedures.
Other ET issues in addition to tips were examined, but adjustment is only to tips. There is a Section 3121(q) liability.	Prepare Form 4666 and issue Letter 4840 <i>Unreported Tips and No Change for Other Examined Issues</i>	Prepare Form 4666*. Special language goes on Form 4666. See IRM 4.23.7.7.3(7)	Letter 4840 notifies the TP that tips was the only issue that warranted adjustments and that no changes were proposed for the other examined issues. The letter also tells the TP that while there is no tax due for the year of examination, there is a tax liability due on the unreported tips. This tax is to be reported as a current period liability. See IRM 4.23.7.7.3(8)

Exhibit 4.23.7-2 (Cont. 1) (10-01-2024)**Chart of Tip Report Writing Instructions**

If	Then	Issue Report	Issue Letter(s)
Tips and other ET issues were examined and all warranted an adjustment.	Prepare applicable employment tax RAR forms. Any tax attributable to the unreported tips will not be shown on the report because the tip adjustment is a current period liability.	Applicable Form 2504, Form 4666*, Form 4667, and Form 4668*. Special language must be entered on Form 4666*. See IRM 4.23.7.7.3(9)	Letter 4121-E, <i>Employment Tax Report Transmittal Letter</i> , is used to transmit the RAR. Letter 3264, gives the taxpayer a brief overview of the process for reporting the additional tax and should include a detailed calculation of the additional taxes to be included in the Section 3121(q) Notice and Demand. See IRM 4.23.7.7.3(9)

Note: No dollar amounts pertaining to a Section 3121(q) tax are to be entered on Form 4666, Form 4668, or Form 2504 - represented by an asterisk (*) above. This is because a Section 3121(q) tax is treated as a current period liability and not subject to interest or deposit penalty if tax is paid timely by the taxpayer.

Exhibit 4.23.7-3 (10-01-2024)
Letters, Publications, and Forms

Letters

Letter Number	Title	Catalog Number
Letter 3071	Tip Program Contact Letter	37178
Letter 3071-B	Tip Program Appointment Letter	37179
Letter 3263	Section 3121(q) Notice and Demand	28337
Letter 3263-A	Section 3121(q) Notice and Demand - Employer Only	52715
Letter 3264	Pre-Notice for Employer Share of Tax due on Unreported Tips	42098
Letter 3264-A	Employer Tip Adjustment Letter	42098
Letter 3265	Tip Program Follow-Up Letter	28339
Letter 3266	Employee Tip Adjustment	27340
Letter 3266-A	Employee Adjustment Letter	48224
Letter 3267	Delinquent 8027 Letter	28341
Letter 3269	Tip Program Application Receipt Acknowledgement Letter	37388
Letter 3346	Tip Program Participation Termination Letter	29295
Letter 3347	Tip Program Appreciation Letter	29296
Letter 3381	No Change Letter for Employment Taxes	29641
Letter 3413	Tip Program Non-Participation Letter	29541
Letter 4520	Section 3121(q) Notice and Demand	53994
Letter 4520-A	Closed- No Adjustments	58929
Letter 4520-B	Tip Compliance Program Closed - No Adjustments	58930
Letter 4520-E	Form 4137 Tip Compliance Program - Extension to Respond to Letter 4520-P	58931
Letter 4520-F	Form 4137 Tip Compliance Program - Extension to Respond to Letter 4520	58932
Letter 4520-P	Pre-Notice for Employer Share of Tax Based on Form 4137	54015
Letter 4571-C	Year End Report - Non-Participants Only on GITCA	54535
Letter 4571-G	Year End Report - All Tipped Employees	54533
Letter 4571-T	Year End Report - Non-Participants Only on TRDA	54534
Letter 4639	Delinquent 8027 Letter (2)	55778
Letter 4640	Incomplete Form 8027	55779
Letter 4730	Compliance Review Appointment Notification	57855
Letter 4761	Agreement Request Denial	58087

Exhibit 4.23.7-3 (Cont. 1) (10-01-2024)
Letters, Publications, and Forms

Letter Number	Title	Catalog Number
Letter 4840	Unreported Tips and No Change for Other Examined Issues	58570
Letter 4879	Compliance Review Closing Letter	58350
Letter 4884	Non Participant Soft Notice (1st letter)	58857
Letter 5237	Tipped Employee Soft Notice Final Notice (3rd letter)	64042
Letter 5238-T	Second Request for Year End Data to Certified TRDA Establishments	64061
Letter 5238-C	Second Request for Year End Data to Certified GITCA Establishments	64060
Letter 5238-G	Second Request for Year End Data to Non-Certified GITCA Establishments	64063
Letter 5243	Rate Review Initial Contact Letter	64066
Letter 5243-A	Rate Review - Confirmation of Appointment	67613
Letter 5243-B	Confirmation of Appointment - New Property	68649
Letter 5244	Soft Notice Follow-Up (2nd letter)	64075
Letter 5327	GITCA Invitation	64042
Letter 5445	4137 Unagreed Report - Cover Letter	66506
Letter 5575	Rate Reduction Ending Period	67896
Letter 5697	Document Signature Request	68372
Letter 5724	Return Signed Document	68439
Letter 5725	8027 Non-Filer Final Letter	68441
Letter 5873	Request of Secure Email MOU	69312
Letter 5874	GITCA Validation	69313
Letter 5874-A	TRDA Validation	69314
Letter 8027-A	Approved Tip Allocation Rate Reduction Determination (less than 10 employees)	52814
Letter 8027-B	Approving Specified Lower Rate Determination	52815
Letter 8027-C	Business Meets Cafeteria Style Establishment Determination	52816
Letter 8027-D	Tip Rate Reduction Request Denied	52817

Exhibit 4.23.7-3 (Cont. 2) (10-01-2024)
Letters, Publications, and Forms

Publications

Publication Number	Title	Catalog Number
Pub 3114	Compliance Checks	26034
Pub 3144	Tips on Tips (A Guide to Tip Income Reporting) for Employer	26288
Pub 3144(BR)	Tips on Tips (A Guide to Tip Income Reporting) for Employer (Braille Version)	51078
Pub 3144(LP)	Tips on Tips (A Guide to Tip Income Reporting) for Employer (Large Print)	58191
Pub 3148	Tips on Tips (A Guide to Tip Income Reporting) for Employee	26307
Pub 3148(SP)	Tips on Tips (A Guide to Tip Income Reporting) for Employee (Spanish)	27444
Pub 4902	Tax Tips for the Cosmetology and Barber Industry	56037
Pub 4902 (SP)	Tax Tips for the Cosmetology and Barber Industry (Spanish)	58889
Pub 4902 (VN)	Tax Tips for the Cosmetology and Barber Industry (Vietnamese)	58888
Pub 4904	How to Report Driver Referral Fees, Incentive Payments, and Other Income you Receive	57445
Pub 4932	Gaming Industry Tip Compliance Agreement (GITCA)	57822
Pub 4936	Your Guide to Maintaining and Complying with GITCA	57823
Pub 4985	Gaming Industry Tip Compliance Agreement - for Tipped Employees (Spanish)	59217
Pub 4985 (SP)	Gaming Industry Tip Compliance Agreement - for Tipped Employees	60743
Pub 5060	Employee Data Report Disk	60947
Pub 5080	Form 4137 Compliance Program Frequently Asked Questions	62616
Pub 5111	Gaming Industry Tip Compliance Agreement Benefit to Participants	65149
Pub 5112	Tip Rate Determination Agreement (TRDA) Benefits to Participants	65156
Pub 3742	Your Tax Responsibilities for Barber Instructors	31643V
Pub 3742-A	Your Tax Responsibilities for Barber Students	31644G

Forms:

Form Number	Title	Catalog Number
Form 14179	GITCA Tip Agreement Routing Checksheet	55901
Form 14180	TRDA Tip Agreement Routing Checksheet	55902

Exhibit 4.23.7-3 (Cont. 3) (10-01-2024)
Letters, Publications, and Forms

Form Number	Title	Catalog Number
Form 14181	GITCA Extension Routing Checksheet	55903
Form 14196	Filing Statement (not required to file Form 8027)	56047
Form 14354	Summary of Compliance Review Findings and Recommendations	58936
Form 14354-A	Compliance Review Acceptance Statement	58937
Form 14439	Employee Data Report	60879
Form 14515	Compliance Review Routing Checksheet	64056
Form 14516	TRAC Request Routing Checksheet	64057
Form 14352	Employee Non-Participant Data Form	58899
Form 14615	Tip Rate Reduction Request Routing Checksheet	66530
Form 14745	Application for TRAC	68615
Form 14980	Employee Tip Examination Worksheet	38404
Form 14980-A	Explanation of Tip Income	68604
Form 14980-B	Computation of Tip Income Using the McQuatter's Formula	68605
Form 14980-C	FICA Tax and Penalty	68606
Form 14980-D	Summary of Employee Tip Examination Worksheets	68740
Form 5345-NTRC	Form 5345 NTRC	52469