



Does your business have employees who get tips? You may qualify for a tax credit

If you're an employer with a business where tipping is routine when providing food and beverages, you may qualify for a federal tax credit involving the Social Security and Medicare (FICA) taxes that you pay on your employees' tip income.

Credit fundamentals

The FICA credit applies to tips that your staff members receive from customers when they buy food and beverages. It doesn't matter if the food and beverages are consumed on or off the premises. Although tips are paid by customers, for FICA purposes, they're treated as if you paid them to your employees.

As you know, your employees are required to report their tips to you. You must:

- Withhold and remit the employee's share of FICA taxes, and
- Pay the employer's share of those taxes.

How the credit is claimed

You claim the credit as part of the general business credit. It's equal to the employer's share of FICA taxes paid on tip income in excess of what's needed to bring your employee's wages up to \$5.15 per hour. In other words, no credit is available to the extent the tip income just brings the employee up to the \$5.15-per-hour level, calculated monthly. If you pay each employee at least \$5.15 an hour (excluding tips), you don't have to be concerned with this calculation.

Note: A 2007 tax law froze the per-hour amount at \$5.15, which was the amount of the federal minimum wage at that time. The minimum wage is now \$7.25 per hour but the amount for credit computation purposes remains \$5.15.

Let's look at an example

Let's say a server works at your restaurant. She is paid \$2.13 an hour plus tips. During the month, she works 160 hours for \$340.80 and receives \$2,000 in cash tips which she reports to you.

The server's \$2.13-an-hour rate is below the \$5.15 rate by \$3.02 an hour. Thus, for the 160 hours worked, she is below the \$5.15 rate by \$483.20 (160 times \$3.02). For the server, therefore, the first \$483.20 of tip income just brings her up to the minimum rate. The rest of the tip income is \$1,516.80 (\$2,000 minus \$483.20). As the server's employer, you pay FICA taxes at the rate of 7.65% for her. Therefore, your employer credit is \$116.03 for the month: \$1,516.80 times 7.65%.

While the employer's share of FICA taxes is generally deductible, the FICA taxes paid with respect to tip income used to determine the credit can't be deducted, because that would amount to a double benefit. However, you can elect not to take the credit, in which case you can claim the deduction.

Get the credit you deserve

If your business pays FICA taxes on tip income paid to your employees, the tip tax credit may be valuable to you. Other rules may apply. Contact us if you have any questions.