

Tax Equity and Fiscal Responsibility (TEFRA) and Tip Reporting Alternative Commitment (TRAC)

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Introduction

TEFRA, the Tax Equity and Fiscal Responsibility Act of 1982, was designed to produce additional revenue through a combination of federal spending cuts, tax increases, and reform measures. One area targeted for reform in this act is the reporting of tips by employees of food and beverage establishments.

According to the IRS, only 16% of tip income was being reported by restaurant and bar employees. By law, employees who receive tips are required to report as income all tips received. With TEFRA, the government increased efforts to collect taxes on the unreported amounts of tip income by the employees of large food and beverage establishments.

Since 1982, the IRS has instituted various initiatives to strengthen its ability to enforce tip reporting requirements. One of the most recent was the creation of the Tip Reporting Alternative Commitment or TRAC. This *pro forma* agreement, worked out by representatives of the food service industry and the Internal Revenue Service, provides both employers and the IRS an important tool in the tasks of compliance and enforcement.

This booklet discusses, primarily by answering commonly asked questions, some of the more important issues of concern to owners of larger food and beverage establishments. The first part covers TEFRA, while the second half discusses the TRAC program.

Questions and Answers About TEFRA

What are the tip reporting requirements?

If your food or beverage establishment qualifies, you will be required to do the following:

- A. File an annual information return, Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips. This return reports information about the establishment's gross receipts, charge receipts, and the amount of tip income reported by all tipped employees.
- B. Allocate by *reporting period* a tip amount to employees when the total amount of reported tips is less than 8% of the establishment's gross receipts.

A reporting period may be a calendar year or any reasonable division of a calendar year. Congress believes that most patrons tip between 10% and 20%. Allowing for people who are dissatisfied with service and may tip less, and for those people who may not tip at all, they arrived at the 8% average.

- C. Report any tip allocation amounts made to your employees on their W-2 forms.

How does tip reporting affect my business?

Only large food or beverage establishments must comply with the TEFRA reporting requirements. An establishment is considered a large food or beverage establishment if it meets all of the following conditions:

- A. Tipping is customary in the establishment. Food or beverage operations where tipping is not customary are not subject to TEFRA. For example, cafeterias and fast food operations would generally not be subject to TEFRA because tipping is not customary.
- B. More than ten people were employed on a typical business day during the preceding calendar year. All employees of the food or beverage operation are included in this count, not just tipped employees.

What if the number of people I employed varied during the preceding year?

The IRS considers you to have employed more than ten people on a typical business day when the average number of hours worked by your employees is more than 80 hours.

To determine the average hours worked by your employees, follow these steps:

Step 1: Using the month with the *greatest* amount of gross receipts from the previous year, divide the total hours worked by all employees during that month by the number of days the establishment was open for business. (This step calculates the average number of hours worked per business day for the month chosen.)

Step 2: Repeat step 1 using the month with the least amount of gross receipts.

Step 3: Add the results from steps 1 and 2.

Step 4: Divide the total from step 3 by two to calculate the average number of employee hours worked on a typical business day. If this average is more than 80 hours, you must comply with the TEFRA tip reporting requirements.

What if I employed fewer than ten people but the average number of hours worked was more than 80?

The determining factor is the average number of hours worked by employees on a typical business day. When this amount is more than 80 hours, you must comply with the TEFRA reporting requirements.

How does a new business determine when it must comply with the tip reporting requirements?

If your establishment was not in operation, or if it was in operation for less than one calendar month during the preceding calendar year, it is considered a new business. To determine when you must comply, calculate the average number of employee hours worked per business day for each month. When two consecutive months average more than 80 hours, your business is considered to employ more than ten employees on a typical business day. At that time, you must comply with the TEFRA reporting requirements beginning with the first payroll period that begins after the first two-month period where the average hours worked per business day exceeds 80 hours.

Can the percentage of gross receipts amount be lowered?

Yes. A majority of the employees or the employer may request to have the percentage of gross receipts reduced from 8%, but not below 2%.

How can the percentage rate be lowered?

A written request must be submitted to your IRS District Director with supporting information such as the type of establishment and location, the charged tip rate, menu prices, and amount of self-service. If available, copies of Form 8027 from previous years should also be attached. Until the employer is notified in writing of a reduced rate from the District Director, the employer must continue to use 8% of gross receipts when allocating.

What information must be reported on Form 8027?

Annually, the employer must report:

1. Total charged tips.
2. Total charged receipts on which there were charged tips.
3. Total of service charges of less than 10% paid as wages to employees.
4. Total tips reported by indirectly tipped employees.
5. Total tips reported by directly tipped employees.
6. Gross receipts from food or beverage operations.
7. Total allocated tips to employees if total amount of reported tips is less than 8% (or lower rate) of gross receipts.

Note: This return *must* be filed even if there were no tip allocations necessary.

If I operate more than one food or beverage establishment, should I combine the information and file one return?

No. If you operate establishments at more than one location, a separate return must be filed for each establishment. In addition, you can report activities in a single location as separate establishments. The customers must be served in different areas of the location and the gross receipts must be recorded separately. Activities conducted at the same place but at different times can also be reported as separate establishments if the gross receipts are recorded separately. Each separate establishment is required by the IRS to maintain tip reporting records and file Form 8027. Form 8027T is used to send multiple Forms 8027 if you have more than one establishment.

How should I record an employee's tips when their total reported tips are for multiple establishments within one location?

If the employee does not report tips received in each establishment separately, you are permitted to make a good faith estimate as to the tips received by the employee for each establishment. The total estimated tips must equal the total tips reported by the employee.

When must Form 8027 be filed?

Form 8027 is due on or before the last day of February of the following year for which the report period is related. The return must be filed with the Internal Revenue Service Center in Cincinnati, OH 45999.

What is included in gross receipts?

Gross receipts include cash sales, charge receipts, and charges to a hotel room. Gross receipts should not include carryout sales, sales with an added service charge of 10% or more, and state or local sales taxes.

What is the difference between a directly tipped and an indirectly tipped employee?

The difference is determined by how the employee receives tips. A directly tipped employee receives tips directly from customers. This includes an employee who, after receiving tips, turns all the tips over to a tip pool. Examples of directly tipped employees are waiters, waitresses, and bartenders. An indirectly tipped employee does not normally receive tips directly from customers. Examples of indirectly tipped employees are busboys, service bartenders, and cooks.

What is a tip allocation?

A tip allocation is a tip amount that is allotted to employees to make up the difference between the total tips reported and 8% of the establishment's gross receipts. The tip allocation amount is used for information purposes only. It is not an amount that is taxed or deducted by the employer from the employees' paychecks.

When do I make tip allocations?

You must allocate tips among employees who receive tips only if the total tips reported during any reporting period are less than 8% of the gross receipts for that period. Allocations can be figured annually or on a more frequent basis during the calendar year. For example, you may choose to allocate tips each pay period or quarterly. The reporting period that you do choose, however, must remain in effect for the entire calendar year.

How do I allocate tips to employees?

The employer must allocate tips using one of these methods:

- a good faith agreement

- the IRS formula based on the employee's individual gross receipts

- the IRS formula based on the employee's directly tipped hours. The directly tipped hours method is restricted to establishments that employ less than the equivalent of 25 full-time employees during a payroll period. An employer qualifies if the average number of employee hours worked per business day during the payroll period is less than 200 hours.

Once you have chosen one of these methods, you must apply that method to the establishment for the entire calendar year.

What is a good faith agreement?

This is an agreement between you and your employees that specifies how you, the employer, should allocate tips when the reported tips do not reach 8% of the establishment's gross receipts. To be binding, the agreement must:

- be written.

- be consented to by the employer and at least two-thirds of the employees of each tipped category.

- specify a method of allocating tips that reflects a good faith approximation of the actual distribution of tip income among tipped employees.

- begin with a reporting period that starts within 30 days of adoption and is renewed annually by vote of all employees.

- be attached annually when filing Form 8027.

A good faith agreement may be revoked by a written agreement adopted by at least 50% of the tipped employees.

Do I allocate tips to all employees?

No. Only directly tipped employees are subject to tip allocations and then only if they have a shortfall for the reporting period. It is important, however, that indirectly tipped employees report all tips received since their reported tips are used to determine whether tip allocations are necessary.

Must I report tip allocations?

Yes. When tip allocations are made to employees, you must report the total tip allocation amounts on their W-2 forms. The total amount of tip allocations made to employees must also be reported on Form 8027. If you fail to report the tip allocation amounts for the employees, you may be subject to civil penalties.

Are employees required to report tip allocations?

Yes. If a tip allocation amount is reported on an employee's W-2 form, it is the employee's responsibility to include the amount as taxable income when filing his or her personal income tax return.

What if an employee does not agree with the allocation amount?

An employee has the right to report a lesser allocation amount on his personal income tax return as gross income. The employee must, however, be able to prove the lesser amount with adequate records.

Do my tax withholding responsibilities change because of TEFRA?

No. Your tax withholding responsibilities remain the same since taxes are not withheld on allocated tips.

What records should I keep?

You should keep records to sufficiently substantiate any Form 8027 returns, employees' W-2 forms, and tip allocations made to employees. These records must be retained for four years after the due date of the return period to which the records relate.

Do employees have any other tip reporting responsibilities?

All tipped employees have tip reporting responsibilities, not just tipped employees who are employed by a qualifying TEFRA establishment. These responsibilities are:

- A. **Reporting all tips received as income.** Every employee who receives more than \$20.00 in tips during a calendar month is required by law to report as income all tips received.

Employers should request employees to report tips weekly, biweekly, or semi-monthly, depending on their payroll schedule. Employees must observe the dates established by their employer.

Note: This tip reporting law is not the result of TEFRA nor is it subject only to employees who are employed by qualifying TEFRA establishments. *This law applies to all tipped employees.* With TEFRA, any tip amount not reported can make the difference between allocating and not allocating tips.

- B. **Providing their employer with a tip statement.** All tipped employees must provide their employer with a written and signed statement reporting the total tips received during the covered period. This statement must be received by the employer on or before the tenth day of the following month.
- C. **Maintaining adequate records.** All tipped employees are required to maintain, for their personal records, accurate accounting of tips received and reported to their employer.

How can I help my employees meet these requirements?

- A. Review and discuss the tip reporting requirements with your employees.
- B. Explain TEFRA and its rules to your employees.
- C. Provide your employees with a tip statement report for submitting tip information. For this purpose, Form 4070 can be obtained from your IRS district office.

The IRS Formula

Step 1 Multiply the establishment's gross receipts by 8% (or lower rate).

Step 2 Subtract the tips reported by indirectly tipped employees from the 8% of gross receipts amount.

- This will determine the directly tipped employees' share of 8% of gross receipts.

Step 3 For each directly tipped employee, multiply the amount calculated from Step 2 by the fraction below based on your tip allocation method:

- A. The employee's gross receipts for the period over the establishment's gross receipts, or
 - B. The directly tipped hours worked by the employee over the total number of directly tipped hours worked by ALL directly tipped employees.
- This step calculates the employee's share of the 8% of gross receipts.

Step 4 Subtract the tips reported by each employee from the calculated employee's share of 8% of gross receipts (Step 3).

- This calculates the employee's shortfall. If tips reported are more than the employee's share of 8% of gross receipts, the employee does not have a shortfall and, therefore, no tip allocation is made.

Step 5 Subtract the total tips reported by all employees (include indirect tips) from the amount calculated in Step 1.

- This calculates the total amount of tip allocation necessary.

Step 6 For each directly tipped employee with a shortfall, multiply the total allocation amount (Step 5) by a fraction consisting of the employee's shortfall over the total amount of all shortfalls for all directly tipped employees.

- The result is the employee's tip allocation amount for the period covered.

HOURS METHOD

Example: XYZ is an operation and gross receipts for the reporting period are \$43,270.00
 Total tips reported by employees for the period are \$3,247.50
 Directly tipped employees reported \$3,026.00
 Indirectly tipped employees reported \$221.50

| <u>Directly Tipped Employees</u> | <u>Hours Worked for Reporting Period</u> | <u>Tips Reported</u> |
|--------------------------------------|--|----------------------|
| A | 36.00 | 462.00 |
| B | 21.00 | 390.00 |
| C | 32.00 | 540.00 |
| D | 42.00 | 581.00 |
| E | 34.75 | 580.00 |
| F | <u>28.50</u> | <u>473.00</u> |
| | 194.25 | \$3,026.00 |

Tip Allocation Computations Would Be:

1. \$43,270.00 X .08 (or lower rate) = \$3,461.60
2. \$3,461.60 - \$221.50 = \$3,240.10
- 3.

| <u>Directly Tipped Employees</u> | <u>Directly Tipped Share of 8% Gross</u> | <u>Hours Worked Ratio</u> | <u>Employee Share of 8% Gross</u> |
|--------------------------------------|--|-------------------------------|---------------------------------------|
| A | \$3,240.10 | X 36.00/194.25 | = \$600.48 |
| B | 3,240.10 | X 21.00/194.25 | = 350.28 |
| C | 3,240.10 | X 32.00/194.25 | = 533.77 |
| D | 3,240.10 | X 42.00/194.25 | = 700.56 |
| E | 3,240.10 | X 34.75/194.25 | = 579.63 |
| F | 3,240.10 | X <u>28.50/194.25</u> | = <u>475.38</u> |
| | | | \$3,240.10 |

4.

| <u>Directly Tipped Employees</u> | <u>Employee Share of 8% Gross</u> | | <u>Tips Reported</u> | | <u>Employee Shortfall</u> |
|----------------------------------|-----------------------------------|---|----------------------|---|---------------------------|
| A | \$600.00 | - | \$462.00 | = | \$138.48 |
| B | 350.28 | - | 390.00 | = | - |
| C | 533.77 | - | 540.00 | = | - |
| D | 700.56 | - | 581.00 | = | 119.56 |
| E | 579.63 | - | 580.00 | = | - |
| F | 475.38 | - | 473.00 | = | <u>2.38</u> |
| | | | | | \$260.42 |

Since employees B, C, and E have no shortfall, allocations are not made.

5. $\$3,461.60 - \$3,247.50 = \$214.10$ (total allocable amount to shortfall employees)

6.

| <u>Directly Tipped Employees</u> | <u>Total Allocation</u> | | <u>Shortfall Ratio</u> | | <u>Employee Allocation*</u> |
|----------------------------------|-------------------------|---|------------------------|---|-----------------------------|
| A | \$214.10 | X | $\$138.48/260.42$ | = | \$113.85 |
| D | 214.10 | X | $119.56/260.42$ | = | 98.29 |
| F | 214.10 | X | $2.38/260.42$ | = | <u>1.96</u> |
| | | | | | \$214.10 |

NOTE: The total allocation amount may be less than the total employee shortfall. Tips reported in excess of the allocation percent are applied to the total allocation amount, therefore, it is reduced.

**May be off cents due to rounding.*

GROSS RECEIPTS METHOD

Example:

| | |
|---|-------------|
| ABC is an operation and gross receipts for the reporting period are | \$34,000.00 |
| Total tips reported by employees for the period are | \$2,400.00 |
| Directly tipped employees reported | \$2,140.00 |
| Indirectly tipped employees reported | \$260.00 |

| <u>Directly Tipped Employees</u> | <u>Gross Receipts for Reporting Period</u> | <u>Tips Reports</u> |
|--------------------------------------|--|---------------------|
| A | \$10,200.00 | \$600.00 |
| B | 8,000.00 | 650.00 |
| C | 6,750.00 | 420.00 |
| D | <u>9,050.00</u> | <u>470.00</u> |
| | \$34,000.00 | \$2,140.00 |

The Allocation Computations Would Be:

1. $\$34,000.00 \times .08$ (or lower rate) = \$2,720.00
2. $\$2,720.00 - \$260.00 = \$2,460.00$
- 3.

| <u>Directly Tipped Employees</u> | <u>Employee Share of 8% Gross</u> | | <u>Gross Receipts Ratio</u> | | <u>Employee Share of 8% Gross</u> |
|--------------------------------------|---------------------------------------|---|---------------------------------|---|---------------------------------------|
| A | \$2,460.00 | X | $\$10,200.00/34,000.00$ | = | \$738.00 |
| B | 2,460.00 | X | $8,000.00/34,000.00$ | = | 578.82 |
| C | 2,460.00 | X | $6,750.00/34,000.00$ | = | 488.38 |
| D | 2,460.00 | X | $9,050.00/34,000.00$ | = | <u>654.80</u> |
| | | | | | \$2,460.00 |

4.

| <u>Directly Tipped Employees</u> | <u>Employee Share of 8% Gross</u> | | <u>Employee Tips Reported</u> | = | <u>Shortfall</u> |
|----------------------------------|-----------------------------------|---|-------------------------------|---|------------------|
| A | \$738.00 | - | \$600.00 | = | \$138.00 |
| B | 578.82 | - | 650.00 | = | - |
| C | 488.38 | - | 420.00 | = | 68.38 |
| D | 654.80 | - | 470.00 | = | <u>184.80</u> |
| | | | | | \$391.18 |

Since employee B has no shortfall, an allocation is not made.

5. \$2,720.00 - \$2,400.00 = \$320.00 (total allocable amount to shortfall employees)

6.

| <u>Directly Tipped Employees</u> | <u>Total Allocation</u> | | <u>Shortfall Ratio</u> | = | <u>Employee Allocation*</u> |
|----------------------------------|-------------------------|---|------------------------|---|-----------------------------|
| A | \$320.00 | X | \$138.00/391.18 | = | \$112.89 |
| C | 320.00 | X | 68.38/391.18 | = | 55.94 |
| D | 320.00 | X | 184.80/391.18 | = | <u>151.17</u> |
| | | | | | \$320.00 |

NOTE: The total allocation amount may be less than the total employee shortfall. Tips reported in excess of the allocation percent are applied to the total allocation amount, therefore, it is reduced.

**May be off cents due to rounding.*

Form 8027 — Delinquent Filing

In March 1985, the IRS began a program to track down delinquent filers of annual Form 8027. The IRS is identifying taxpayers who filed Form 941 reporting FICA taxable tips, and appeared to operate a food or beverage establishment, but have not filed Form 8027.

Procedures have been outlined in an IRS manual supplement (5G- 296). Two attempts will be made to contact delinquent filers by telephone.

- If the taxpayer is contacted, an attempt will be made to resolve the case. The IRS will determine if the taxpayer is liable or not. If the IRS finds them liable, they will request that a Form 8027 be submitted within the next ten days. If the taxpayer does not agree with the IRS, the case will be considered unresolved.
- If the taxpayer is not contacted after two attempts, the case will be considered unresolved.
- Unresolved cases will then be sent to IRS district offices for field contact by IRS collection personnel. Taxpayers who fail to file Form 8027 or to provide the tip allocations required will be assessed a penalty of up to \$50 for each omission.

The Background of the TRAC Program

The Internal Revenue Service continues to seek ways to maximize the reporting of tip income in the food service industry, where the noncompliance rate has been estimated to be over 40%. In June 1995, a new program was announced by the IRS called the Tip Reporting Alternative Commitment (TRAC). The word “alternative” is an important one, for a TRAC provides an option to two common initiatives that will continue in use—the Tip Rate Determination Agreement (TRDA) and the tip examination.

The tip examination (also known as a tip audit) is a comprehensive look at an establishment’s tip rates and compliance. The IRS has the authority to conduct audits on liability for reported and unreported FICA taxes on tips.

The IRS can offer a TRDA in lieu of a tip audit. A TRDA is an agreement where an establishment agrees to determine the average rate of tipping in their place of business. Then, they must get a majority of workers to report tips at that rate or higher.

A TRAC program was developed by the IRS in cooperation with representatives of the food service industry as an alternative to a TRDA. While somewhat similar to a TRDA, TRAC shifts a great deal of emphasis to educating employees about the responsibilities and benefits of proper tip reporting, to establishment of tip reporting procedures, and proper tax filing and payments. For conscientious efforts in these areas, business owners are exempted from “employer-first” and “employer-only” audits.

The following questions and answers discuss TRACs in greater detail.

Questions and Answers About TRAC

Why would a business want a TRAC?

While enrolled in and properly complying with a TRAC, you are protected from “employer-first” and “employer-only” audits. The IRS promises not to bill you for unreported tips without first establishing that FICA taxes are owed by individual employees.

Is signing a TRAC mandatory?

No. Each business is free to weigh the pros and cons of a TRAC for its particular situation.

What does an employer agree to do?

Employers must do three things, and these are spelled out in section III of the Tip Reporting Alternative Commitment agreement. They are as follows:

1. *Educational Programs.* Employers must start, and maintain for each calendar quarter, an educational program that explains reporting obligations to employees.
2. *Returns, Taxes, and Records.* Employers must meet the requirements for filing Form 941 (Employer’s Quarterly Federal Tax Return), Form 8027 (Annual Information Return of Tip Income and Allocated Tips) if required, and Forms W-2. An employer also agrees to comply with requirements for paying and depositing taxes due, to maintain certain records, and to make quarterly totals available to the IRS upon request.
3. *Tip Reporting Procedure.* Employers agree to set up a tip reporting procedure for directly and indirectly tipped employees. This includes cash and charged tips.

Must the employer continuously meet all three areas to keep the TRAC in effect?

Yes, an agreement can be revoked for failure to “substantially comply” with any of the three parts. However, the IRS has indicated that if an employer is willing to work with them to correct the reasons for the proposed revocation, the agreement may stay in effect.

What does the educational program involve?

The broad purpose of the educational program is to inform current and newly hired tipped employees about their reporting obligations. The program may take the form of on-site or off-site training. You may deliver the information in any number of ways, as varied as booklets to video programs. You must maintain the program for each calendar quarter so that existing employees get periodic updates.

What information would be included in an educational program?

The program must emphasize the following points:

- All cash tips that employees receive and retain must be reported to their employer. It’s suggested that the establishment’s ratio of charged sales to cash sales be illustrated so that employees understand that there is a correlation between charged tips and cash tips.
- Employees are obligated to maintain records of the tips they report. There are significant benefits to proper tip reporting, including maintenance of a Social Security credit history, proper retirement plan contributions, and creation of adequate records for tax purposes.

How quickly must all of this be put in place?

You have until the start of the second calendar quarter following the quarter in which the TRAC becomes effective before the IRS can do an official evaluation.

Why would a TRAC be revoked?

The IRS could revoke a TRAC for several reasons, including the following:

- You are not properly educating employees on their responsibility to report tips.
- You have not set up or implemented proper tip-reporting procedures.
- You have not kept proper tip records.
- You have not filed returns or made tax payments in a timely and accurate manner.

- Employees have “collectively and substantially” failed to report tips. The TRAC can be revoked retroactively for the first two reasons, but only prospectively for the other reasons.

Could a small number of careless employees get a TRAC revoked?

No. Employees must be “collectively and substantially” underreporting their tips. Even then, these shortfalls must happen for two calendar quarters in a row and the IRS must follow employee-first auditing for the period the TRAC was in effect.

For whatever reason, if a TRAC is revoked, are any periods free from audits?

You are free from tip audits for any times during the time the TRAC was in effect. Any times before and after are also open to audits. For example: a TRAC was in effect for two years. It's ruled that your establishment was in “substantial noncompliance” during the last six months of that time, and the IRS revokes the agreement as of that time. You could be subject to an audit for that final six-month period, for the time after the TRAC was revoked, and for any time prior to the establishment of the TRAC.

If a new establishment applies for a TRAC, when would it go into effect?

A TRAC for a new business takes effect at the beginning of the calendar quarter after application. Application must be made within the first year of operation. After that, the new business has to wait until the quarter after the District Director's approval.

When does a TRAC go into effect if it is not a new establishment?

For established businesses, TRACs take effect at the start of the calendar quarter after approval by the IRS District Director. Presumably, the approval time will depend on the workload in the district office.

Can anyone be refused a TRAC?

Even with automatic acceptance policies, the IRS may reject an application if there have been past filing or tax payment problems. However, if rejection is for failure to file or deposit, and there is willingness to correct the problem, the application should be accepted.

After a TRAC takes effect, when can the IRS start checking for compliance?

The IRS believes it will take an establishment an initial outlay of time and money and up to six months to get programs in place. Therefore, a business is given until the second calendar quarter following the quarter in which the agreement takes effect. (If the effective date was 7/1/00, an evaluation could not begin until 1/1/01.)

My business is already under TRDA validation. Can I apply for a TRAC?

Yes, and the effective date will follow the normal schedule or conditions.

My business is a subsidiary of a larger company. Who would sign up for the TRAC?

The employer enters into the agreement. If you file your own 941 forms and have your own EIN, you would be considered the employer. If 941s are submitted by a parent organization, using their EIN, they would be the employer and would sign the TRAC.

How do you apply for a TRAC?

The entity that is the employer submits an application to the IRS District Director for the district where the employer is located.

How does a TRAC differ from a TRDA?

Here are the basic differences:

- *Tip Rates.*
A TRDA requires establishment of tip rates for the different types of occupations in a restaurant. A TRAC does not require establishment of tip rates.
- *Educational Program.*
There is no specific training requirement in a TRDA. TRAC businesses agree to set up an educational program that explains reporting responsibilities to new hires and existing employees. The program must be ongoing on a quarterly basis.

- *Employee Participation Agreement.*
A TRDA requires that employees enter into an agreement with their employer called a Tipped Employee Participation Agreement (TEPA). TRAC has no such requirement.
- *75% Rule.*
Employers must get 75% of employees to sign TEPA's and report at or above the determined tip rate if they have a TRDA. Under a TRAC, all employees are affected.
- *Non-participants.*
TRDA: employers must provide information to the IRS about employees who don't report tips at the determined rate for the establishment. TRAC: because all employees are affected, their tip reporting is examined collectively. If the rate of reporting does not improve, the TRAC may be revoked and the employer subject to a TRDA or tip examination.
- *Prior Periods.*
During the period that either a TRDA or TRAC is in effect, the IRS agrees not to examine prior periods for noncompliance and the possibility of taxes due.