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Waitress Tipped \$100,000---But Don't Forget IRS

The IRS, restaurants, and their workers have battled for years over tip reporting and fairness. Sometimes, the IRS even attributes tip income where it can't get the *real* data. Yet in a real-life feel good story, an 85 year old man who dined at the same restaurant for 50 years [left \\$100,000 in his will for his two favorite waitresses](#). Regulars say Robert Ellsworth sometimes dined at Donahue's Steak House twice a day, tipping a generous 20%. But no one knew he was wealthy until he died and left [\\$50,000 to each of two waitresses](#).

The art collector was worth millions and lived in a 20-room apartment on Fifth Avenue. He didn't even know the waitresses names, giving the \$50,000 bequests to them as "Maureen-at-Donohue's" and "Maureen-at-Donohue's Niece Maureen." But aren't tips income? Yes, and IRS rules are clear that taxable tips include tips the employer pays to employees for charge customers, tips employees receive directly from customers, etc.



In fact, the IRS pushes hard to try to ferret out tip reporting. The IRS can even claim it after someone's death. Think of all those nurses and caregivers who end up named in a will. Are the payments *really* meant as an inheritance, or rather as a kind of bonus for services rendered? The gift and estate tax is increasingly unified, and the rules are often confusing.

After all, suppose a loyal long-time employee gets a 'gift' on retirement from a grateful employer. The IRS says that isn't a gift so *always* taxes the worker. It simply isn't a gift according to the IRS. Even so, most bequests like a \$100,000 tip do not get taxed as income. The answer is mostly about matching and tax deductions.

The IRS usually doesn't disturb employees and former employees named in wills, unless the estate tries to deduct the payment. That happens more than you might think. After all, a bequest to a worker does not generate a deduction by the estate. A payment for services—or a payment to resolve a claim against the estate—is tax deductible by the estate.

For that reason, if the estate claims a deductible payment but the recipient says it was a non-taxable bequest, there is a mismatch. The IRS could miss out on either estate tax or income tax.

Here, though, unless the estate tries to deduct something it shouldn't, the two waitresses should take their money tax-free. These weren't tips after a meal.

Tip rules are vastly more complex than you might think. Even though employees receive tips from customers, they are generally subject to withholding by the employer. Employees report tip income on [Form 4070](#). This signed report, due the 10th of the month after the tips are received shows: (a) Employee's name, address, and Social Security number; (b) Employer's name and address; (c) The month or period; and (d) Total tips received. (No report is required for months when tips are less than \$20.)

Employers must collect income tax, employee Social Security tax and employee Medicare tax on tips reported by employees. The employer can collect these taxes from an employee's wages (withhold excess amounts from wages to allow for the tips). The amount of tip income allocated to each employee is shown in Box 8 of their [Form W-2](#) for the year. Employers operating large food or beverage establishments must file [Form 8027](#) to report employee tips.

Notice now the IRS gets a piece of just about everything?

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