



Pennsylvania Compensation Rating Bureau

United Plaza Building • Suite 1500
30 South 17th Street • Philadelphia, PA 19103-4007
(215)568-2371 • FAX (215)564-4328 • www.pcrb.com

July 22, 2016

PENNSYLVANIA TEST AUDIT PROGRAM **BULLETIN #119**

TIPS vs. AUTOMATIC GRATUITIES (effective April 1, 2015)

PENNSYLVANIA AND DELAWARE MANUALS **(GENERAL AUDITING & CLASSIFICATION GUIDE)**

The IRS has ruled that when a business adds services charges to customers' bills (such as "automatic gratuities") and distributes those charges to its employees, the business should characterize the distributed amounts as social security wages, not as social security tips.

Payments must meet all of the following criteria to be considered as tips:

- *The customer must freely determine the payment.*
- *The customer must be able to determine the amount without restriction.*
- *The payment cannot be determined by negotiations between the customer and the employer, or dictated by the employer.*
- *The customer should generally have the right to decide who receives the payment.*

Historically, tips, including automatic gratuities, have been excluded from remuneration and, therefore, have been excluded from the basis for premium in Pennsylvania. However, in recognition of this IRS ruling, the PCR B directs that automatic gratuities be included as remuneration. Note that tips, as defined above (and thus distinguished from automatic gratuities), remain an exclusion from remuneration in Pennsylvania and Delaware.

Effective with policies selected for test audit with inception dates of April 1, 2015 and forward test audit differences attributed to the misapplication of this Manual rule will be strictly enforced. To date, when presented by this issue in a test audit review, the PCR B has deferred to the carrier to either include service charges/automatic gratuities as wages (per IRS guidelines) or exclude service charges/automatic gratuities (considered a tip). Such deference will no longer be provided. A service charge (as distinguished from a tip; see above) will be considered remuneration and must be included as payroll.