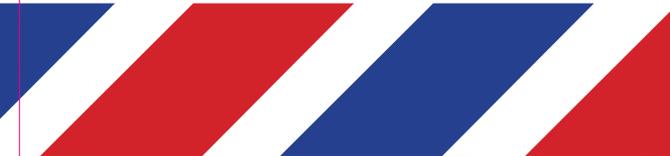




Tax Tips for the

COSMETOLOGY & BARBER INDUSTRY



Whether a shop owner, an employee, or a booth renter (independent contractor), you need to know your federal tax responsibilities, including how to report your income and tips you receive from your customers.

The most common forms of business are the sole proprietorship, partnership, and corporation. Your form of business determines which income tax return form you have to file. Publication 583, *Starting a Business and Keeping Records*, available free from the IRS, can help you decide.

The purpose of this publication is to describe some of the Federal tax responsibilities that owners and workers must address each day.

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Shop Owner

As a shop owner you can elect to structure your business in different forms. You can choose to operate your business as a sole proprietorship, partnership, or as a corporation. Your business may have employees who work for you or you may decide to operate without employees. Another common arrangement is renting space to another individual who operates an independent business. This is commonly referred to as a booth renter and will be discussed later in this publication.

It doesn't matter which business structure you choose; there are basic principles that do not change. Income received in the course of your business is taxable income and must be reported on the appropriate income tax return form.

If you operate your business without employees, where you are the only worker, then your federal tax responsibilities would be limited to reporting your income earned (including tip income) and expenses on the appropriate tax form. For example, a sole proprietorship would file Form 1040, using Schedule C to report business income and expenses and Schedule SE to report Self-Employment tax.

Once you decide to hire workers you must make a determination if they are your employees or if they will operate their own independent business (booth renters).



Who is an employee?

Simply stated, an employee is an individual who works at the control and direction of another. It is important to remember that as the employer you do not have to control the worker all of the time, you simply have to have the right to control. The following questions are helpful in determining if someone is your employee or an independent contractor:

- As the owner, do you establish the hours the shop is open?
- Who makes the determination regarding who works specific shifts?
- Do the workers purchase their own supplies with their own money?
- Who determines the prices charged to customers?
- Do the workers each set their own appointments?
- Who is responsible for expenses, such as insurance, advertising, etc.?

These questions are not all inclusive, but they will provide insight as to whether you are their employer. If you give extensive instructions as to how, when, or where to do the work and where to purchase the supplies, then more than likely you are the employer and the worker is your employee. For additional information, see Publication 1779, *Independent Contractor or Employee?*

Shop Owner/Employer Tax Responsibilities

As an employer, federal law requires you to withhold taxes from your employees' paychecks. Depending on the wages, you must take out of your employees' paychecks certain amounts for federal income tax, social security tax, and Medicare tax. You must then pay any liability for the employer's share of social security and Medicare taxes. This portion, your share, is not withheld from employees. You may also be required to pay unemployment (FUTA) taxes on these wages. In addition to reporting all taxable income on the appropriate income tax form, you would also have the responsibility for issuing Form W-2, *Wage and Tax Statement*.

The wages paid, along with the taxes withheld, are reported on a quarterly basis by filing Form 941, *Employer's QUARTERLY Federal Tax Return*. You may also be required to file an annual form to pay Federal unemployment taxes. This is done by filing Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*. Form W-2 is furnished to employees after the close of the calendar year, but no later than January 31st.

For more information about payroll taxes, see Publication 15 (Circular E), *Employer's Tax Guide* that you can download at www.irs.gov/businesses and click on the Employment Taxes link.



Booth Renters

A booth renter is someone who leases space from an existing business and operates their own business as an independent contractor. As a booth renter, or independent contractor, you are responsible for your own record-keeping and timely filing of returns and payments of taxes related to your business.



Indications that you are an independent contractor include, but are not limited to:

- Having a key to the establishment
- Setting your own hours
- Purchasing your own products
- Having your own phone number and business name
- Determining the prices to be charged

If these factors are not present, then you are likely an employee of the business who is providing the space to you.

If the above factors are present, then as an independent contractor you would be responsible for your federal taxes. Your tax responsibilities would include:

- Reporting all income (including tips) on the appropriate income tax return form, such as Form 1040, using Schedule C or Schedule C-EZ. Social Security and Medicare Taxes are reported on Schedule SE.
- As a booth renter you must issue Form 1099-MISC for business rent paid of more than \$600 or more to non-corporate landlords each year.
- Issue Form 1099 MISC or W-2 to workers you hire or employ.

As a booth renter, or independent contractor, you may need to make estimated tax payments during the year to cover your tax liabilities. This is because as a booth renter (independent contractor), the business does not withhold taxes from your pay. Estimated tax is the method used to pay tax on income that is not subject to withholding, such as earnings from self-employment you receive as a booth renter.

Estimated tax payments are made each quarter using Form 1040-ES, Estimated Tax for Individuals. For additional information regarding tax withholding and estimated tax, see Publication 505, *Tax Withholding and Estimated Tax*.

If you hire others to work for you it is possible that these workers would be your employees. As a booth renter you can hire others to work for you as your employees. If you have employees in your business, you would be required to deduct from their pay social security, Medicare and federal income taxes. This would require you to file quarterly Forms 941, as well as an annual Form 940. You would also be required to file Forms W-2 for each employee who worked for you during the calendar year.



Tip Income Responsibilities for the Employer or Booth Renter



Tips are considered taxable income and are subject to Federal income taxes. Tips that your employee receives from customers are generally subject to withholding. Your employees must report tips they receive to you by the 10th of the month after the month that the tips are received. The report should include tips that you paid over to the employee from customers that added the tip to their charged or debit card receipt and tips that the employee received directly from customers.

You must collect income tax, employee social security tax, and employee Medicare tax on the employee's tips. For more information on the taxation of tips, see Publication 15, *Circular E – Employer's Tax Guide*, available free from the IRS.

Employees are required by law to keep a daily record of all tips they receive. The IRS furnishes free, Publication 1244, *Employee's Daily Record of Tips and Report to Employer*, which employees can use to record their tips on a daily basis. Publication 1244 includes Form 4070, *Employee's Report of Tips to Employer* and Form 4070A, *Employee's Daily Record of Tips*.

If you operate your own business as a sole proprietor or booth renter, any tips received in the normal course of your business must be reported in gross receipts, and then reported on the appropriate income tax form.

See Publication 531, *Reporting Tip Income*, for more information regarding tip income reporting.

Employee Tip Reporting Responsibilities

All tips you receive are income and are subject to federal income tax. You must include in gross income all tips you receive directly from customers, charged tips paid to you by your employer, and your share of any tips you receive under a tip-splitting or tip-pooling arrangement.

You can use Form 4070A, *Employee's Daily Record of Tips* to record your tips, or any diary of your choosing. You can also keep copies of documents that show your tips, such as customer receipts and credit card slips. Publication 1244 includes Form 4070, *Employee's Report of Tips to Employer* and Form 4070A, *Employee's Daily Record of Tips*, available free from the IRS. You can use an electronic system provided by your employer to record your daily tips. If you do, you must receive and keep a copy of this record.

Tip Rate Determination and Education Program (TRD/EP)

Employers may participate in the Tip Rate Determination and Education program. The program consists of various voluntary agreements designed for specific industries where tipping is customary. There is one designed specifically for this industry. TRAC, Tip Reporting Alternative Commitment, has characteristics unique to the Cosmetology and Barber industry.

The IRS developed this program to encourage voluntary compliance with tip income reporting through outreach and education and using enforcement actions as a last resort.

To learn more about the voluntary agreement program, access the irs.gov website at **Market Segment Understandings (MSU)**

You can get copies of the forms and publications referenced in this publication, by searching for them by the form or title shown below at the IRS website at: www.irs.gov.



Publication 4902

Tax Tips for the **Cosmetology & Barber Industry**

