

Support the Small Business Tax Equalization and Compliance Act

Background:

Prior to 1988, employers were required to pay FICA taxes only on tips used to meet minimum wage obligations. (Many states allow employers to pay tipped employees a cash wage that is below the minimum wage and apply tip earnings toward the balance of the minimum wage; this is known as the “tip credit.”) However, beginning in 1988, Congress required employers to pay the employer FICA tax on all tips, rather than just on tips used to meet minimum wage obligations. Congress reasoned that, since employees earned a substantial portion of their income from tips, that income should be accounted for in the employee’s Social Security wage histories and related withholdings.

In 1993, Congress granted the restaurant industry a dollar-for-dollar tax credit – now known as the 45(b) tax credit – on the employer’s share of FICA taxes paid on tip income above the minimum wage. This policy was instituted because Congress recognized that tips are a gratuity paid to wait staff by the customer, and employers should not be responsible for paying FICA taxes on income that was not paid by them. Employers in the salon industry are not currently eligible to receive the 45(b) tax credit, even though their employees, like the restaurant industry, earn a large portion of their income through tips received directly by employees – not by the salon.

Congress can:

Support a vital and growing sector of America’s Economy. Job growth in the salon industry has outpaced the overall economy in eight of the past nine years, and 2008 marked its 16th consecutive year of job growth. This industry is home to a large number of entry-level jobs in which employees have a significant potential for training and upward mobility. The vast majority of managers and salaried employees in salons started out in entry-level positions. Additionally, the salon industry is one of America’s most diverse industries. According to the Bureau of Labor Statistics, the salon industry employs a higher proportion of African-Americans, Asians and women than the overall U.S. workforce. Even so, this industry is not immune to the current economic crisis. **Extending the 45(b) tax credit to salons will help this vibrant and important sector.**

Improve Tip Reporting. In recent years, there has been a significant shift from traditional employment-based salons, where cosmetologists function as regular payroll employees (with benefits such as paid vacation time and retirement savings plans) to non-employer salons, where cosmetologists simply rent a booth from a salon owner and function as a self-employed, independent contractor. While employer-based salons are required to collect tip information from their employees, independent contractors are responsible for reporting their own tips. Although non-employer salons comprise 87 percent of establishments, their reported sales represent only 36 percent of total salon industry revenues, implying a significant underreporting of income in the non-employer segment. **This legislation includes education and reporting requirements which may reveal a valuable new source of tax revenues for the federal government.**

Promote Tax Fairness. Tips to restaurant workers should not be treated differently from tips to salon workers. These industries share tip reporting burdens, but do not share the relief granted to the restaurant industry 15 years ago.

Help Small Businesses. Small businesses are the backbone of America’s economy and the salon industry is an industry of small businesses. According to the U.S. Census Bureau, 98 percent of salon industry firms have only one establishment; 92 percent of salon establishments have sales of less than \$500,000; and 82 percent of salon establishments have fewer than 10 employees. **Extending the 45(b) tax credit to salon owners would allow them to reinvest in their businesses and employees, granting new economic and employment opportunities in their local communities. Additionally, the salon industry is vitally important to the success of many other industries in the economy.**