Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Daniel Lauer, Acting Chief
(SBSE Employment Tax)

from: Marie Cashman, Special Counsel
(Tax Exempt & Government Entities)

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subject: Taxicab Payments

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

This follows up on our earlier response to your questions related to the proper treatment of payments made by certain establishments to taxicab drivers and takes into account the additional facts provided since that time. This advice may not be used or cited as precedent.

ISSUES

1. Whether the payments are income to the drivers?

2. Whether the payments are tips for services the drivers perform as employees of the taxicab companies (tips in the course of employment) or are payments for separate and distinct services?

3. What reporting requirements apply to the payments?

CONCLUSIONS

1. The payments to the drivers are income to the drivers.

2. Under the facts and circumstances described, the payments are not tips received by the drivers in the course of their employment with their respective taxicab companies.

The drivers are not responsible for reporting the payments to the taxicab company pursuant to I.R.C. § 6053(a). The payments are for services separate and distinct from the drivers' employment with the taxicab companies.

3. The clubs and other establishments are responsible for complying with the reporting requirements under I.R.C. § 6041 with respect to such payments.

FACTS

The drivers are employees of taxicab companies engaged in the business of transporting passengers for a metered fare. The cabs are equipped with meters which calculate and display the fares for any transportation. The drivers pick up and transport passengers to their requested destinations. Typically, the driver collects the fares from the passengers, and the meter fare is split between the driver and the taxicab company. It is customary for the passengers to tip the drivers an amount in addition to the meter fare for the transportation provided.

Some adult entertainment clubs (and other establishments) have a practice of making payments to taxicab drivers who bring passengers to their establishments. Generally, the club personnel will not render payment to the driver until the passengers first pay a cover charge or otherwise indicate in some manner that they are patrons of the club (such as purchasing drinks or drink tickets). Payments are usually made in cash, although some clubs issue vouchers to the drivers that can be exchanged for cash at a later time. The amount of the cash or voucher payment may or may not bear any relationship to the meter fare, may vary depending upon the number of passengers, and may be far greater than either the metered fare or the customary tip for the transportation. Typically, one or more passengers are transported from a hotel directly to a club. In some cases the driver may make agreements with certain hotel personnel so that when a guest wants to go to a club, the hotel personnel will summon the driver's taxicab from the queue at the hotel and the driver will split the payment from the club with the hotel personnel. In some cases the passenger may not request a particular destination and the driver or hotel personnel will recommend a club that will pay an amount for delivering the passenger/club patron. Several clubs and other establishments advertise in a local magazine, specifically targeted at drivers in the transportation industry, that they will pay a "referral fee" or "tip" or "incentive" for delivery of passengers/patrons.[1]

Generally, the clubs making the payments at issue are not reporting the payments to the individual drivers on a Form 1099, Miscellaneous Income. The clubs appear to argue that the payments should be treated as tips received in the course of the drivers' employment that the drivers should report to their employer taxicab companies. The

[1] The industry magazine also contains advertisements referencing discounts and free items for drivers such as meals, entertainment tickets and other "rewards;" however, these discounts and rewards do not appear to be linked directly to delivery of patrons but rather at garnering the goodwill of the cab drivers. This memorandum does not address the proper tax treatment of these items.

drivers are not separately reporting the payments to the taxicab companies as tips.[2] Thus, the taxicab companies are not treating the payments as wages subject to employment taxes and required to be reported on Forms W-2. The absence of reporting on either Forms 1099 or Forms W-2 may result in some drivers not reporting the payments as income on their income tax returns.

LAW AND ANALYSIS

Issue 1: Payments are income to drivers.

I.R.C. § 61(a)(1) provides that gross income means all income from whatever source derived, including (but not limited to) compensation for services, including fees, commissions, fringe benefits and similar items. Treas. Regs. § 1.61-2(a)(1) provides that tips are income to the recipients. The payments made by the clubs to the drivers are income to the drivers regardless of whether the payments are tips or remuneration for services that are separate and distinct from their employment by the taxicab companies.

Issue 2: Under the facts and circumstances described, the payments are not tips received in the course of employment with the taxicab companies but are for services separate and distinct from those the drivers perform for their employer taxicab companies.

Tips are not defined in the Code or regulations. However, published guidance is instructive in determining whether a payment is a tip. Rev. Rul. 59-252, 1959-2 C.B. 215, provides criteria which indicate when amounts received in an employment relationship are tips rather than service charges. The revenue ruling provides that the absence of any of the following factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge: (1) the payment must be made free from compulsion; (2) the customer must have unrestricted right to determine the amount thereof; (3) the payment should not be the subject of negotiation or dictated by employer policy; and (4) generally, the customer has the right to determine who receives the payment. While the criteria listed in Rev. Rul. 59-252 are instructive, they were set out in the context of determining whether payments from a customer of the employer were tips to the employees. Accordingly, application of the criteria is not necessarily determinative in all instances in classifying a payment as a tip in the course of employment or as something else altogether. All of the surrounding facts and circumstances must be considered.[3]

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[2] In this regard, we note that cab drivers who have signed a participation agreement under the taxicab company's Tip Rate Determination Agreement (TRDA) with the IRS agree to report tips to their employer at or above the agreed upon rate. Nothing indicates that these payments were taken into account in determining the tip rates under the taxicab companies' TRDAs .

[3] For example, a few court cases have used a test to analyze whether certain payments from patrons were "tips" includible in income or gifts excludable from income. Generally, the test used to determine whether or not the payments were "tips" rather than gifts is whether the payments were "an incident of the

On the question of whether the payments at issue are tips received in the course of employment or payments for separate and distinct services, the facts and circumstances presented support the characterization that the payments at issue are for the drivers' separate and distinct service of referring patrons, influencing patrons and delivering patrons to particular clubs, rather than merely transporting passengers as part of their duties for their employers, the taxicab companies. The fact that the payments from the clubs are contingent upon the "passenger" becoming a "patron" of the club--whether by entering the club, paying the cover charge, buying a drink, etc.--illustrates that the payment is made for the separate service of delivering a patron rather than transporting a passenger. The club is not the recipient of the transportation service; they are the recipient of the delivery of a patron. Furthermore, the fact that drivers frequently recommend the passenger's destination, sometimes in collaboration with hotel personnel, in order to secure the payment from a particular club further strengthens the conclusion that the clubs are paying the drivers for bringing them customers, a service separate and distinct from merely transporting passengers to the passenger's requested destination. Certainly, in cases where a passenger requests a particular destination and the driver tries to persuade the passenger to go to a different destination because of the payment the driver expects to receive, the purpose of the payment for these separate services becomes even more apparent; however, this fact is not necessary to our conclusion that drivers are providing services that are separate and distinct from transporting passengers.[4]

Differences in the facts and circumstances discussed above may influence the determination of whether particular payments are tips for driving passengers as an employee of a taxicab company or payments for separate and distinct services. For example, if the taxicab company shared in the payments made by the clubs (or other

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services provided". In Roberts v. Commissioner, 176 F.2d 221 (9th Cir. 1949), the Ninth Circuit, in considering whether tips to an employee taxi driver from customers were taxable income, recognized that tips "lacked the essential element of a gift,- namely, the free bestowing of a gratuity without consideration." *Id*. at 223. Furthermore, the court noted that "a tip is connected directly with the service and its quality." *Id*. at 224. The taxpayer "received tips as an incident to the service which he rendered to his patrons." *Id*. at 226. In Bevers v. Commissioner, 26 T.C. 1218 (1956), the Tax Court, relying primarily on Roberts, found that tokes (tips) were taxable income because the dealer received the monies as an incident of the services which he performed as an employee for the patrons. These cases further support the conclusion herein that the payments from the clubs are not tips in the context of the drivers' employment relationships because they are not incident to the transportation services.

[4] Some of the drivers may be engaged in a separate trade or business of supplying patrons to the clubs. The U.S. Supreme Court stated in Commissioner v. Groetzinger, 480 U.S. 23, 36 (1987) that the question of whether a taxpayer is engaged in a trade or business requires an examination of the relevant facts in each case. Furthermore, to be engaged in a trade or business the taxpayer must be involved in the activity with continuity and regularity, and the taxpayer's primary purpose for engaging in the activity must be for income or profit. Id. at 36. While a determination that a driver has a separate trade or business of delivering patrons is wholly consistent with our conclusion that the payments are made by the clubs for separate and distinct services rather than as tips received in the course of the drivers' employment, such determination is not critical to a finding that the payments are made for separate and distinct services provided by the driver for the clubs.

establishments) and drivers were aware that they must turn over a portion of the payments to the taxicab company to keep their jobs, then the portion of the payments the drivers keep may be tips as remuneration for driving the taxicab for the company.

Issue 3: The clubs and other establishments are responsible for complying with the reporting requirements under I.R.C. § 6041 with respect to such payments.

The reporting requirements applicable to the payments for services separate and distinct from the drivers' employment are provided in I.R.C. § 6041(a) which requires all persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of $600 or more in any taxable year, to file an information return with the Service and to furnish an information statement to the payee. Treas. Reg. § 1.6041-1(c) provides that payments are fixed when they are paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. Treas. Reg. § 1.6041-1(a)(2) requires payments that are fixed or determinable to be reported on Form 1099.[5]

I.R.C. § 6721 provides for a penalty when an information return, such as Form 1099 or Form W-2, is not timely filed. The I.R.C. § 6721 penalty is waived if the failure to file the information returns is due to reasonable cause and not to willful neglect. I.R.C. § 6724(a). Treas. Reg. § 301.6724-1(a)(2) provides that the penalty for failure to file information returns is waived for reasonable cause only if the filer establishes that there are significant mitigating factors with respect to the failure (and that the filer acted in a responsible manner) or the failure arose from events beyond the filer's control. Significant mitigating factor include, but are not limited to- (1) the filer was never required to file this return or statement with respect to this type of transaction previously, or (2) the filer has an established history of complying with the information requirements with respect to this type of transaction. Treas. Reg. § 301.6724-1(b). A filer acts in a responsible manner if the filer exercised reasonable care, undertook significant steps to avoid or mitigate the failure, and rectified the failure as promptly as possible once the impediment was removed or the failure discovered. Treas. Reg. § 301.6724-1(d). Whether or not the filer's actions were reasonable is an objective inquiry. Lefcourt v. United States, 125 F.3d 79, 84 (2d. Cir.1997).

Because the payments at issue are for separate and distinct services of delivering patrons to the clubs, the clubs are required under I.R.C. § 6041 to file a Form 1099 with

[5] I.R.C. § 6041(e) provides that the reporting requirement contained in subsection (a) does not apply to tips with respect to which § 6053(a) applies. I.R.C. § 6053 generally requires employees to report tips to received in the course of their employment to their employer. When a club makes payments for the delivery of patrons either to a nonemployee driver or to an employee driver performing a service that is not in the course of his employment with the taxicab company employers, such as those under the facts and circumstances described in this memo, it cannot rely on § 6041(e) as authority for not reporting the payments to the drivers because such payments are not required to be reported under § 6053(a).

the IRS for each taxicab driver to whom they paid $600 or more during the calendar year.[6] If the clubs do not file Form 1099, whether they are subject to penalties under I.R.C. § 6721 depends on the facts and circumstances.

Case Development and Hazards

While the facts you have collectively presented warrant the conclusion in this memorandum that the payments at issue are for services separate and apart from the drivers' employment, we note that an examination of a specific club or of a specific driver may produce different or varied facts, including indications that the cab companies receive part of the payments, that may or may not warrant the same conclusion or may present a differing degree of uncertainty regarding the proper characterization of the payments, thereby increasing the hazards of litigation. [redacted]

In addition, while published guidance and some case law provide helpful analysis in characterizing the payments at issue, we have found no prior cases or other authority which definitively defines tips in the context of the facts and circumstances described. Accordingly, the legal issue would be somewhat novel in litigation.

[redacted]

[redacted]

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call me at 202-622-6000 or Linda Conway at 202-622-0047 if you have any further questions.

[6] If the clubs were paying the taxicab companies, not the taxicab drivers, the clubs generally will not be required to file a Form 1099 because under current law the reporting requirement does not apply if the taxicab companies are corporations. But see, § 9006 of the Patient Protection and Affordable Care Act (PL. 111-148), enacted in March 2010, which requires information reporting for payments of $600 or more for property or services to a non-tax-exempt corporation after 2011.