Accounting Services

· A Guide For Restaurant Owners · 2026

A U-NIQUE ACCOUNTING FIELD GUIDE

How To Do Tips Correctly In 2026

Bookkeeping, tax, and CFO services with a side of practical advice.

By U-Nique Accounting · 2026 Edition

Table of Contents

01 INTRODUCTION

Introduction

If you run a restaurant, you've probably heard that tipping and payroll have become more complicated, especially with the new tax rules that started in 2025. And... if you haven't heard or kept up to date with these changes, now is your wake-up call.

Many owners don't realize: the way your systems are currently tracking and reporting tips could be eroding your tax benefits and exposing you to compliance risk (that could lead to costly audits and penalties).

How your restaurant tracks and reports on tips determines whether:

- Your employees get the tax benefits they deserve.
- You qualify for valuable credits like the FICA Tip Credit.
- Your tax filings and payroll reports match, so you don't trigger red flags with the IRS.
- Your financial reports truly reflect what's happening on the floor.

> Over the next few pages, we're going to break down exactly how to get your tips done right, so you don't have to lose sleep over it, ever.

02

THE BASICS

What the IRS Actually Means by “Tips”

What the IRS Actually Means by "Tips"

Before we talk about POS systems and payroll reports, we need to clarify one thing: **not all extra money left on a check is treated the same way.**

For tax and payroll purposes, the IRS makes a very clear distinction between **tips** and **service charges** (like auto-gratuities), which changes how the money must be reported.

What Is a Tip?

A tip is money that:

- A customer voluntarily leaves.
- The customer decides the amount of.
- The amount is not required as part of the bill.
- Funds belong to the employees.
- Are required to be paid/distributed to employees.

Tips belong to the employee. Even if the payment runs through your POS or is distributed through payroll, that money is considered **employee income**. It is not restaurant revenue.

Examples of tips include a customer adding 20% to a credit card receipt, or a cash tip left on the table.

What Is a Service Charge?

A service charge is different. A service charge is money that:

- A customer is required by the restaurant to pay the amount.
- The customer does not control the amount.
- The amount is automatically added to the bill.
- Funds belong to the business.
- Are not required by law to be paid/distributed to employees.

Common examples include automatic gratuity for large parties, banquet or event service fees, and a mandatory 18% added to checks.

Under IRS rules, service charges are not considered tips. They are treated as revenue to the business and then regular wages (or gratuity wages) when paid to employees.

02 PAYROLL TREATMENT

How Each Is Handled in Payroll

That distinction — tip vs. service charge — changes the payroll classification, the W-2, the tax credit, and what the employee can claim on their personal return.

FOR TIPS

PAYROLL CLASSIFICATION

Must be reported as "tip" wages. In payroll programs these are commonly labeled as:

- cash tips
- credit card tips paid
- paycheck tips

PAYROLL TAXES

Subject to all payroll taxes

W-2 TAX FORM

Must be reported on the employee's W-2 as Social Security tips.

FORM 8846 TAX CREDIT

90% - 100% will qualify the employer for the FICA Tip Credit

EMPLOYEE TAX RETURN

Up to **$25,000** will qualify as non-taxable tip wages on your employees' personal tax return.

FOR SERVICE CHARGES

PAYROLL CLASSIFICATION

Must be reported as "gratuity" wages (Not "tip" wages). In payroll programs these are commonly labeled as:

- distributed service charges
- nonqualified tips
- gratuity

PAYROLL TAXES

Subject to all payroll taxes.

W-2 TAX FORM

Must be reported as regular wages.

FORM 8846 TAX CREDIT

0% qualify for this credit.

EMPLOYEE TAX RETURN

Reported as taxable wages. None **($0)** of these wages qualify as non-taxable tip wages on your employees' personal tax return.

02 WHY THIS DISTINCTION MATTERS FOR PAYROLL

Tip vs. Service Charge

If your POS does not clearly distinguish between the two, payroll cannot process them correctly. Here's the working reference.

	IF IT'S A TIP	IF IT'S A SERVICE CHARGE
Voluntary?	Voluntary	Mandatory
Funds belong to	The Employees	The business
Form 8846 Tip Credit	Eligible	Not eligible
Required to be paid to employees	Required	Not required
Reported as	Tip wages	Regular / gratuity wages

And if payroll processes them incorrectly, your tax filings, employer payroll taxes, FICA Tip Credit, and employee W-2 reporting can all be affected. Gusto has a good article on their help center about the new tip/gratuity rules.

> If you don't clearly know whether the money in your system is categorized as a tip or a service charge, you can't know whether it's being reported correctly.

03

HOW TIPS SHOULD FLOW

Through Your Systems

Tips move through your system.

They start in your POS, flow into payroll, and ultimately appear in your financial reporting. Both systems may look accurate on their own. Your POS shows detailed tip reporting. Payroll shows tips paid to employees.

The issue isn't whether tips are recorded. It's whether they are **classified the same way in both systems**. That's where many restaurants get tripped up.

STEP 1

POS

Source of truth. Records gross sales, payment method, tip amount, employee, pooled vs. assigned.

STEP 2

Payroll

Maps tip data into wage categories — tips, service charges, regular wages — and runs taxes and the FICA Tip Credit.

STEP 3

Financials

Tips clear through tips payable liability. Wages and distributed service charges hit the P&L correctly.

Example sales summary report in a POS

POS — Daily Sales Summary

LINE	AMOUNT	TYPE
Net food & bev sales	$8,420.00	REVENUE
Credit-card tips	$1,212.50	TIP
Cash tips reported	$184.00	TIP
Auto-grat (parties 6+)	$246.00	SERVICE CHARGE
Banquet service fee	$420.00	SERVICE CHARGE

Payroll — Pay Stub Detail

EARNINGS	HOURS	AMOUNT
Regular wages	32.0	$512.00
Credit-card tips	-	$402.10
Cash tips	-	$60.00
Distributed service charges	-	$110.50

Example pay stub showing tips and gratuity wages reported separately.

Step 1: Tips Start in Your POS

Your POS is the source of truth. Every tip, whether cash or credit card, begins at the transaction level. The system should clearly record:

- Gross sales
- Payment method
- Tip amount
- Employee associated with the check
- Whether the tip is pooled or assigned directly

Note: If you are pooling tips and gratuities in a spreadsheet (very common) you have to **stop combining both amounts together**. You need to do a pooling calculation for tips and a separate one for gratuities since you have to report these separately in payroll.

At this stage, accuracy matters more than complexity. The POS should:

- Distinguish between tips and service charges
- Track tips by employee
- Reflect whether tips are distributed immediately or pooled

Step 2:
Tip Data Transfers Into Payroll

This is where most breakdowns occur. Payroll simply processes what it receives. When tip data transfers from your POS to payroll, either through integration or manual entry, it must be mapped into the correct wage categories:

- Regular wages
- Cash tips
- Credit card tips
- Distributed service charges

Payroll must then correctly calculate:

- Employee withholding
- Employer payroll taxes
- FICA Tip Credit eligibility
- W-2 reporting

Check: Are These Happening In Your Payroll System?

If you spot any of these, you may have compliance issues building in the background.

SELF-CHECK

Review your last three pay runs. Any of these patterns means you may have problems quietly accumulating.

- ✕ Service charges treated as tip wages
- ✕ All tips marked non-taxable
- ✕ Tip categories merged into base wages

PRO TIP

There isn't one universal "correct" payroll setup. The right configuration depends on how your POS is structured, among other factors. Your Restaurant CPA should advise on the best setup for you.

Why POS and Payroll Tips Don't Match

Most payroll errors don't start in payroll. They start in the handoff between your POS and payroll system. Here are the most common breakdown points:

1 PAYROLL MAPPING DOES NOT REFLECT POS INTENT

Your POS may clearly separate cash tips, credit card tips, and service charges. But once those categories enter payroll, they must be mapped to specific wage types. If the mapping is incorrect, the tax treatment changes, even though payroll runs without error. Payroll won't flag this as an error — it assumes the mapping is intentional. **You must review this and stop assuming the technology is doing it correctly for you.**

2 MANUAL ADJUSTMENTS CREATE INCONSISTENCIES OVER TIME

When payroll data is imported and then manually adjusted, it can create inconsistencies between what the POS recorded and what payroll ultimately reports. Over time, these small overrides can distort wage reporting and tax calculations.

3 TIP POOLING CALCULATIONS ARE INCORRECT

You are combining tips and gratuities into one amount for pooling purposes, and are incorrectly reporting gratuities as tips on the employees payroll. Your spreadsheet also doesn't validate that the total amount pooled is the same as the total unpooled amount from the POS, resulting in over/under reported tip wages.

03 STEP 3

Tips Should Not Inflate Your Revenue.

Tips are not restaurant income. They are employee income. If your accounting system is not separating tip liability correctly, tips can inflate gross revenue, labor expense, and prime cost calculations.

The correct treatment typically looks like this:

- Sales recorded as revenue.
- Auto-gratuities / service charges recorded as **service charge revenue.**
- Tips recorded as a **liability** (money owed to employees).
- Tip payouts clearing that liability account.
- Gratuities paid reported as **wage expense** or **gratuity wage expense** on the P&L.

When this isn't set up properly, your P&L can tell a misleading story about how your restaurant is performing.

> This matters more than many owners realize. If you're making decisions about staffing, menu pricing, or expansion based on distorted labor metrics, you're not working from clean data.

04

THE RIGHT WAY

To structure your tip pool in 2026.

Run two pools, not one.

The single biggest mistake restaurants make in 2026 is pooling tips and service charges together in the same spreadsheet, then handing payroll one combined number. The two have to live in separate pools because they are reported as separate wage types.

The structure that works

1 SEPARATE THE BUCKETS AT THE SOURCE

Your POS should be configured to record tips and service charges as distinct line items. If your POS rolls them into one "gratuity" field, fix that before you do anything else — everything downstream depends on it.

2 CALCULATE TWO POOLS, SEPARATELY

Run one pooling calculation for tips, and a second, independent pooling calculation for service charges. They can use different distribution rules, different participants, and different timing, that's expected. Read More Here.

3 MAP EACH POOL TO THE CORRECT PAYROLL WAGE TYPE

Tips → tip wages (cash tips, credit card tips, paycheck tips). Service charges → gratuity / distributed service charge / nonqualified tips. Same employees, two different earning codes on the same paystub.

4 RECONCILE BACK TO THE POS EACH PAY PERIOD

Total tip wages on payroll should match total tips recorded in the POS for the period. Same for service charges. If the numbers don't tie, find the gap before you run the next payroll — small drifts compound fast.

> Two pools, two earning codes, one reconciliation each period. That's the whole structure — the rest is configuration.

CONCLUSION & NEXT STEPS

A second set of eyes on your setup.

If you reviewed your systems and everything aligns, that's excellent. If you found a few areas where you're unsure how tips are categorized, pooled, or reported, that's completely normal. Most restaurants don't realize how technical tip reporting has become until they look closely.

The good news is that most issues are configuration-based and fixable.

At **U-Nique Accounting**, we specialize in restaurant accounting. We review how your POS, payroll, and financial reporting work together and ensure your tip structure reflects current rules. If you'd like a second set of eyes on your setup, we're happy to help.

BOOK AN INTRODUCTORY CALL

VISIT OUR SITE

SCHEDULE	SPECIALTY	EDITION
u-niqueaccounting.com /contact-us	Restaurants, breweries & hospitality	2026 — Tips & FICA Tip Credit