ALASKA LEGISLATURE COMMITTEE FILES 1997-1998 8672
9323 HOUSE LABOR & COMMERCE

has had in recent years is an ever-shrinking budget. To combat the reduction in resources, the IRS has attempted to enforce the tax law using stiffer penalties for non-compliance. The Tip Reporting Law was an attempt by Congress and the IRS to address the widespread underreporting of tip income by food-service employees. However, as indicated by the research shown above, many hospitality firms either misunderstand the law, apply the law incorrectly, ignore the law, or willfully flout or evade the law. Regardless, hospitality firms and their employees face potential penalties, in addition to the payment of back taxes, for noncompliance.

Many of the respondents' statements prove that they either knew what was right and willfully did not do it or at least knew that what they were doing was not right. The problem in those cases is not one of ignorance but of ethics. As Steve Hall has stated, ethics is a matter of "knowing what ought to be done and having the will to do it."(7) On this basis, many respondents apparently lack the will. Certainly in the 1990s, when business ethics is such a hot topic in both the hospitality curriculum and in the media, it is discouraging to see responses such as those above.

Employee Issues

The law clearly states that all income received from tips be reported to the IRS, not just the first 8 percent of qualified sales. Depending on the seriousness of employees' actions, the IRS can impose additional taxes and penalties upon on employees for underreporting their income.

The IRS also requires that all tipped employees who earn over $20 a month in tips maintain a daily record or other documentation to prove the amount of tip income they receive. Such employees must show the following for each workday:

(1) The amount of cash tips they receive directly from customers;

(2) The amount of credit-card tips they are allocated by employers; and

(3) The amount of tips they pay one another through tip pooling and splitting, and the names of the employees with whom the tips were shared.

The IRS provides Publication 1244 and Form 4070A, "Employee's Daily Record of Tips," to record tips. Employees should keep the daily record along with copies of any written reports they give to their employer (Form 4070).

[ILLUSTRATION OMITTED]

The IRS can use accuracy-related penalties to punish tipped employees who either negligently or substantially understate their taxable income. The penalty rate is 20 percent of the amount that is underreported. The penalty can be abated, however, if the IRS deems the understatement of income was due to reasonable cause. For example, it may be deemed a reasonable cause by the IRS if an employer tells employees to declare tips totaling only 8 percent of sales (and in which case the IRS would probably issue a warning to the employer).

If the IRS finds that employees intentionally underreported income, they could be subject to a fraud penalty. The fraud penalty is imposed at 75 percent of the portion of any underpayment that is attributable to fraud (but the employee will not then be subject to the 20 percent accuracy-related penalty). There is no statute of limitations for fraud, so for serious transgressions an employee could be looking at many years of exposure. It should be noted that the IRS uses the fraud penalty only when a strong case can be made and the amounts involved are significant, since proving intentional disregard is not easy.

In addition to the penalties mentioned above, the IRS imposes interest on any underpayment of taxes found. Unlike penalties, interest cannot be abated for reasonable cause. The interest rate prescribed by law is the short-term

federal rate plus three percentage points. The short-term federal rate is determined quarterly and is compounded dally. Interest on any underpayment of tax runs from the last day prescribed for payment of the tax to the date it is paid.

The statute of limitations for an IRS audit is generally three years. However, if the IRS dtermines that a taxpayer has underreporrted his or her gross income by over 25 percent, the statute of limitations is six years; if fraud is involved, as mentioned above, there is no statute of limitations.

In addition to income-tax liabilities and penalties, employees who do not report tips as required may be subject to a penalty equal to 50 percent of the Social Security tax due on those tips. Employes can avoid this penalty if they can show reasonable cause for not reporting tips to an employer.

IRS Form 4137, "Social Security and Medicare Tax on Unreported Tip Income", is to be used by employees who fail to declare all their tips, or who have an allocated tip amount with no documentation to support the tips claimed. The current IRS procedure is to pull all employee W-2s where tip allocation is shown and to ask employees to forward a copy of their tip log, if they have maintained one. When employees do have a log, and it supports the tips actually reported to the employer, it is unlikely that any further action will be taken. However, if employees cannot produce a log, the IRS will assess an additional tax plus interest on the tips allocated on the W-2. Those employees would also have to file Form 4137 and pay additional Social Security tax. If an employee fails to report 8 percent of qualified sales as tips and the food-service operation as a whole does not report 8 percent, then the restaurant must allocate tips to employees who have underreported.

[ILLUSTRATION OMITTED]
Exhibit 4
Worst-case tax-fraud scenario

Qualified sales: $100,000
Actual tips received: $15,000
Tips declared: $0
Assumption: Employee intentionally underreported income

Payment due IRS:

Estimated income tax on tips (15 percent of $15,000)	=	$2,250.00
Fraud penalty (75 percent of $2,250)	=	1,687.50
Estimated FICA, employee's portion (7.65 percent of $15,000)	=	1,147.50
Penalty on FICA due (50 percent of $1,147.50)	=	573.75
Interest (assumes 7 percent for one year)	=	396.11
Total		$6,054.86

A hypothetical worst-case scenario for a single-year's violation of the tip-reporting laws is shown in Exhibit 4. Assume an excellent waiter had $100,000 of qualified tip sales for a year and actually received tips of 15 percent of sales, or $15,000, as proven by a log. Further, assume the employee intentionally underreported his income by not reporting any tips. The employee's total bill due the IRS could be as high as $6,054.86. This amount is based on several assumptions:

* A marginal federal tax rate of 15 percent;

* A 75-percent fraud penalty;

* A 50-percent FICA penalty; and

* Liability for one-year's interest.

In addition, the IRS most likely will press the employer for its portion of FICA along with interest and penalties. The state income-tax agency will almost certainly follow up later with a tax-deficiency notice.

Employer Issues

Although employees face the greatest exposure from underreporting tip income, employers face some important issues as well. Employers are required to pay Social Security taxes (equal to what the employee is required to pay) on all employee tip income reported. If employers force or encourage their tipped employees to report less than 100 percent of their tips, those employers are illegally lowering the amount of Social Security taxes they should pay.

Starting in tax-year 1994, a food-service business will be allowed a business-tax credit for the amount equal to the employer's FICA contribution (Social Security tax). This credit is attributable to reported tips in excess of those treated as wages for purposes of satisfying the minimum-wage provisions under the Fair Labor Standards Act (FLSA). Although this credit helps many hospitality firms, there is still incentive for many hospitality firms to underreport tips, because the credit is nonrefundable. That means if the hospitality business owes no federal income taxes, a refund of the credit is not possible, although the credit can be carried over to future years.

If employers are found to be purposefully not reporting all tips or are preventing them from being reported, they could be held liable not only for their portion of the Social Security taxes but for the employees' portion as well. This could add up to a significant amount of money, especially since interest will be added to any deficiency. It is unclear whether employers who make wait staff report a specific amount of tips are violating the law that requires employees to report all their tip income to employers, because if the amount employees are required to report is equal to or greater than actual tips received, employees are not violating the law.

Future Managers

Our survey reveals that a large percentage of food-service employees, if our pool of hospitality students is representative, are not properly reporting their tips. The potential impact on employees is significant in terms of penalties and interest imposed by the IRS. Likewise, employers may be subject to additional taxes and interest for their failure to pay the proper amount of taxes.

The labor costs for most food-service firms are high; however, failure to comply with existing laws can result in increased costs when the IRS discovers noncompliance. Most hospitality programs have at least one course that covers payroll taxes. Given this, if hospitality students are themselves unsure of the tip-reporting laws, employees drawn from the general population may be even less likely to be familiar with them. It is important that future food-service managers fully understand the tip-reporting laws so that they can educate their employees and help themselves and their employees avoid financial penalties.

1 IRS Reg. #31.6053-3(j)(11) defines a tipped employee as someone who customarily receives tip income from his or her employment. An employee who occasionally receives a small amount of tips is not considered a tipped employee. Generally, an employee who receives less than $20 per month in tip income is not considered a tipped employee.

2 IRS Reg. #31.6053-4.

3 IRS Reg. #31.6053-3(b)(5).

4 Marcel R. Escoffier and Shirley Dennis-Escoffier, "The New Tip-Reporting Law: A Cloud with a Silver Lining?," Cornell Hotel and Restaurant Administration Quarterly, Vol. 23, No. 4 (February 1983), pp. 8-14.

5 Conf. Rept. PL 97-248, 9/3/92.

6 John M. Tarras and Raymond Schmidgall, "Tip Allocation: A Compliance Study for Restaurants," FIU Hospitality Review, Vol. 7, No. 1 (Spring 1989), pp. 78-84; and John M. Tarras and Raymond Schmidgall, "Tip Allocation: A Hotel Compliance Study," Cornell Hotel and Restaurant Administration Quarterly. Vol. 29, No. 3 (November 1988), pp. 58-61.

7 Ethics in Hospitality Management: A Book of Readings, ed. Steve S.J. Hall (East Lansing, MI: Educational Institute of the AH&MA, 1992), p. 10.

Raymond S. Schmidgall, Ph. D., CPA, is Hilton Hotels professor at Michigan State University's School of Hotel, Restaurant, and Institutional Management, where John Tarras, J. D., CPA, is an associate professor.

-- End --

Database: Business Index ASAP
Subject: tipping
Library: Capital City Libraries

Source: The Tax Adviser, March 1995 26 n3 p154(1).

Title: National tip rate determination between restaurant owners and IRS.
Author: Linda Martin

Abstract: The IRS is initiating a program called the National Tip Rate Determination\Education Program to increase reporting of tip income and reduce the discrepancy between the figures that restaurant owners and employees report. The IRS will be offering employers an agreement that will state that at least 75% of employees agree to properly report tips. If signatures are obtained by at least 75% of employees, the employer will not get audited. The restaurant industry is not happy with this compliance strategy, but the same technique was used to great success in casinos.

Subjects: Tipping - Taxation
Taxpayer compliance - Laws, regulations, etc.
Jurisdctn: United States
SIC code: 5812

Business Collection: 85Q1078
Electronic Collection: A16665839
RN: A16665839

The Service has established a National Tip Rate Determination/Education Program, which involves mutual agreements between restaurant owners and IRS District Directors on the rate of tip income reported by tipped employees. The program is aimed at the problem of unreported tip income and

underreported FICA taxes on tips. The Service has found that the traditional approach (that is, auditing the restaurants and the waiters and waitresses after the returns were filed) was not correcting the problem. Forms 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, often show more charged tips than the total tips reported by the waiters and waitresses. The IRS has decided to try to ensure greater compliance by dealing with the issue before future returns are filed.

Under this new program, the Service is contacting restaurants and offering them a tip agreement. If the restaurants can get 75% of their waiters and waitresses to sign an agreement to report the correct amount of tips (as worked out by the IRS), the Service will agree not to audit the restaurants or their tipped employees on the tip issue as long as they are in compliance with the agreement. The IRS follows the method contained in McQuatters, TC Memo 1973-240, to compute the tip rate. The McQuatters formula uses charged tips as the foundation to establish the tip rate. The Service is using a sample period (it may be as short as 28 days) to develop the formula, which will then be used by the waiters and waitresses when reporting their tip income on their tax returns. The IRS plans to monitor compliance with the tip agreements through the information contained on Forms 8027. The effect on the restaurants - the increased FICA taxes on the tips - is offset by Sec. 45, which allows a credit to employers for FICA taxes paid on tips reported by their employees in excess of the minimum wage.

The Service is using data from Forms 8027 as a starting point for determining which restaurants to contact. Those with the biggest discrepancies between the charged tips shown on Form 8027 and the total tips reported are expected to be the first contacted. IRS personnel have indicated that, if a restaurant does not sign an agreement, the Service will generally conduct a full tip project, auditing both the restaurant and the waiters and waitresses on the tip reporting issue. After the IRS worked out similar agreements with casinos in Las Vegas, the amount of tip income reported increased dramatically; the Service expects this program to have a similar effect.

IRS personnel are aware of the concerns raised by restaurant owners that their employees may leave and go to work for another establishment if the owners try to get them to agree to report the correct amount of tips. This possible outcome was discussed during a recent IRS video conference with field Examination personnel, who were advised to be sensitive to this concern and to avoid creating "an uneven playing field. "

IRS National Office executives have held three meetings with industry representatives and understand that the industry is not happy about the program. IRS personnel explained the problems the Service is trying to address and asked the industry representatives to suggest other approaches for achieving tip reporting compliance. To date, the IRS has received no suggestions.

- This is the Full Content -

-- End --

Subject: tipping
Library: Capital City Libraries

Source: The National Public Accountant, May 1996 v41 n5 p11(1).

Title: Tip reform's blow can be softened for restaurateurs.
Author: Richard E. Hughes

Abstract: The IRS is helping Congress fulfill its goal of higher reporting of tip income especially in the restaurant industry. Restaurants have two options for reporting tip income: Tip Rate Alternative Commitment (TRAC) or Tip Rate Determination Agreement (TRDA). Under TRAC, employers are required to set a method for recording charged tips on a per-employee basis. Under TRDA, participating employees record charged and cash tips at a fixed percentage of total sales. Both of these approaches reject existing practices in the restaurant industry. Restaurants should be prepared for tip reform.

Subjects: Tipping - Accounting and auditing
Restaurant industry - Taxation
Gov Agncy: United States. Internal Revenue Service - Laws, regulations, etc.
SIC code: 5812

Business Collection: 94V1692
Electronic Collection: A18390234
RN: A18390234

Tip reform is real. For quite some time now, the Internal Revenue Service has been working to implement Congress' intent to strive for increased reporting of tip income - particularly at the restaurant level.

Government statistics indicate that a mere 25% of tips are reported - leaving 75% unreported and never taxed at all, either for income tax purposes or for FICA/retirement tax purposes. According to government reports, this results in ten billion dollars of lost revenue.

With a Social Security system in financial disarray and more older adults seeking retirement with less money to live on (because they have relatively little Social Security paid throughout their working lifetime), Congress has pressed the IRS to do better. What "better" may mean to a restaurant owner is trouble. This trouble is going to come very, very soon, both from above and below.

The trouble from above, of course, will be coming from the IRS in the form of audits, penalties, interest - and worse. From below, trouble translates into unhappy employees wanting to move elsewhere to escape the government's wrath. It matters not that this is a government mandate. Perception is reality. Many employees will believe that the employer, not Uncle Sam, is forcing the change on them.

Many restaurateurs remain confused about tip reporting. Some report only charged tips. The tip-allocation procedure may lead others to conclude that as long as they report tips equal to 8% of sales, all parties are safe. This is a dangerous misperception. The 8% figure is not a safe harbor for a restaurateur or employees. The tips recorded on charge receipts are a dead giveaway of a higher tipping rate - and the IRS knows this. It is in the best interest of every restaurateur to hold meetings with employees to apprise them of the IRS' tough new policies.

Restaurants are being given two basic choices: TRAC (Tip Rate Alternative Commitment) or TRDA (Tip Rate Determination Agreement). Neither permits an establishment to continue its practice of reporting - or not reporting - tips, as the case may be.

tips on an employee-by-employee basis. By signed agreement with the employer, the employee must verify his or her tips (taking into consideration tip-outs).

The employer must establish a reasonable method for reporting charged tips received by indirectly tipped employees. The employer must also establish a procedure for employees to report cash tips. This procedure may be similar to the procedure for charged tips.

The restaurateur is also required to educate all tipped employees quarterly so that they understand that the law requires all tips to be reported. A restaurateur's tip policy application requires IRS acceptance. The IRS may reject a TRAC application by an employer for any one of three reasons:

1. Employer's failure to file tax returns or to pay the resulting taxes;

2. Employer's failure to hold educational meetings with employees;

3. An ongoing administrative or judicial action against the employer.

The IRS is not required to inform the employer of the specific reason for rejection. If an application is rejected, the IRS may revoke the establishment's participation, effective with the next calendar quarter.

Under TRDA, participating employees report charged and cash tips at a fixed percentage of total sales, even though some employees may have received more or less than the fixed rate. Tipped rates are determined by the IRS under the "McQuatter's" formula and historical data relative to tips for an establishment's employees.

No specific educational requirements are needed to participate in the TRDA, but employees must be warned that there is an audit risk, both for employer and employees, if fewer than 75% of tipped employees do not comply by signing up (agreeing to report the established percentage). The IRS may terminate the TRDA agreement if this percentage is not met. An employer may, however, terminate the agreement with 30 days written notice, as can the IRS.

Participation requires that an establishment undergo examination by the IRS of two pre-TRDA quarters, which, if not reported properly, could be expensive. In practice, the IRS has not conducted any of these audits after an employer has entered into a TRDA.

Following a termination, the IRS may examine non-participating employees. Under normal circumstances, the IRS probably would not conduct a tip examination of employees who report tips at the pre-determined rate.

Tip reform must be accepted - and faced now. It is advisable for restaurateurs to contact a tax consultant and prepare in earnest for the volumes of paperwork that will be necessary to address the onslaught of additional taxes.

Richard E. Hughes is principal of Hughes, Wilner & Wolfe, an accounting and tax firm that specializes in the food and beverage industry.

- This is the Full Content -

-- End --

Database: Business Index ASAP
Subject: tipping
Library: Capital City Libraries

Source: Nation's Restaurant News, August 19, 1996 v30 n32 p1(2).

Title: Tax breaks salve sting of minimum-wage war.(new legislation)
Author: Robin Lee Allen

Abstract: New federal legislation to raise the minimum wage includes some business tax breaks which will help restaurants cope with the increased expenses of the wages. A new bill would raise minimum wage in two increments a total of $.90 in 14 months. Changes on FICA tip tax credits will save restaurants about $.10 for every dollar they spend on increased wages. The bill also includes a Work Opportunities Tax Credit and allows more deductions for new equipment.

Subjects: Restaurant industry - Taxation
Tipping - Taxation
Wages - Minimum wage
SIC code: 5812

Electronic Collection: A18609869
RN: A18609869

WASHINGTON -- Foodservice operators are finding limited relief in a package of tax breaks intended to cool the burn of the long-awaited 90-cent increase in the federal minimum wage recently approved by Congress.

While most were grateful that the $8.6 billion in tax credits over the next seven years were added to the increase, they noted the impact of the more immediate jump to a $5.15 hourly minimum wage was nonetheless detrimental.

"We still consider it destructive economic policy or at least misguided," said Rick Walsh, senior vice president of corporate relations for Orlando, Fla.-based Darden Restaurants, "but it could have been worse. Congress tried to balance it with some good incentives, which is laudable."

"I haven't heard of anybody jumping up and down and saying, `hooray,' " commented James M. Coleman, general counsel for the National Council of Chain Restaurants, "but depending on what sort of operation you run, there is some good in it."

In a flurry of prerecess activity, a Congress hot to get home and campaign approved the first boost in the federal minimum wage in five years, voting to raise it 90 cents in two phases over 14 months. As proposed, the wage would jump 50 cents, to $4.75, on Oct. 1 and 40 cents more, to $5.15, on Sept. 1, 1997.

Then in a concession to businesses -- like the foodservice industry -- that did not share the public's apparent enthusiasm for the increase, Congress tacked on billions of dollars in business-friendly tax breaks. President Clinton is expected to sign the measure into law.

"We never think an increase in the minimum wage is a good thing," noted Elaine Graham, senior vice president of government affairs for the National Restaurant Association. "But when the political tea leaves showed us very clearly it would happen, we jumped into full gear and tried to do a wide range of things to protect the industry."

For instance, the bill includes an opportunity wage allowing employers to pay workers less than 20 years old $4.25 per hour during their first 90 days of employment. Other huge concessions for the food-service industry were several changes in and clarifications of the FICA tip tax credit. Most notably, business lobbyists were able to freeze at $2.13 cash wages for tipped employees, which increases the tax credit available to many employers. The freeze could save employers with 10 tipped employees nearly $6,500 annually and those with 250 tipped employees nearly $160,000 annually, according to the NRA.

"The freeze recognizes finally that tipped employees earn more than the starting wage already and should not be considered starting-wage earners," Darden's Walsh stated.

Unfortunately, the freeze does not help employers in the seven states, including California, Washington and Oregon, where no tip credit exists. Efforts to help operators in these states win language in the federal bill preempting their no-credit status at the state level failed.

Another major concession for the foodservice industry was a provision expanding the FICA tip tax credit to delivery employees. Currently, tip credits are available only for those employees who make their tips on the business premises.

"Over the past couple of years Domino's and other pizza companies got involved writing letters to people on tax committees and what not," said Harry Silverman, vice president of finance and administration and chief financial officer for Ann Arbor, Mich.-based Domino's Pizza Inc. "People in Washington began seeing it as the same issue."

tips, the minimum-wage increase -- especially coming as cheese prices are near an all-time high -- will basically dilute its beneficial effects, Silverman stated.

"If the minimum wage costs us a dollar, the tip credit will pay us back seven to 10 cents," he said. "We're grateful for it, obviously, but it's small compensation."

The minimum-wage bill also includes a clarification of the 1993 tax law allowing restaurateurs to take a credit for taxes paid on all tips. The Internal Revenue Service previously had stated that no credits could be taken for taxes paid on unreported tips discovered during audits.

Despite each of those changes and clarifications, however, Congress continues to avoid the issue of the classification of tip income, Walsh said.

"Are tips wages or not?" he asked. "If the answer is yes, that's OK, but then the tip credit ought to be 100 percent, so that all tips are used to calculate the starting-wage equation and employers pay FICA on all that's reported and deduct them as labor expenses.

"If not, that's OK, too," he continued, "but then employers shouldn't be required to pay Social Security taxes on it because you pay Social Security only on wages. Nobody wants to answer that question right now, and they've got it both ways."

Another favorable bone in the minimum-wage bill was the inclusion of the Work Opportunities Tax Credit. A revamped version of the Targeted Jobs Tax Credit that expired in 1994, WOTC allows employers a tax credit for hiring people from seven designated economically disadvantaged groups. TJTC, which grew quite controversial before its expiration, targeted nine groups.

"It's targeted fewer people, but the fewer people targeted, the less it costs in terms of foregone tax revenue," NCCR's Coleman said. "But having said all that, it's better than nothing."

WOTC, which will be effective from Oct. 1 to Sept. 31, 1997, will allow employers who hire from specified groups, including food stamp recipients, former felons and high-risk youths, a 35-percent credit for the first $6,000 in wages after 400 hours of employment.

In addition, the minimum-wage bill includes a $7,500 increase in the allowable deduction of new equipment to $25,000 by 2003 for small businesses as well as a loosening of the requirements for forming S corporations, which provide individual tax breaks. Finally, the bill delayed for six months a new rule requiring small businesses to file payroll taxes electronically. Originally, the rule was to take effect Jan. 1, 1997.

While the federal minimum wage is now a foregone conclusion, several separate ballot initiatives still threaten to raise minimum wages even higher at state and local levels.

Residents of California, Oregon, Montana, Missouri and Denver will vote on those initiatives this fall.

- This is the Full Content -

-- End --

Nat-bbs

Source: Nation's Restaurant News, Nov 4, 1996 v30 n43 p1(2).

Title: Court: IRS must confirm tip total before taxing it; tip-tax-liability formula questioned.(Internal Revenue Service)

Author: Richard L. Papiernik

Abstract: The US Court of Federal Claims has overturned the Internal Revenue Service's (IRS) tip-tax-liability formula by which the IRS assesses employers for taxes on unreported tip income of their employees. The decision was a big victory for the restaurant industry. In the case that was adjudicated, Bubble Room Inc. sued the IRS over its employer-only audits of sales records that are used to levy tip taxes on restaurateurs. The court criticized the IRS for failing to validate the tip-tax-liability formula and struck it down.

Subjects: Restaurant industry - Taxation
Restaurateurs - Taxation
Tipping - Taxation
Companies: Bubble Room Inc. - Cases
Gov Agncy: United States. Internal Revenue Service - Laws, regulations, etc.

Electronic Collection: A18851065
RN: A18851065

In the second significant tax ruling affecting restaurants this year, a Florida operator has won a favorable federal court decision overturning attempts by the Internal Revenue Service to hit employers for taxes on allegedly unreported tips.

The court found that the IRS could not base its tax bill on an audit that examined only the restaurant's sales records. Industry leaders immediately hailed the ruling as a precedent-setting ruling that would help clarify a "murky area" of tax law as it applies to tip reporting - but they cautioned that the IRS is almost certain to appeal the decision.

In a statement issued immediately following the ruling, the industry's largest trade and lobbying group, the National Restaurant Association, said, "The restaurant industry. claimed a major victory ... when the U.S. Court of Federal Claims struck down the IRS' `employer only' method of assessing restaurateurs FICA taxes on unreported tips."

The precedent-setting case was brought before the U.S. Court of Federal Claims by Bubble Room Inc. - which at the time operated two restaurants in Florida - with backing from the NRA. Bubble Room challenged the IRS method of using employer-only audits to collect the tip tax from the restaurant

Judge Mariah Blank Horn ruled that the IRS audit of the employer's sales records and tax returns, without direct corroboration that employees had underreported tips, had no basis in law, and she ordered the return of nearly $32,000 plus interests and costs to Bubble Room. In her finding Oct. 21, Horn also criticized the IRS for its "inability ... to validate its methodology in arriving at the tax assessment." She further found that the agency, in its assessment against the employer, erroneously applied a method - known among tax practitioners as the "McQuatters formula" - that is used to estimate tax liability for individuals.

At stake, according to various sources, are taxes on unreported tip income estimated to run anywhere between $7 billion and $30 billion a year.

"We may not necessarily agree on what the exact number is," said Thomas Burger, director of the IRS office of employment tax administration and compliance. "But everyone recognizes the number begins with a `B' for billion not an `M' for million."

He conceded that an appeal was "probable" within the next 60 days and that the decision is being reviewed. Burger also cautioned that the ruling probably would force the agency into a more intensive look at the tax returns of tipped individuals working at bars and restaurants - a program that did not come under review by the courts in recent, cases brought by restaurant operators.

The ruling in Washington, D.C., by a U.S. court that has jurisdiction over federal tax policy litigation, is viewed by the industry as the strongest precedent established to date on the predominant method used by the IRS to force operators to collect the tip tax. A similar ruling disallowing the employer-only audit was issued in February by a U.S. District Court in Alabama as a result of a challenge by Morrison Restaurants Inc. That decision, however, does not carry the same precedent-setting weight in tax policy as the Federal Claims court ruling.

The New York-based Riese Organization, which operates some 200 restaurants, also is contesting the same IRS methodology in filing a similar complaint against the agency in U.S. District Court for the Southern district of New York. The complaint involves eight Riese-operated restaurants.

As a result of the Bubble Room ruling in addition to the previous finding by the U.S. District Court in Alabama, restaurants should see a significant pullback by the IRS in employer-only audits, said Peter G. Kilgore, general counsel for the NRA. Burger conceded that the policy is under review following Judge Horns ruling, but the agency had other ways of monitoring employers for tip reporting.

"If someone still is willing to play the audit lottery ... and they have a low-reporting tip-rate profile," he said, they will be high on our list of first contacts."

Meanwhile, Burger said, the IRS has been continuing with two programs asking for voluntary compliance by employers on tip reporting. Both of the programs, he noted, were started after the actions were taken in the recent cases that involve taxes going back to 1989.

He described the latest program, known as the TRAC, or Tip Reporting Alternative Commitment program, as "good for the IRS and good for the employer because it doesn't involve forcing something down their throats."

The program, which has produced higher taxes, basically requires employers to set up programs for persuading employees to file more accurate returns in exchange for the promise of less auditing pressure. Rick Walsh, a spokesman for Darden Restaurants Inc., agreed that the TRAC program in which his company's restaurants are parties, was an indication that the IRS was very

The Bubble Room decision, Walsh said, is welcomed because it helps to clear up "some very unclear legislation that has evolved on collecting taxes on tips."

"I don't think that there is any dispute in the industry that there certainly is an underreporting of tip income, and there is no dispute that tips are wages under the revenue code and should be reported," said Kilgore of the NRA. "But is it right for the IRS to pass its policing obligation onto the employer?"

"And there were a number of problems with the way the IRS has handled this," he said.

At the heart of the issue, according to the court finding, is that without identifying the specific employees who underreported and the specific amount of their tax obligations, there was no way of applying the collected monies to their FICA accounts.

"The Social Security system was set up to benefit the fund for employees, not for the employer," Kilgore said, so where is the money to go if the IRS can't identify the employee accounts that should benefit?"

The court agreed with that argument, stating, "There is nothing in the statutory language or in the legislative history to suggest that Congress intended ... the IRS to assess an employer only the FICA tax on the aggregate estimate of allegedly unreported tips of employees."

Addressing the IRS argument that the employer-only audits were more efficient for the agency which had to deploy its resources carefully, the court said, "Congress has given ... the IRS the power to enforce accurate reporting of tip income by individuals. If such power is insufficient or too expensive to be practicable, the IRS should take such argument to Congress."

-- End --

Database: Business Index ASAP
Subject: tipping
Library: Capital City Libraries

Source: Tax Notes, Nov 18, 1996 73 n7 p767-770.

Title: Court decisions on tips prompt IRS to halt employer FICA assessments.
Author: Sheryl Stratton

Abstract: The IRS has terminated its program of assessing restaurant employers for tipped employee's FICA taxes, following the 1996 Morrison Restaurants and Bubble Room case decisions holding the IRS was not empowered to make such assessments. Since tips are often underreported or unreported income, the IRS has made several attempts to improve compliance, including employer-only assessments and the unpopular tip rate determination agreement program. The restaurant industry has been somewhat more receptive to the Tip Reporting Alternative Commitment program.

Subjects: Tipping - Taxation
Restaurants - Taxation
Social security taxes - Litigation
Tax collection - Litigation
Cases: Morrison Restaurants, Inc. v. United States - 918 F.Supp. 1504 (S.D. Ala. 1996)
Bubble Room, Inc. v. United States - 78 A.F.T.R.2d (P-H) 96-5477 (Cl. Ct. 1996)
Locations: United States
SIC code: 5812

RN: A18909995

-- End --

Database: Expanded Academic ASAP
Subject: su "tipping"
Library: Capital City Libraries

Source: Esquire, Sept 1994 v122 n3 p60(2).

Title: The case against tipping.
Author: John Berendt

Abstract: The practice of tipping is old-fashioned and demeaning to those who work for tips. Waiters and others who earn tips are paid low wages. Europeans factor in service charges on restaurant bills. Tippers Anonymous and other topics are discussed.

Subjects: Tipping - Social aspects

Magazine Collection: 75B1951
RN: A15824240

-- End --

Database: Expanded Academic ASAP
Key Words: wages minimum
Library: Capital City Libraries

Source: National Journal, Oct 26, 1996 v28 n43 p2289(4).

Title: A bounty for business. (impact of 1996 minimum-wage law)
Author: Julie Kosterlitz

Abstract: The law passed in Aug 1996, to boost minimum wages by 90 cents an hour contains some provisions which will help big business while potentially hurting low-income workers. The bill became a vehicle for many diverse corporate tax breaks, affecting the insurance, banking, computer and chemical industries. Small businesses were given several important deductions. The bill could also put worker pension funds at risk, raise social security taxes, and make employee purchases of their companies more difficult.

Subjects: Wages - Minimum wage
Tax exemption - Political aspects
Small business - Taxation
Employees - Salaries, benefits, etc.

RN: A18854033

-- End --

Database: Expanded Academic ASAP
Subject: su "tipping"
Library: Capital City Libraries

Judge rejects I.R.S. method for assessing taxes on tips. (Judge Marian Blank Horn strikes down Internal Revenue Service's new technique for assessing taxes) David Cay Johnston. The New York Times, Oct 24, 1996 v145 pC1(N) pD4(L) col 6 (17 col in).

Database: Expanded Academic ASAP
Subject: su "tipping"
Library: Capital City Libraries

Source: The New York Times, Oct 24, 1996 v145 pC1(N) pD4(L) col 6 (17 col in).

Title: Judge rejects I.R.S. method for assessing taxes cn tips. (Judge Marian Blank Horn strikes down Internal Revenue Service's new technique for assessing taxes)

Author: David Cay Johnston

Subjects: Tipping - Cases
Restaurant industry - Cases
Waiters - Cases

People: Horn, Marian Blank - Practice

Gov Agncy: United States. Internal Revenue Service - Cases

SIC code: 5812

RN: A18791879

-- End --

Source: Forbes, August 29, 1994 v154 n5 p18(2).

Title: Not so Big Easy. (Internal Revenue Service takes action against employees of New Orleans restaurateur Ella Brennan and family) (Brief Article)

Author: Toni Mack

Subjects: Restaurant industry - Taxation
Tipping - Taxation
People: Brennan, Ella, family - Investigations
SIC code: 5812

Magazine Collection: 75B2121
Business Collection: 82W3390
Electronic Collection: A15707314
RN: A15707314

Perhaps because of their high visibility, the IRS is bullying the Brennans, the New Orleans restaurant operators. Led by matriarch Ella Brennan, the clan runs one of the city's most popular eateries, Commander's Palace, plus three other restaurants there and two in Houston. There's no problem with the family's own taxes, but the IRS wants to punish the Brennans because it thinks some of their employees are cheating on their taxes. Here's the sad story:

Restaurant owners are required to report their revenues to the IRS. The agency can use those figures to decide if it thinks employees are underreporting tip income. The IRS concluded that waiters at two Brennan restaurants had indeed done so. It went after a few of the alleged tax cheats, but mainly it went after the Brennans for not paying $317,754 in payroll taxes on the phantom "income." Seems more than a bit unfair considering that federal labor laws allow restaurateurs no way to keep tabs on their employees' tips.

In this same spirit, the IRS is now asking restaurateurs to sign a "Tip Rate Determination Agreement" under which employees are supposed to report a certain percentage of revenues as tip income. The implicit threat: Don't sign, and you may be audited and held liable for back taxes, as the Brennans were.

"It'll probably cost us $150,000 to fight this in court," says Alex Brennan-Martin, Ella's son, who recently was invited to Washington by the Republican Task Force on Competitiveness to describe his family's travails. "We're a $30 million [revenues] business. We can afford it. But a lot of people can't."

-- End --

Database: Business Index ASAP
Subject: tipping
Library: Capital City Libraries

Source: Nation's Restaurant News, Nov 11, 1996 v30 n44 p4(1).

Title: Employees face added audits after court ruling.(taxation of restaurant employees' unreported tip income)
Author: Richard L. Papiernik

Abstract: Individual restaurant employees will face heightened scrutiny from the Internal Revenue Service (IRS) in light of the Oct 21, 1996 decision by the US Court of Federal Claims that restricted the IRS' right to collect taxes on unreported tip income from restaurant owners. As a consequence of the ruling, the tax returns of key restaurant personnel who receive tip income will be subjected to increased audits by the IRS.

Subjects: Restaurant industry - Taxation
Tipping - Taxation
Income tax - Cases
Gov Agncy: United States. Internal Revenue Service - Investigations
SIC code: 5812

Business Collection: 97X5033
Electronic Collection: A18856093
RN: A18856093

WASHINGTON -- A recent federal court ruling that prevents the Internal Revenue Service from using employer only audits to levy and collect taxes from restaurant operators on unreported tip income will trigger intensified enforcement action against individual restaurant workers, according to a top IRS official.

The Oct. 21 ruling by the U.S. Court of Federal Claims against the IRS in a case involving a Florida restaurant operator "makes it clear we will have to modify the way we are doing the audits," said Thomas R. Burger, director of the IRS Of Office of Employment Tax Administration and Compliance.

Modification in that case means that tax returns--especially from key restaurant workers who generate tip income--will be facing increased audits by the IRS warned Burger, chief of the agency charged with enforcing tax compliance in the restaurant industry. The agency's stance on expanding the audit function to individual returns, Burger said in a telephone interview, was based on a more intensive review of U.S. Judge Marian Blank Ham's ruling in the case brought by Bubble Room Inc. with the backing of the National Restaurant Association.

The court ordered the IRS to return the nearly $32,000 it collected for alleged 1989 tax liabilities from the Bubble Room in addition to paying interest and certain costs involved in litigating the case.

A decision on whether to appeal the ruling, Burger said, is under review by the U.S. Treasury Department. "I think they will appeal, but that decision rests with Treasury," he said.

In arguing the case, the IRS had said it did not have the resources to do the more tedious individual audits and match them up against the sales records of the restaurants. The taxing agency characterized its technique for auditing only the employers' sales records as a valid and much more efficient process for generating FICA tax tip income assessments against employers.

Under the employer-only audit method, the IRS examined the restaurants' credit-card sales, checked the tip rates and, with minor adjustments, applied those rates to cash sales--billing the restaurant operator for the difference. However, there was no corresponding effort to then identify and assess the individuals who underreported their tips and tax liability.

Critics of that system found it created problems not only because it put the burden of compliance on only one party but also because it produced FICA employer payments that went to the general Social Security fund and were not designated for individual benefits accounts as prescribed by law.

The court agreed.

It is that whole employer only auditing process that is being modified, Burger said.

He conceded that individual audits of employees will be more costly and time consuming than the employer only assessment method, which the court struck down, but he said the agency now must "spend the resources" because of the high amount of apparent tax evasion.

Unreported tip income generally runs between $7 billion arid $10 billion a year, according to most estimates by government and industry sources. After recent IRS and industry efforts to step up compliance, however, some government sources have estimated that the amount could reach as high as $30 billion.

Helping to spur such speculation is a recent analysis of the step-up in IRS enforcement of tip-income reporting, which also includes IRS programs for employer agreements to educate employees on the requirements for accurate reporting. That analysis found that reported tip income among restaurant and bar employees went up to about $5 billion a year from the average of about $3 billion in each of the years from 1988 through 1993.

Restaurant industry officials conceded that there is a problem with tip income reporting.

Typical of the industry sentiment was a comment by Carol Dover, executive vice president and chief executive of the 5,000-member Florida Restaurant Association.

"Both the government and the industry acknowledge that there exists a

disparity between the amount of tips reported and the actual amount of tips received," Dover said, "but the methodology that the IRS has chosen to use is what is problematic. ... Under no circumstances should the employer be held liable for the difference."

Joe Yuhas, executive director at the 1,700-member Arizona Restaurant Association, said: "The IRS cannot make the argument that it does not have enough staff to do a fair and responsible audit, and that's the bottom line. If it has a problem with getting the proper resources, then that's a problem it should take before Congress."

The court in the Bubble Room case said it is "sympathetic to the ... [IRS] argument that a substantial amount of employee cash tip income appears to be unreported throughout the-restaurant industry."

However, the court noted that it agreed with a U.S. District Court finding involving the former Morrison Restaurants Inc. and its Ruby Tuesday restaurants in Alabama earlier this year "that employers should not have to police the reporting of tips by employees on behalf of the IRS."

The judge also found that the IRS documentation of tip income in the Bubble Room case "suggests substantial underreporting for 1989 and certainly was significantly below the norm for the industry." Nevertheless, the court concluded: "Even a substantially low reporting of cash tips ... does not justify allowing the IRS to shift its responsibility to the employer for policing the acknowledged problem of underreporting of tips by employees.

"It is the responsibility of the IRS to track down and collect unreported income. If the IRS wishes to shift its duty to employers to ensure proper compliance, it should do so through a congressional enactment and continued cooperation between restaurants and the IRS."

The court pointed out that the IRS and the industry already are engaged in a viable cooperative program known as the Tip it-ate Alternative Commitment, or TRAC, agreement.

The IRS' Burger agreed that the TRAC program is producing good results. Nonetheless, he pointed out, it is the responsibility of his agency to vigorously and immediately pursue compliance in an area that has been-identified as a prime source for unreported tax liabilities.

"There's just too much money out there for us to walk away from," Burger said.

Explaining how the agency will enforce compliance within the ruling handed down by the court, Burger said: "We will talk to the owners of the establishment and pick a representative number of employees. That probably is not going to make everyone happy.

"They probably will be key employees, who, naturally, would be putting in the most hours. We'll talk to the owners and get the payroll records and find who was working at what times and then go from there."

Burger advised servers bartenders and other tip-dependent employees that it would be best for them to keep or submit "contemporaneous records" to establish their own documentation.

"The tip rates may be higher at some hours than at other hours, and tips, infect, may be shared among various employees," he pointed out, noting that various levels of service from those busing tables to bartending might be dividing tips.

"A revenue agent can take those contemporaneous notes from the employees and use them as evidence to establish the proper rates," Burger said.

Meanwhile, Burger pointed to the growth in the IRS TRAC program, noting that

"a significant number of major hotel and restaurant chains have signed up." Under the agreement operators pledge to conduct quarterly education programs for employees about tip-reporting requirements, maintain adequate records and establish procedures to ensure accurate tip reporting by employees. The IRS pledges not to conduct the employer-only audits.

At the end of September Burger said, 2,700 TRAC agreements had been signed representing 16,200 establishments.

-- End --

Database: Business Index ASAP
Subject: tipping
Library: Capital City Libraries

Source: Nation's Restaurant News, March 18, 1996 v30 n11 p1(2).

Title: Morrison beats IRS in FICA tip-tax battle; Alabama court rules against employer-only assessments; IRS weights appeal.(Morrison Restaurants Inc., Federal Insurance Contributions Act)

Author: Robin Lee Allen

Abstract: Morrison Restaurants Inc. won a tax case involving Federal Insurance Contributions Act contributions in a US District Court in Alabama. Morrison objected to the IRS assessment of restaurant employee tip taxes solely on employers. The IRS assesses tip taxes on restaurateurs on the basis of average calculated tip income. In a precedent-setting ruling, the Alabama court ruled against employer-only assessments. The IRS may appeal the court ruling.

Subjects: Restaurants - Cases
Tipping - Taxation
Restaurateurs - Taxation
Federal Insurance Contributions Act
Companies: Morrison Restaurants Inc. - Cases
Statutes: Federal Insurance Contributions Act
Gov Agncy: United States. Internal Revenue Service - Cases
SIC code: 5812

Business Collection: 92Y4166
Electronic Collection: A18115697
RN: A18115697

MOBILE, Ala. - Morrison Restaurants Inc. has prevailed over the Internal Revenue Service in a precedent-setting court decision that could relax the tax agency's ability to strong-arm other foodservice operators into blindly accepting its tip-tax collection agreements.

In an 18-page decision, a U.S. District Court in Alabama ruled that the IRS did not have the authority to assess only employers for FICA taxes based on a calculated average tip income when several employees underreport tip-income amounts. Such practice is common in the IRS' tip rate determination agreement, TRDA, in which operators and their employees agree to pay FICA tip taxes at a predetermined rate to avoid audits.

"We think it's a tremendous victory for this industry, and it puts us on a more equal footing with the IRS and in a better position to negotiate with it," said Tracy Power, who is a partner at Power & Coleman in Arlington, Va.. and represented Morrison in the case.

"There are many overzealous IRS agents who have attempted to force employees to pay tips at 15 percent," she explained. "The employers are scared that they may be audited, so they make their employees do it. And with this [decision], there won't be that type of threat."

The IRS is weighing an appeal.

Even so, some IRS officials question the breadth of the decision now that more foodservice operators enroll in the newer tip-reporting alternative commitment, TRAC, program than in TRDA. The former plan focuses on employee tip-tax education rather than on formulaic collection to increase tip-tax revenues.

"The Morrison case was a direct result of TRDA, which led to negotiations with the food and beverage industry and then TRAC," said Thomas R. Burger Sr., director of the agency's Office of Employment Tax Administration and Compliance. In addition, the IRS can still flex its collection muscle.

"The reaction could be that if we can't do employer-only assessments, we can still do both the employer and the employee," Burger noted. "Obviously, that's much more resource intensive for us and the taxpayer."

Filed in October 1994, the Morrison lawsuit was based on an audit conducted at a Ruby Tuesday in Pensacola, Fla., assessing the unit for $10,124 in tip taxes not paid in 1990 and 1991. Ruby Tuesday is one of Mobile Ala.-based Morrison's concepts.

While the suit did not dispute the facts of the case, it did seek a summary judgment on the manner in which the tax bill was calculated and collected. IRS officials had used "McQuatter's Formula", which is establishes an average tip rate, by finding an average charged tip rate and an average cash tip rate. The formula, which is integral to the IRS' TRDA program, has long been opposed by the foodservice industry as unfair to those employees who make less than the estimated average amount.

In its decision the Alabama court found no statutory basis, or law, allowing the IRS to assess employers FICA taxes for employees' underreported tip income without first auditing each individual employee.

Furthermore, the court said that without such individual investigations, the IRS unjustly was forcing employers to contribute more to FICA coffers than their employees had to pay, which Congress had not intended in its tax laws.

The court also said employees were receiving no benefit from those contributions because individual Social Security accounts were not credited.

The intent of the law is not to force employers to act as police." Power said. "There are very good reasons why the employee is responsible for his or her tip taxes. It's a transaction between an independent third party and the employee. We're the only employer in the country that's being requested to pay over and withhold taxes on income not within our control."

Officials at Morrison were pleased with the decision.

"What this means for Morrison is we'll get our money back - this was a refund case," said John Fountain, a Morrison attorney involved in the suit. "And hopefully it will provide protection for Morrison from future assessments by the IRS."

Other operators could benefit, too, Fountain added.

"Hopefully, other companies will hear about this case and realize they have an option," he said. "And if they go into court, hopefully it will provide a basis to reject the IRS' position."

The IRS' Burger does not expect widespread reaction, however, given TRAC's popularity.

While TRDA had fewer than 500 participants after two years in effect, TRAC has solicited more than 575 agreements, representing 7,000 foodservice units nationwide, in less than a year. Many more agreements are waiting to be processed at regional offices, he added.

"The TRAC initiative is still good for both the employer and the IRS," Burger commented. "It saves resources on both sides."

Ultimately, the IRS' goal remains to collect taxes on the estimated $7 billion to $10 billion in tips that go unreported. Since compliance was stepped up three years ago, the number of Form 8027 documents filed by the restaurant industry has increased 23 percent, resulting in an additional $1.5 billion in reported tips.

"Most employers are well advised to continue to cooperate with the IRS," Power stated. "But in light of this decision, they should steel themselves

up to cooperate in a manner that's fair to employees."

- This is the Full Content -

-- End --

Source: Nation's Restaurant News, May 27, 1996 v30 n21 p3(2).

Title: CRA Lobby Day draws operators to issues.(California Restaurant Association)
Author: alan Liddle

Abstract: There were 60 restaurateurs, restaurant supplier representatives and chain restaurant executives at Lobby Day 1996 in Sacramento, CA, which is sponsored by the California Restaurant Assn. Association members are encouraged to attend this event to meet their elected politicians. Several restaurant owners are concerned about an increase in the minimum wage because their employees receive tips and California is one of only seven states that does not have a tip credit.

Subjects: California - Economic policy
Restaurant industry - Political activity
SIC code: 8611; 5812; 8743
Organizations: California Restaurant Association - Political activity

Electronic Collection: A18330804
RN: A18330804

SACRAMENTO, Calif. - Driven to let California lawmakers know where some foodservice professionals stand on key legislative issues, 60 restaurateurs, chain executives and supplier representatives recently rolled through the capital here.

The operators and suppliers gathered in Sacramento for the California Restaurant Association's annual Lobby Day. Each year the CRA encourages operators from its chapters throughout the state to assemble in Sacramento for a day of meetings with their elected representatives. Participants, armed with CRA-prepared position papers, lobbied Assembly and Senate members for support on a number of measures, including Assembly Bill 2791 - legislation that would give the state's Industrial Welfare Commission the statutory authority to devise a tip credit.

As it now stands, the commission cannot consider a tip credit because the state Supreme Court in 1988 upheld a lower court finding that the IWC could not create a subminimum wage for tipped workers. Gratuities are the property of the employees who receive them, so employers cannot use the existence of such tips to" justify the payment of a lower alternative to the minimum wage, the California court ruled.

California is one of just seven states that do not offer employers some form of tip credit.

Along with asking for support for AB 2791, Gary Honeycutt, chairman of Fresno, Calif.-based BJ's Country Kitchen Inc., asked his representative, Sen. Jim Costa, to oppose attempts to raise the minimum wage. At his restaurant, Honeycutt said, tipped workers are the only people paid minimum wage, and when their gratuities are factored in, they make substantially more than the mandated base rate.

"Raising the minimum wage would only reward the people already making the most money," Honeycutt pointed out.

"My standard [for judging the adequacy of the minimum wage is the cost-of-living index," Costa said.

The lawmaker said he supports a higher minimum wage because California's base wage has remained the same for eight years, while the cost-of-living index has risen.

"I look at all the 49-cent hamburgers we're competing against, and I think what we really need is a minimum pricing law," Honeycutt quipped, suggesting that philosophies such as, Costa's fail to consider the intense pressures on restaurant and retail margins.

The lawmaker told the Fresno delegation that he was not yet sure how he would vote on Assembly Bill 1502, which would give foodservice companies a tax credit of up to 6 percent of the cost of acquiring food-processing equipment. But he warned that the Senate would have to weigh all pending requests for tax credits carefully because "if you add them all together, there is no way in hell you can afford them."

Asking the senator to remember how many jobs are created by the restaurant industry Fresno-area operator Jose Rivas, president of J&A's Taqueria La Mexicana, politely implored Costa to push for this one [tax credit]."

When a group from the Los Angeles area brought up the tax credit with the chief of staff for their Assembly member, Louis Caldera, they were disappointed to hear that the representative probably would oppose it, as he does a similar request by farmers. Caldera prefers to restrict the use of such credits to their original intent, which was to provide large single-site employers, such as manufacturers and fabricators, with an incentive to stay in California, the aide, Jim Gelb, explained.

"But I take in raw food and sell finished products," Lynne Davidson, vice president and manager of Tito's Tacos of Culver City, Calif., said, making a case for restaurants as manufacturing plants.

The California Restaurant Association, along with other employer groups, is supporting Assembly Bill 398, a measure that would eliminate the California requirement that employers pay overtime after eight hours, in favor of federal rules, which require overtime pay after the first 40 hours in a work week. The employers argue that they must now turn down worker requests for more flexible schedules, such as four 10-hour days, because of the high cost of overtime. They also argue that the greater flexibility afforded by the federal standard is needed by the restaurant industry, which serves customers around the clock.

But many opponents of AB 398, including organized labor, contend that the bill is little more than an attempt by employers to put the federal overtime standard in place so they can force workers to put in longer days.

He's pretty uncomfortable with repealing eight-hour overtime without assurances and provisions that the change would be used to help employees and not be used against them,' Gelb said of Caldera.

Requests to support the tax credit for food-processing equipment got a much warmer response from Assembly an George House of Modesto, Calif. He said that if manufacturers and fabricators could have such a credit, why not [a credit! for all?"

That kind of talk was music to the ears of the delegation in House's office, which included government affairs specialists for Taco Bell and KFC, two PepsiCo Inc. chains with substantial holdings in California. Christopher Townsend, Taco Bell's senior director of government and community affairs, said his chain could use the tax credit to help offset unfunded mandates" in California, such as environmental regulations requiring the phasing out of refrigeration equipment using certain coolants.

"Restaurant companies would like to put m some new equipment and HVAC system PepsiCo contract lobbyist and former CRA senior director of government affairs Jo-Linda Thompson told House. "If we could get a credit, you'd see more sales tax.'

House, at the request of the restaurant association and other retailers, is carrying Assembly Bill 2509, which, if adopted, would permit California and community affairs said his chain could use the credit to help offset unfunded mandates" in California, such as environmental regulation requiring the phasing out of refrigeration equipment using certain coolants.

Restaurant companies would like to put m some new equipment and HVAC systems," PepsiCo contract lobbyist and former CRA senior director of government affairs Jo-Linda Thompson told House. If we could get a credit, you'd see more sales tax."

House, at the request of the restaurant association and other retailers, is carrying Assembly Assembly Bill 2509, which, if adopted, would permit California restaurant employers to forgo paying overtime to any employee who earns $25,000 or more per year and whose primary duty is managing others.

Unlike existing California wage orders, which require that managers spend at least half of their time supervising others if they are to be exempt from overtime pay, AB 2509 would permit restaurant companies to classify as overtime-exempt managers employees who supervise others but who do so while spending more than half of their time performing hourly duties, such as cooking or operating a cash register.

Opponents of the bill, including the Teamsters, charge that the measure would aid employers in cheating assistant managers out of overtime pay when just a small part of their workday is spent truly supervising others.

Lobby Day participation was down substantially this year compared with 1995, when more than 120 operators took part. CRA officials attributed much of the fall off to a substantially conflict that forced them to move Lobby Day from April to May, when fewer legislators could take part.

-- End --

Source: Journal of Accountancy, Jan 1994 177 n1 p32(1).

Title: IRS scrutinizes food service industry: are employees reporting tips?

Abstract: Tips received by employees of eating and drinking establishments are fully taxable as compensation for services, and the IRS is acting to address the substantial underreporting of this form of income. Tips are subject to all employment taxes in addition to income tax. Employers are subject to reporting requirements and can be held liable for employees' nonpayment if they fail to file the proper forms. The IRS relies on voluntary compliance, but auditors are alerted when disparities between the receipts of the establishment and the income reported by employees differ substantially.

Subjects: Food service employees - Taxation
Tipping - Taxation
Internal Revenue Code - I.R.C. 3121(q)
Statutes: Internal Revenue Code - I.R.C. 3121(q)
Jurisdctn: United States
SIC code: 5812; 5813

Business Collection: 75W1738
Electronic Collection: A14728732
RN: A14728732

Properly reporting tip income has presented difficulties for the food service industry and the Internal Revenue Service for many years. The problems are attributable to a number of factors, including widespread misunderstanding of what actually is required to be reported and a perceived absence of vigorous IRS enforcement.

According to the U.S. Statistical Abstract, there were 391,500 eating and drinking establishments in the United States in 1990, with a payroll of $46.1 billion. Recent IRS analysis of filings of Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, highlighted some serious concerns, including the number of forms filed compared with the known number of establishments required to file, the significant number of restaurants reporting tips received on charge sales in excess of total tips reported by employees and the reported tip rates.

Reporting Tips

Tips are compensation for services rendered and are fully reportable by recipients under Internal Revenue Code section 6053. Tips also are subject to the full range of employment and withholding taxes. Both the employer and employee portions of Social Security taxes must be paid on tip income.

In 1987, the Omnibus Budget Reconciliation Act extended the employer tax to the full amount of employees' tips by amending IRC section 3121(q), which holds employers liable for Federal Insurance Contributions Act taxes attributable to tip income not properly reported by tipped employees. Section 3121(q) creates the potential for significant contingent tax liabilities to accrue against restaurants or similar establishments. The statute of limitations does not begin to run until gratuities are reported by an employee or until the IRS calculates, through some reasonable means, the proper tax liability and gives notice and demand to the employer.

Employer liability is determined through a simple analysis of charge invoices and employee interviews. Applying methods such as the so-called McQuatters formula (in McQuatters vs. Commissioner [TC Mem. 1973-240] the court said it was reasonable for the IRS to reduce the charge tip rate by 2% to calculate the cash tip rate) long has been held by the Tax Court to be a reasonable basis for calculating the proper amount of tip income and the related employment tax liability. Other reasonable methods also are acceptable.

Employers who operate large food or beverage establishments must file from 8027. If a taxpayer owns more than one restaurant, a form must be filed for each establishment. A large food or beverage establishment is one that provides food or beverages for compensation on premises where tipping is customary and that generally has more than 10 employees.

IRS efforts

The IRS is initiating program to address the high lev of noncompliance in the food service industry. In addition to analyzing form 8027 filings, it sampled specific taxpayers. Numerous examples of apparent nonfiling were encountered.

The IRS program relies heavily on voluntary compliance. Each district office works with restaurants that come forward on their own or by invitation to address their tip rates (both cash and charged). The objective is to have tipped employees report and pay employment taxes accurately and in a timely

rate to be reported. Once agreement is reached on that rate, the IRS agrees that, as long as at least 75% of an establishment's tipped employees report at or above the calculated rate, it will not raise the issue in future examinations of the establishment.

The decision by restaurant owners to participate and encourage their employees to comply restricts their establishments' liability under IRC section 3111. This program enables the IRS to focus the limited resources available for enforcement on the segment of the food service population that chooses not to do so.

Financial reporting implications

In instances of known potential tax liability, the IRS reviewed entities' financial statements to see if these contingent tax liabilities were disclosed; no disclosures were found. When charged tips exceed total reported tips, an obvious potential tax liability exists that should be acknowledged in the entities' audited financial statements. Similarly, nonfiling of form 8027 and large discrepancies between charged tip rates and cash tip rates could indicate to auditors potential understated tax liabilities.

Urging compliance

CPAs have a vested interest in urging their clients to comply with these rules. CPAs expressing opinions on financial statements of companies with contingent liabilities also may have a potential liability if clients do not comply and do not disclose the potential liability in the statements. Practitioners can educate clients to the potential tax exposure and help them develop compliance strategies that will meet IRS guidelines.

- This is the Full Content -

-- End --

SENATE BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTIETH LEGISLATURE - FIRST SESSION

BY THE SENATE LABOR AND COMMERCE COMMITTEE BY REQUEST

Introduced:
Referred:

A BILL

FOR AN ACT ENTITLED

"An Act relating to payment of minimum wages to tipped employees; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

*** Section 1.** This Act may be cited as the Tip Credit Act of 1997.

*** Sec. 2.** AS 23.10.065(a) is amended to read:

(a) Except as provided under (b) and (d) of this section, an employer shall pay to each employee wages at a rate of not less than 50 cents an hour greater than the prevailing Federal Minimum Wage Law for hours worked in a pay period, whether the work is measured by time, piece, commission, or otherwise. [AN EMPLOYER MAY NOT APPLY TIPS OR GRATUITIES BESTOWED UPON EMPLOYEES AS A CREDIT TOWARD PAYMENT OF THE MINIMUM HOURLY WAGE REQUIRED BY THIS SECTION. TIP CREDIT AS DEFINED BY THE FAIR LABOR STANDARDS ACT OF 1938 AS AMENDED DOES NOT APPLY TO THE MINIMUM WAGE ESTABLISHED BY THIS SECTION.]

* **Sec. 3.** AS 23.10.065 is amended by adding a new subsection to read:

(d) An employer must pay a tipped employee a minimum wage of at least $5.25 an hour and, if the employee does not receive an amount in tips that is sufficient to increase the employee's wage rate to the minimum wage under (a) of this section, the additional amount necessary to raise the employee's wage to the minimum wage under (a) of this section.

* **Sec. 4.** This Act applies to work performed on or after the effective date of this Act.

* **Sec. 5.** This Act takes effect immediately under AS 01.10.070(c).

JC -
JS - Y
TB - N
JR - Y
BH - Y
MR - Y

4/14/97 Hudson W/Incl Refs Bruce Objected

0-LS0883\A

HOUSE BILL NO. 237

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTIETH LEGISLATURE - FIRST SESSION

BY THE HOUSE LABOR AND COMMERCE COMMITTEE BY REQUEST

Introduced: 4/7/97
Referred: Labor and Commerce

A BILL

FOR AN ACT ENTITLED

"An Act relating to payment of minimum wages to tipped employees; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* **Section 1.** This Act may be cited as the Tip Credit Act of 1997.

* **Sec. 2.** AS 23.10.065(a) is amended to read:

(a) Except as provided under (b) and (d) of this section, an employer shall pay to each employee wages at a rate of not less than 50 cents an hour greater than the prevailing Federal Minimum Wage Law for hours worked in a pay period, whether the work is measured by time, piece, commission, or otherwise. [AN EMPLOYER MAY NOT APPLY TIPS OR GRATUITIES BESTOWED UPON EMPLOYEES AS A CREDIT TOWARD PAYMENT OF THE MINIMUM HOURLY WAGE REQUIRED BY THIS SECTION. TIP CREDIT AS DEFINED BY THE FAIR LABOR STANDARDS ACT OF 1938 AS AMENDED DOES NOT APPLY TO THE MINIMUM WAGE ESTABLISHED BY THIS SECTION.]

COMMITTEE COPY

* Sec. 3. AS 23.10.065 is amended by adding a new subsection to read:

(d) An employer must pay a tipped employee a minimum wage of at least $5.25 an hour and, if the employee does not receive an amount in tips that is sufficient to increase the employee's wage rate to the minimum wage under (a) of this section, the additional amount necessary to raise the employee's wage to the minimum wage under (a) of this section.

* Sec. 4. This Act applies to work performed on or after the effective date of this Act.

* Sec. 5. This Act takes effect immediately under AS 01.10.070(c).

HB

247

FISCAL NOTE

STATE OF ALASKA
1998 LEGISLATIVE SESSION

BILL NO. HB 247

Revision Date:
Title: Escrow Accounts

Department: Commerce and Economic Development
BRU: Banking, Securities and Corporations
Component: Banking, Securities and Corporations

Sponsor: Labor & Commerce
Requestor: Representative Rokeberg

COMPONENT SERIAL NO.

Expenditures/Revenues (Thousands of Dollars)

OPERATING EXPENDITURES	FY 99	FY 00	FY 01	FY02	FY 03	FY 04
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
CHANGE IN REVENUES	0.0	0.0	0.0	0.0	0.0	0.0

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 General Fund						
1005 GF/Program Receipts						
1006 GF/Mental Health						
Other						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY 98) cost: $ 0.0

POSITIONS

FULL-TIME						
PART-TIME						
TEMPORARY						

ANALYSIS: (Attach a separate page if necessary)

Prepared by: Willis F. Kirkpatrick, Director — Phone: 465-2521
Division: Banking, Securities and Corporations — Date: 1-21-98

Approved by Commissioner: Deborah B. Sedwick — Date:
Agency: Commerce and Economic Development

PREPARER TO PROVIDE ALL DISTRIBUTION COPIES TO GOVERNOR'S LEGISLATIVE OFFICE
For further distribution information, call the Governor's Legislative Office

ALASKA STATE LEGISLATURE
House of Representatives

COMMITTEE MEMBERS

REPRESENTATIVE NORMAN ROKEBERG, CHAIRMAN
REPRESENTATIVE JOHN COWDERY, VICE CHAIRMAN
REPRESENTATIVE BILL HUDSON
REPRESENTATIVE JOE RYAN
REPRESENTATIVE JERRY SANDERS
REPRESENTATIVE TOM BRICE
REPRESENTATIVE GENE KUBINA
COMMITTEE AIDE, SHIRLEY ARMSTRONG
COMMITTEE SECRETARY CATHY WOOD
COMMITTEE HEARING ROOM 17 STATE CAPITOL

INTERIM:
716 WEST 4TH AVENUE, SUITE 640
ANCHORAGE, AK 99501
PHONE: (907) 258-8191
FAX: (907) 258-2916

SESSION:
STATE CAPITOL, ROOM 24
JUNEAU, AK 99801-1182
PHONE: (907) 465-4954
FAX: (907) 465-2040

Labor and Commerce Committee

L&C Has Not Received A Fiscal Note

From The Effected Departments

HOUSE COMMITTEE REPORT

(7)

Date Referred to Committee: April 11, 1997 **FURTHER REFERRALS:**

Date of Committee Action: 4/29/98

The LABOR AND COMMERCE Committee considered: **HB 247**

HOUSE BILL NO. 247 **REGULATION OF ESCROW ACCOUNTS**

"An Act relating to escrow accounts; and providing for an effective date."

recommends it be replaced with the following committee substitute CSHB 247(L+C) [ ] the same title [X] a new title

[ ] additional referral to _____ Committee
[ ] attached amendment(s)

ADOPTS: _____ Letter of Intent

ATTACHES NEW FISCAL NOTE(s): (Dept)

[ ] fiscal note(s) _____

_____

[X] zero fiscal note(s) DCED

_____

APPROVES PREVIOUS: (Dept/Date)

[ ] fiscal note(s) _____

_____

[ ] zero fiscal note(s) _____

_____

SIGNING WITH RECOMMENDATIONS	DP	DNP	NR	AM
John Coonley			✓	
Gary Sanders	✓			
Pat Pegues	✓			
Bill Hudson			✓	
Norm Rokeberg	✓			

CHAIR'S SIGNATURE Norm Rokeberg 4-29-98

Author: Shari_Kochman@gov.state.ak.us at CC2MHS1
Date: 1/20/98 11:46 AM
Priority: Normal
TO: Shirley Armstrong at LAA_TRANS
Subject: Re: Fiscal Notes

i've put in requests for hb 247 and hb 33.
no fiscal note is needed for eo 100 because the program transfer is reflected in the budget. we determined a fiscal note would just complicate/confuse things.

thanks.

_____ Reply Separator _____

Subject: Fiscal Notes
Author: Shirley_Armstrong@legis.state.ak.us ("Shirley Armstrong") at CC2MHS1
Date: 1/19/98 6:39 PM

Dear Shari Kochman,

Please prepare a fiscal notes for:

HB 247	Regulation of Escrow Accounts - Dept of Commerce
EO 100	Moving the Silver Hand Program From DCED to DOE Dept of Commerce and Education
HB 33	Real Estate Licensing - Dept of Commerce

Thanks

Shirley

Nan,
If they cannot get the fiscal notes done - then L+C will put a zero fiscal note on it. Need response. Shirley

Suggested changes for HB 247

Section 3
Page –4-
Sec.34.75.090. Definitions.
Line20
(5) "financial institution" means a financial institution;

(A) whose deposits are insured by an agency of the federal Government.

[this would correctly state the intent of current (A) and (B)]

Section 4
Page –5-
Sec.45.55.110(g) why put in Bill

It is requested that this reference to the Alaska Securities Act be excluded from the Bill. This provision of escrowed and impounded funds does not relate to real or personal property transactions. In a public offering of a security, promoters may be required to restrict their distributions of "cheep" promoters stock for a period of time. If the public offering requires a certain amount of dollars to be raised for a specific purpose, to make the purpose successful, the division may require that the funds be placed in an escrow account. If the offering is successful in raising the specific amount of funds the division will release them to the issuer. Should the offering not be successful in raising the specific amount of funds, the division will then have the funds returned to the investors.

Securities are generally considered intangible shares of ownership, debt or preference and would seem to fall outside of the Legislative Purpose (Section 1. ... in the course of property transactions)

Willis Kirkpatrick
2521
FAX 2549

FAX TRANSMITTAL

STATE OF ALASKA
DEPARTMENT OF COMMERCE
AND ECONOMIC DEVELOPMENT

DEBORAH B. SEDWICK
COMMISSIONER

DIVISION OF BANKING,
SECURITIES AND CORP.
P.O. BOX 110807
JUNEAU, AK 99811-0807
TELEPHONE: (907) 465-2521
FAX: (907) 465-2549

TO: Shirley Armstrong DATE:

COMPANY: Venco L&C

FAX NO.: 2040

FROM: Willis Kirkpatrick (Banking) DCED

NUMBER OF PAGES: 2

HARD COPY TO FOLLOW? ☐ YES ☒ NO

RE:

Hope this makes some sense WK

If this FAX does not transmit properly, please call
(907) 465-2521 immediately

ALASKA MORTGAGE BANKERS ASSOCIATION
RESOLUTION

WHEREAS, the Alaska Mortgage Bankers Association is a non-profit association whose main purpose is to educate those associated with any facet of the finance portion of the home ownership process thus encouraging home ownership by providing access to affordable housing loan programs,

WHEREAS, the Alaska Mortgage Bankers Association promotes and supports affordable loans programs for Alaskans such as the Alaska Housing Finance Corporation's Tax Exempt Programs, Anchorage Neighborhood Housing Services' various loan programs, Municipality of Anchorage's ANCHOR program and Cook Inlet Housing Program,

WHEREAS, the Alaska Mortgage Bankers Association believes that knowledgeable Real Estate Professionals are a valuable and integral part of the education process for buyers and sellers, especially in understanding and executing a real estate contract,

WHEREAS, the Alaska Mortgage Bankers Association concludes when third party affinity groups become involved in Real Estate transactions, the consumer is likely to be referred to an affinity partner who may provide limited, if any, education of the Alaska home buying process and who may restrict referrals to lenders who do not actively promote affordable Alaska home loan programs,

THEREFORE RESOLVED, the Alaska Mortgage Bankers Association hereby supports enforcement of Alaska Statute 08.88.161 which states in part, "Unless licensed as a real estate broker, associate real estate broker, or real estate salesman, a natural person, foreign or domestic corporation, or partnership, or limited partnership, or other entity may not .... (5) assist in or direct the procuring of prospective buyers..." , and

FURTHERMORE, the Alaska Mortgage Bankers Association supports a regulatory ruling or legislative statute that would extend the intent of this statute to include non-payment of fees to a broker or other agent if it is known that the broker intends to pass that fee through to an unlicensed party.

Amber Hutchens, President
Alaska Mortgage Bankers Association
12/12/97

JOHN CARMAN
HOMESTATE MORTGAGE
3201 C ST #105
ANCH, AK 99503
907 762 5890
F
HOME ADDRESS
12120 RUSKWOOD CIR
ANCH, AK 99516

AGENDA
January 21, 1998

Good Afternoon

This Meeting Of The House Labor & Commerce Committee Is Called To Order
On January 21, 1997 At 3:15 P.M.

For The Record The Committee Members Present or on Teleconference are:

Rep. Norman Rokeberg, Chairman
Rep. John Cowdery, Vice Chairman
Rep. Bill Hudson
Rep. Joe Ryan
Rep. Jerry Sanders
Rep. Tom Brice
Rep. Gene Kubina
Committee Secretary, Paula Smedley

If A Committee Member Arrives Late Announce:
Representative (Name) Has (Joined) (Left) The Committee At (Time).

A Quorum (Is) (Is Not) Present.

On Today's Calendar We Have:

1. A public hearing on:

HB 247 Regulation of Escrow Accounts

Anyone Wishing To Testify On HB 247 and Who Has Not Already Done So, Please Sign The Witness Register For The Secretary, Printing Your Name, Address, Telephone Number, Agency Or Business And Title.

Witness Testimony Will be Limited To 3 to 5 minutes

2. EO 100 Moving the "Silver Hand" Program For Native Handicrafts from DCED to DOE

1. Tom Lawson, Dept of Commerce
2. Helen Harwood, Dept of Education, Council on the Arts

Witness Testimony Will be Limited To 3 to 5 minutes

Take Testimony In Order, Recognizing Each Witness By Name:

1. Other Legislators (Ask Other Legislators To Join The Committee At The Table)
2. Individuals With Time Constraints
3. Individuals In Order On Witness List.
4. Teleconferenced Testimony Should Be Rotated Between Locations. (Teleconference Moderator Will Provide You With A List Of Witnesses At The Various Locations)

THIS COMMITTEE STANDS AJOURNED AT (time)

REC 1/20/98 - 10:35AM
ak

ALASKA STATE LEGISLATURE
House of Representatives

COMMITTEE ASSIGNMENTS:

LABOR & COMMERCE COMMITTEE, CHAIRMAN
SPECIAL COMMITTEE ON OIL & GAS, MEMBER
JUDICIARY COMMITTEE, MEMBER
CORRECTIONS BUDGET SUBCOMMITTEE, MEMBER
ADMINISTRATION BUDGET SUBCOMMITTEE ,MEMBER
HESS BUDGET SUBCOMMITTEE, MEMBER

INTERIM:
716 WEST 4TH AVENUE, SUITE 640
ANCHORAGE, AK 99501
PHONE: (907) 258-8191
FAX: (907) 258-2916

SESSION:
STATE CAPITOL
JUNEAU, AK 99801-1182
PHONE: (907) 465-4968
FAX: (907) 465-2040

Representative Norman Rokeberg

SPONSOR STATEMENT
HOUSE BILL 247
An Act Relating to Escrow Accounts
GOOD FUNDS

At the request of the Alaska State Escrow Association, I introduced House Bill 247 in an effort to assure consumers that their money will be safe and properly accounted for when delivered to a settlement agent for a property transaction. Currently, there are no Alaskan laws addressing these concerns.

The bill has the support of the Alaska State Escrow Association. Consumers need to be assured that their funds (which can be rather large amounts) will not be jeopardized and will be available as needed during the course of a real estate transaction. From the seller's viewpoint, the execution of a deed and the deposit of that deed will bring forth proceeds upon recording of the deed. Under current Alaskan business practices, a buyer deposits a cashier's check prior to recording a property deed; however, this is not the case if a lender provides the purchase funds. In the case of a lender, the deed is recorded along with the lender's lien and the funds are deposited after the deed and other documents have been recorded.

This procedure leaves sellers and settlement agents in the middle. The seller's interest in the property has been transferred but no funds have been received. This bill requires that before a settlement agent records documents transferring property or creating a security interest in the property other than the seller's current interest that the money required under the escrow agreement must be available for distribution in accordance with AS 34.75.040 as set forth in the bill.

The basic thrust of the bill is to protect Alaskans who are selling their property and to make sure that the funds due those sellers are available in a timely fashion.

I would urge your support of this legislation.

ED1:01/20/98

[redacted]

SPONSOR STATEMENT

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
LEGISLATIVE AFFAIRS AGENCY
STATE OF ALASKA

(907) 465-3867 or 465-2450
FAX (907) 465-2029
Mail Stop 3101

130 Seward Street, Suite 409
Juneau, Alaska 99801-2105

MEMORANDUM April 11, 1997

SUBJECT: Sectional Summary of HB 247 (Work Order No. 20-LS0635\B)

TO: Representative Norman Rokeberg
Attn: Janet Seitz

FROM: Theresa Bannister
Legislative Counsel

You have requested a sectional summary of the above-described bill.

As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents.

Section 1. States that the purpose of the Act is to assure the public that their money will be safe when delivered to a settlement agent for a property transaction.

Section 2. Amends AS 21.66.250 (in the chapter on title insurance companies) to make its trust fund provisions subject to the proposed new chapter on escrow accounts.

Section 3. Establishes a new chapter on escrow accounts.

Sec. 34.75.010. States that the money in an escrow account does not belong to the settlement agent and cannot be used to satisfy a claim against the agent. Prohibits using escrow money for anything other than what the escrow account agreement calls for. Prohibits paying out or using escrow money until the conditions for its use are satisfied.

Sec. 34.75.020. Directs a settlement agent to separate the money of one escrow account from all other money and to show this in the records. Requires the settlement agent to deposit escrow money in a bank or other financial institution in this state.

Sec. 34.75.030. Prohibits collecting or paying interest on escrow money unless the parties agree to do so.

Sec. 34.75.040(a). Establishes the circumstances when a settlement agent may pay out escrow money.

[redacted]

— SECTIONAL ANALYSIS —

Sec. 34.75.040(b). Prohibits paying out escrow money on the same business day as when the checks, drafts, money orders, and transfers are deposited, unless the money is received for deposit in certain forms, e.g. cash.

Sec. 34.75.040(c). Describes the circumstances when a settlement agent can pay out escrow money on the business day after the business day the items representing the money are deposited.

Sec. 34.75.040(d). Defines a phrase for the section.

Sec. 34.75.050. Prohibits a settlement agent from recording, filing, or delivering escrow documents until the money to be paid out is available under AS 34.75.040 for payment.

Sec. 34.75.060. Subjects a settlement agent who wilfully violates the chapter to a civil penalty.

Sec. 34.75.070. Directs the Department of Commerce and Economic Development to supervise compliance with this chapter. Limits when the department may audit a settlement agent and limits the scope of the audit.

Sec. 34.75.080. Allows the Department of Commerce and Economic Development to adopt regulations for the chapter.

Sec. 34.75.090. Defines certain terms for the chapter.

Section 4. Amends AS 45.55.110, a section in the Alaska Securities Act of 1959 (AS 45.55) that deals with the registration of securities. Makes the conditions established for a required escrow account subject to the new chapter on escrow accounts.

Section 5. Applies this Act to escrow accounts that are set up on or after the Act's effective date.

Section 6. States that the act goes into effect January 1, 1998.

If I may be of further assistance, please advise.

TLB:jdr
97-263.jdr

January 16, 1998

Alaska State Escrow Association
P.O. Box 242614, Anchorage, AK 99524-2614

Representative Norman Rokeberg
Alaska State House of Representatives
State Capital
Juneau, AK 99801
FAX #(907)465-2040

Re: HB 247 - Good Funds

Dear Representative Rokeberg:

On behalf of the Alaska State Escrow Association I am writing in support of the proposed House Bill #247, as shown in version "B". The Alaska State Escrow Association is an association of settlement professional with members throughout all of Alaska. We are a member of the American Escrow Association, whose mission is to enhance the education of the escrow settlement professional; improve escrow settlement services; promote uniformity in such services and increase public knowledge and understanding of such services.

As escrow settlement professionals, we see this proposed legislation as a way to assure the public that their funds will not be jeopardized and will be available during the course of a real estate transaction. In most cases, a settlement agent provides a place for money and documents to be deposited and exchanged under certain conditions. A seller executes a deed to the property and deposits it into escrow with the understanding that he or she will receive the sale proceeds upon recording of the deed. Current business practice in Alaska generally requires that a buyer deposit a cashier's check prior to recording a deed to the property. The same is not required of lenders providing the purchase funds. The deed is recorded along with the lender's lien or deed of trust. The lender deposits the loan funds after the deed and deed of trust have been recorded. Although, on the surface, this may appear a reasonable business practice, it is potentially a volatile situation if the lender refuses or is unable to fund the loan with sellers and settlement agents caught in the middle. The seller's interest in the property has been relinquished yet the seller has received no sale proceeds nor have his or her existing liens been paid off.

The real estate lending industry is required to provide many disclosures to its borrowers, however most seller and borrowers alike have no idea of this current practice. The need for the good funds legislation is stronger than ever in the fast pace of today's business. With electronic mail and computer networks available, meeting the guidelines of this legislation should not cause undue hardship on any party.

We urge you to support this proposed legislation as we are convinced that its passage will provide consumers with the protection they deserve and the service they expect. Please feel free to call me at (800)770-0510 should you have any questions.

Sincerely,

D.J. Webb
Legislative Affairs Chair
Alaska State Escrow Association

[redacted]

LETTERS OF SUPPORT

ALASKA LAND TITLE ASSOCIATION

P.O. Box 241811 • Anchorage, Alaska 99524

January 19, 1998

Representative Norman Rokeberg
Alaska State Legislature
House of Representatives

Dear Representative Rokeberg:

The Alaska Land Title Association hereby supports the proposed House Bill 247, An Act Relating to Escrow Accounts - Good Funds.

Respectfully submitted,

Steve Jewett
President

First American Title Company of Alaska

510 W. TUDOR, SUITE 1 ANCHORAGE, ALASKA 99503 PHONE (907) 562-0510 FAX (907) 562-0173
CUSTOMER SERVICE (907) 562-0501 ESCROW (907) 562-0504 TOLL FREE (800) 770-0510

January 19, 1998

Representative Norman Rokeberg
Alaska State Legislature
House of Representatives

Dear Representative Rokeberg:

First American Title Company of Alaska is in support of the proposed House Bill 247, An Act Relating to Escrow Accounts - Good Funds.

Very truly yours,

Steve Jewett
President

First American Title Insurance Company
510 W TUDOR, SUITE 1 ANCHORAGE, ALASKA 99503 PHONE (907) 562-0510 FAX (907) 562-0173

January 19, 1998

Representative Norman Rokeberg
Alaska State Legislature
House of Representatives

Dear Representative Rokeberg:

In regards to House Bill 247, An Act Relating to Escrow Accounts - Good Funds, First American Title Insurance Company is in support of the proposed bill.

Very truly yours,

Steve Jewett
Vice President

Pacific Rim Title Insurance Agency, Inc.
307 E. Northern Lights Blvd., Anchorage, Alaska 99503 • (907) 274-2562 Fax (907) 258-4656

January 20, 1998

Representative Norman Rokeberg
Alaska State Legislature
House of Representatives
State Capitol
Juneau, Alaska 99801-1182
Telephone (907) 465-4968
Fax (907) 465-2040

JAN 20 1998

Re: HB 247 – Good Funds Legislation

Dear Representative Rokeberg:

Thank you for the fax from your office on January 17, 1998 with regard to House Bill 247 and your proposed "Sponsor Statement". I have reviewed your statement and found that in my opinion it succinctly describes the present situation in Alaska and the possible pitfalls of sales of real estate.

From the viewpoint of Pacific Rim Title Insurance Agency, Inc., this legislation is welcome and long over due. As you understand we do not, as escrow agent, dictate the terms of a transaction, but there are times that we are uncomfortable with what is happening.

Statute requirements dealing with the delivery of funds will greatly aid the industry in working with sellers and buyers in completing their transaction as agreed rather than as dictated by the lender. The concern of the industry is when promised funds are not delivered in a timely manner after the documents have been recorded. Even though all parties in theory understand the situation we know that the reality of the "possibility of no funds available" does not come home until it happens. During the bad times of the middle 1980s we did have lenders from the outside who failed to deliver funds in a timely manner causing great concern for all parties involved. Even if funds are delivered as promised we find it ironic that sellers pay interest on their old loans until funds are sent to that lender while the buyer pays interest on the new loan from the date of closing rather than the time of delivery of funds. This practice causes the potential double charging of interest.

Please feel free to use this letter with regard to your proposed legislative.

Sincerely,

Jeff Blake

Jack White Real Estate
Since 1953

3201 C Street
Suite 200
Anchorage, Alaska
99503-3994

Bus. (907) 563-5500
Fax (907) 762-3189

December 12, 1995

First American
Lynn Hart
510 West Tudor #1
Anchorage, AK 99503

Re: Good Funds Legislation

Dear Lynn:

In our age of electronic mail and network capabilities it is more important than ever we have the "Good Funds" legislation. We no longer deal with just local lenders, but with national companies. Once documents record it can no longer be assumed that funding will happen immediately thereafter. Just a year ago I was dealing with such a situation.

An earnest money agreement was accepted and signed by both buyer and seller in October of 1994. The home was scheduled to close by mid December. After numerous delays, the sale finally recorded just before Christmas. After recording, the buyer went to the home and found a minor leak from ice dams in the foyer & breakfast area. He immediately called the out-of-state lender and asked them to halt funding.

Originally the buyer wanted the roof repaired, the wall torn apart and dried, any wet insulation replaced, then everything put back together. The seller felt it was not necessary to do such extensive repair for a minor ice dam.

When this information was given to the buyer, he said if the seller was not going to do the repairs to his specifications, he would only deed the property back to the seller after reimbursement of all costs he incurred during the purchase. The seller however had to continue making mortgage payments

on a home he no longer had title to. Fortunately there was no damage, (i.e. fire, vandalism) that would have generated an insurance claim. We don't know whether the insurance covered the home when the seller wasn't in title but was still responsible for the house payments. The buyer held the property hostage and asking the seller to pay the ransom.

At this point attorneys got involved. It took two more months before they reached a compromise and resolved the issues. Until then the buyer held title to the property, but the seller was responsible for the previous mortgage, insurance payments, utilities and the property's safety.

The property was resold shortly after it was deeded back to the seller.

It was a nightmare come true for all concerned. It can still happen, even though we are aware of the loophole. There are many laws and standard procedures on the books to protect both buyers and sellers during the sales process. However, the real question is when is a deal a deal. Society and the real estate industry believe that once a transaction is recorded — it's over. Without the "Good Funds" legislation the chance for abuse is tremendous.

Sincerely,

Clair Ramsey
Associate Broker

HB247

ALASKA ASSOCIATION OF REALTORS, INC.
741 Sesame Street, Suite 100 • Anchorage, Alaska 99503
Telephone 907-563-7133 • Fax 907-561-1779

Representative Norm Rokeberg
State Capital
Juneau, AK 99801

January 20, 1998

Dear Representative,

The Alaska Association of REALTORS®, with its over 1100 members statewide, joins with the Alaska Escrow Association in support of HB 247, an act relating to escrow funds.

This legislation would assure the public that funds are in fact available to pay off a sellers existing loan upon recording of documents. Settlement agent policies and procedures will be standardized and clear to both the real estate and lending communities. In addition Alaska statutes will parallel the statutes of most of the States in the Western U. S.

AAR supports passage of HB 247

Sincerely,

Dea Turner

Dea Turner
Executive Vice President

01-21-98P12:32 RCVD

ALASKA STATE LEGISLATURE
House of Representatives

INTERIM:
716 WEST 4TH AVENUE, SUITE 640
ANCHORAGE, AK 99501
PHONE: (907) 258-8191
FAX: (907) 258-2916

SESSION:
STATE CAPITOL, ROOM 24
JUNEAU, AK 99801-1182
PHONE: (907) 465-4954
FAX: (907) 465-2040

Labor and Commerce Committee

MEMORANDUM

TO: Representative Norman Rokeberg, Chairman
Representative John Cowdery, Vice Chairman
Representative Bill Hudson
Representative Joe Ryan
Representative Jerry Sanders
Representative Tom Brice
Representative Gene Kubina

FROM: Shirley Armstrong, Staff
House Labor & Commerce Committee

DATE: April 29, 1998

SUBJECT: **Additional Backup For Committee Bill Packet - HB 247**

Attached is information that has come to the House Labor and Commerce Committee since our committee hearing.

Please insert in your HL&C, HB 247 committee packet.

Attachment

First American Title Company of Alaska

610 W. TUDOR, SUITE 1 ANCHORAGE, ALASKA 99503 PHONE (907) 562-0510 FAX (907) 562-0173

FAX COVER LETTER

Date 4/28/98 **Time** 3:40

To: Janet

Rep. Rokeberg's Office

Fax: (907) 465-2040 **Phone:**

From: D.J. Webb , Legislative Affairs Chair, Alaska State Escrow Assoc.
Phone #(907) 562-0510 (800)770-0510 Fax #(907)562-0173

Re: HB 247

Comments:

I have reviewed the draft changes to HB 247 which replaces "transaction" for "accounts and do not have a concern over that change. The definition of transaction and financial institution are also fine.

I look forward to passage of this bill and hope you will call on me if I can assist further.

0-LS0635\K
Bannister
4/28/98

CS FOR HOUSE BILL NO. 247(L&C)

IN THE LEGISLATURE OF THE STATE OF ALASKA

TWENTIETH LEGISLATURE - SECOND SESSION

BY THE HOUSE LABOR AND COMMERCE COMMITTEE

Offered:
Referred:

Sponsor(s): REPRESENTATIVE ROKEBERG BY REQUEST

A BILL

FOR AN ACT ENTITLED

"An Act relating to the characterization of, use of, segregation of, deposit of, interest on, and disbursement of escrow money; relating to the recording, filing, and delivery of escrow documents; relating to civil penalties for violations of certain escrow provisions by escrow settlement agents; relating to the supervision by the Department of Commerce and Economic Development of escrow settlement agents; and authorizing the adoption of regulations to implement certain escrow provisions."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* **Section 1.** LEGISLATIVE PURPOSE. The purpose of this Act is to provide maximum assurance to the public that their money will not be placed in jeopardy when entrusted to a settlement agent in the course of residential real property transactions.

* **Sec. 2.** AS 21.66.250 is amended to read:

Sec. 21.66.250. Trust funds. <u>Except as provided in AS 34.80, trust</u>

[TRUST] funds or assets held in a fiduciary capacity by a title insurance company that is authorized to do a trust business shall be invested in accordance with AS 06.25.

*** Sec. 3.** AS 34 is amended by adding a new chapter to read:

Chapter 80. Escrow Transactions.

Sec. 34.80.010. Characterization of escrow money. The money that is received by a settlement agent for an escrow transaction is not the property of the settlement agent and is not subject to execution, attachment, or other form of collection for a claim against the settlement agent. Escrow money may not be used for a purpose other than to fulfill the terms of the escrow transaction agreement and may not be disbursed or otherwise used until the happening of the event or performance of the condition on which the delivery of the money is conditioned.

Sec. 34.80.020. Segregation and deposit of escrow money. (a) A settlement agent shall segregate the escrow money from one escrow transaction from all other money, including the escrow money of other escrow transactions. The records of a settlement agent must reflect this segregation.

(b) A settlement agent shall deposit escrow money in a depository escrow account of a financial institution located in this state.

Sec. 34.80.030. Interest on escrow money. Notwithstanding any other provision of law, interest may not be collected or paid by a settlement agent on money held for an escrow transaction unless authorized in writing by the parties to the escrow transaction, including the settlement agent.

Sec. 34.80.040. Disbursement of escrow money. (a) A settlement agent may not disburse escrow money unless items that are at least equal in value to the proposed disbursements have been received by the settlement agent for the escrow transaction, have been deposited as required by AS 34.80.020(b), and are available for withdrawal as a matter of right from the depository escrow account.

(b) A settlement agent may not disburse escrow money on the same business day as the items are deposited under AS 34.80.020(b) unless the deposit is made in cash, by interbank electronic transfer, or in a form that permits conversion of the deposit to cash on the same day the deposit is made.

(c) A settlement agent may not disburse escrow money on the business day

after the business day on which the items are deposited under (a) of this section unless the deposit is made by

(1) a cashier's check or a certified check if the cashier's check or certified check is payable in the state and drawn on a financial institution located in the state;

(2) a cashier's check, a negotiable order of withdrawal, a money order, or another item if the check, order of withdrawal, money order, or other item has been finally paid before the disbursement; or

(3) a depository check, including a cashier's, certified, or teller's check, that is governed by 12 U.S.C. 4001 - 4010 (Expedited Funds Availability Act).

(d) In (a) of this section, "available for withdrawal as a matter of right" means

(1) when the item has been submitted for collection and payment for the item has been received;

(2) when the financial institution where an item has been deposited considers the money represented by the item available for withdrawal; or

(3) unless written notification has been received from the financial institution where the item was deposited establishing a longer period for an item drawn on an out-of-state financial institution, after a reasonable time has passed for prohibiting customers from drawing on the item.

Sec. 34.80.050. Recording, filing, or delivery of escrow transaction documents. A settlement agent may not record in the office of the recorder in this state or record in an office in another state that is equivalent to the office of the recorder, file under AS 45.09 in this state or file under an equivalent statute in another state, or deliver a conveyance of property, loan documents, documents establishing a security interest in property, or other documents from an escrow transaction until the money required by the escrow transaction agreement to be disbursed at the same time is available for disbursement under AS 34.80.040.

Sec. 34.80.060. Civil penalty. A settlement agent who wilfully violates this chapter is liable to the state for five times the amount of the consideration paid to the agent for the services rendered for the escrow transaction that is the subject of the violation. In this section, "settlement agent" does not include an employee of a person

who engages in the business of handling escrow transactions.

Sec. 34.80.070. Department supervision. The department shall supervise the compliance of settlement agents with the provisions of this chapter, except that the department may not audit a settlement agent's records and accounts unless a person who is a party to an escrow transaction of the settlement agent has complained in writing to the department about the agent's noncompliance with this chapter and the audit is limited to the records and accounts of the escrow transaction to which the person is a party.

Sec. 34.80.080. Regulations. The department may adopt regulations under AS 44.62 (Administrative Procedure Act) to implement this chapter.

Sec. 34.80.090. Definitions. In this chapter,

(1) "department" means the Department of Commerce and Economic Development;

(2) "depository escrow account" means an account that holds escrow money pending completion of an escrow transaction, and that is in a financial institution;

(3) "escrow transaction" means a transaction where, for the purpose of effecting and closing the sale, purchase, exchange, transfer, encumbrance, leasing, or other disposition of an interest in residential real property,

(A) money, written documents, evidence of title to real or personal property, or other things of value are delivered to a person for retention until the happening of a specific event or the performance of a prescribed condition; and

(B) upon the happening of the event or performance of the condition, the person holding the things of value delivers them to the persons entitled to them under the escrow transaction agreement;

(4) "escrow money" means the money that is received by a settlement agent for an escrow transaction;

(5) "financial institution" means a financial institution

(A) whose accounts are insured by an agency of the federal government;

(B) that is located in this state and does not meet the requirements of (A) of this paragraph, but is subject to regulation by the division of banking, securities and corporations in the Department of Commerce and Economic Development; or

(C) that is located in another state and does not meet the requirements of (A) of this paragraph, but is subject to regulation in the other state by an agency comparable to the division of banking, securities and corporations in the Department of Commerce and Economic Development;

(6) "item" means cash, a check, a negotiable order of withdrawal, a share draft, a traveler's check, a money order, or an interbank electronic transfer; in this paragraph, "check" includes a cashier's check;

(7) "residential real property" means real property on which is located a building containing one to four dwelling units;

(8) "settlement agent" means a person who engages in the business of handling escrow transactions, but does not include a financial institution or person who collects money for the sole purpose of applying the money to the payment of a loan during the term of the loan; "settlement agent" includes an employee of a person who engages in the business of handling escrow transactions when the employee is carrying out the employee's duties in the business.

*** Sec. 4.** This Act applies to escrow transactions that begin on or after the effective date of this Act. In this section, "escrow transaction" has the meaning given in AS 34.80.090, enacted by sec. 3 of this Act.

*** Sec. 5.** This Act takes effect January 1, 1999.

HOUSE COMMITTEE REPORT

(7)

Date Referred to Committee: April 11, 1997 **FURTHER REFERRALS:**

Date of Committee Action: 4/29/98

The LABOR AND COMMERCE Committee considered: **HB 247**

HOUSE BILL NO. 247 **REGULATION OF ESCROW ACCOUNTS**

"An Act relating to escrow accounts; and providing for an effective date."

recommends it be replaced with the following committee substitute CSHB 247(LTC) [ ] the same title [X] a new title

[ ] additional referral to _____ Committee
[ ] attached amendment(s)

ADOPTS: _____ Letter of Intent

ATTACHES NEW FISCAL NOTE(s): (Dept)

[ ] fiscal note(s) _____

_____

[X] zero fiscal note(s) DCED

_____

APPROVES PREVIOUS: (Dept/Date)

[ ] fiscal note(s) _____

_____

[ ] zero fiscal note(s) _____

_____

SIGNING WITH RECOMMENDATIONS	DP	DNP	NR	AM
John Coudrey			✓	
John Sanders	✓			
Jan Ryan	✓			
Bill Hudson			✓	
Norm Rokeberg	✓			

CHAIR'S SIGNATURE Norm Rokeberg 4-29-98

February 25, 1998

Norman:

RE: HB 247

(Note: page and line references are to original bill as introduced)
Changes suggested by Bankers:

Page 5, line 8:
AFTER: "but does not include a"
INSERT: "financial institution or"

Page 3, line 12:
AFTER: "of escrow documents."
DELETE: "A"
INSERT: "Unless the party to the escrow agreement that is to provide the escrow money is a financial institution that conducts general deposit business in this state, a"

These two suggestions would: (a) excepts the Bankers' Association from the definition of "settlement agent"

(b) narrows the requirements under the "recording, filing, or delivery of escrow documents" provisions.

Norman, from my brief discussion with DJ Webb prior to receipt of this proposed language, she indicated that it was their intent to cover local financial institutions. You need to talk with her (1-800-770-5010). They want to get moving on this.

Page 3, line 25. Kirkpatrick cannot understand what the Department is to supervise and wants language setting out whether or not the Department can issue cease and desist orders, fine (in what range – which is already in the bill), etc.

Page 5, Section 4 – DELETE entire section

Page 4, line 20
AFTER: "financial institution"
INSERT: (A) whose deposits are insured by an agency of the federal government

Apparently then you would delete lines 21-26, renumber remaining sections as Kirkpatrick indicates that the (A) above "correctly state the intent of current (A) and (B)".

What next?

Janet

MEMO

277-9883

RECEIVED
COMPLIANCE DIV
FEB 18 1998

To: David A. Lawer
FNBA/Compliance Department

From: John R. Beard

Date: February 17, 1998

Re: HB No. 247

You have asked on behalf of the Alaska Bankers' Association for my suggestions as to how the above bill might be amended so that it (1) does not apply to closing and collection escrow activities of Association members and (2) does not require other closing agents, when they are employed from time to time by Association members (or by other lenders or purchasers that also conduct deposit business in Alaska), to collect the "escrow money" from the member before they have accomplished the recording, filing or other perfection that is a condition to disbursement by the member, as a lender or purchaser, under the contract with its borrower or seller.

(1) The bill applies to conduct of "settlement agents," a term it defines at §090(7). It also defines "financial institution" in a manner that embraces Association members, §090(5). The Association's first objective would be accomplished by an amendment that excepts the latter from the former — e.g. an amendment of §090(7) that adds (underscored) language as follows:

> "settlement agent" means a person who engages in the business of handling escrow accounts*, but does not include a <u>financial institution or</u> a person who. . .etc.

Line 8 p 5

---

* A problem with the bill as drawn is that it has a great deal to say about "escrow accounts," but it does not say what they are. I understand that this and like problems are not of concern to the Association so long as the amendments it seeks are made.

(2) The bill's definition of financial institution is broader than the Association wants or, perhaps, the title companies will accept for purposes of the second objective, which is to relieve members from having to disburse to third party escrow agents ("settlement agents" under the amended definition) prior to perfection. You indicate that financial institutions (as defined by the bill) that accept deposits in Alaska would be, politically and from the Association's perspective, a sufficiently narrow class. The amendment I suggest is to §050 of the bill:

> "Unless the party to the escrow agreement that is to provide the escrow money is a financial institution that conducts general deposit business in this state, a settlement agent may not. . .etc."

LINE 12 P. 3

Let me know if you have any questions or if you detect any problem with these suggestions.

John R. Beard
Lawyer

First National Building
425 G Street. Suite 630
Anchorage, Alaska 99501
907/277-4531 FAX 907/277-9883

Roger Cremo.
of counsel

TELECOPIER COVER LETTER

DATED: ~~3~~ 3/20/98

ATTENTION: SHIRLEY ARMSTRONG

AT: REP. ROKEBERG OFFICE 907-465-2040

RE: HB 247

FROM: _____

AT: JOHN R. BEARD, Lawyer
Anchorage, Alaska

OUR FILE NO.: _____

No. of pages sent: 3 (including cover letter)

Documents sent: _____

_____

PLEASE CONTACT THIS OFFICE IF YOU HAVE NOT RECEIVED ALL OF THE DOCUMENTS SENT. [FAX (907) 277-9883]

MESSAGE>>>>>

PLEASE CALL ME IF THIS DOESN'T ANSWER YOUR QUESTION

ALASKA STATE LEGISLATURE
House of Representatives

COMMITTEE MEMBERS:

REPRESENTATIVE NORMAN ROKEBERG, CHAIRMAN
REPRESENTATIVE JOHN COWDERY, VICE CHAIRMAN
REPRESENTATIVE BILL HUDSON
REPRESENTATIVE JOE RYAN
REPRESENTATIVE JERRY SANDERS
REPRESENTATIVE TOM BRICE
REPRESENTATIVE GENE KUBINA
COMMITTEE HEARING ROOM 17 STATE CAPITOL

INTERIM:
716 WEST 4TH AVENUE, SUITE 640
ANCHORAGE, AK 99501
PHONE: (907) 258-8191
FAX: (907) 258-2916

SESSION:
STATE CAPITOL, ROOM 24
JUNEAU, AK 99801-1182
PHONE: (907) 465-4954
FAX: (907) 465-2040

Labor and Commerce Committee

MEMORANDUM

TO: Representative John Cowdery
Representative Bill Hudson
Representative Joe Ryan
Representative Jerry Sanders
Representative Tom Brice
Representative Gene Kubina

FROM: Representative Norman Rokeberg, Chairman
House Labor & Commerce Committee

DATE: February 26, 1998

SUBJECT: **Additional Bill Information -** HB247

Attached is information that has come to he House Labor and Commerce Committee since our committee hearing.

Attachments

586-1931 Wes Cooper
265-2920 Jerry Weaver

MEMO

To: David A. Lawer
FNBA/Compliance Department

From: John R. Beard

Date: February 17, 1998

Re: HB No. 247

You have asked on behalf of the Alaska Bankers' Association for my suggestions as to how the above bill might be amended so that it (1) does not apply to closing and collection escrow activities of Association members and (2) does not require other closing agents, when they are employed from time to time by Association members (or by other lenders or purchasers that also conduct deposit business in Alaska), to collect the "escrow money" from the member before they have accomplished the recording, filing or other perfection that is a condition to disbursement by the member, as a lender or purchaser, under the contract with its borrower or seller.

(1) The bill applies to conduct of "settlement agents," a term it defines at §090(7). It also defines "financial institution" in a manner that embraces Association members, §090(5). The Association's first objective would be accomplished by an amendment that excepts the latter from the former — e.g. an amendment of §090(5) that adds (underscored) language as follows:

> "settlement agent" means a person who engages in the business of handling escrow accounts*, but does not include a financial institution or a person who. . .etc.

Line 8 p 5

---

* A problem with the bill as drawn is that it has a great deal to say about "escrow accounts," but it does not say what they are. I understand that this and like problems are not of concern to the Association so long as the amendments it seeks are made.

(2) The bill's definition of financial institution is broader than the Association wants or, perhaps, the title companies will accept for purposes of the second objective, which is to relieve members from having to disburse to third party escrow agents ("settlement agents" under the amended definition) prior to perfection. You indicate that financial institutions (as defined by the bill) that accept deposits in Alaska would be, politically and from the Association's perspective, a sufficiently narrow class. The amendment I suggest is to §050 of the bill:

> "Unless the party to the escrow agreement that is to provide the escrow money is a financial institution that conducts general deposit business in this state, a settlement agent may not. . .etc."

LINE 12 P. 3

Let me know if you have any questions or if you detect any problem with these suggestions.

01/27/98
Willis Kirkpatrick
465-2521

JAN 2 7 1998

HB 247

An Act relating to escrow accounts

Possible amendment to address what the department's responsibility actually is to "supervise" settlement agents. The following is taken, in part, from AS 45.50.495; 45.50.501 and 45.50.511.

In HB 247, see Section 3, page –3-, line 25, **Sec34.75.070. Department supervision.**

Sec. 34.75.070. Investigative power of the department. (a) When the department, upon receipt of a written complaint from a party to an escrow of the settlement agent, has cause to believe that a settlement agent has engaged in, is engaging in, or is about to engage in a practice in violation of this chapter, the department may

1. Request persons, party to the escrow, to file a statement or report in writing, under oath, on forms prescribed by the department, setting out all facts and circumstances concerning the proposed violation, and other information considered necessary;
2. Examine under oath the settlement agent and any person subject to the complaint;
3. Examine record, books, documents, account, or paper that the department considers necessary;
4. Make true copies of any or all items listed in (3) of this subsection, which may be offered in evidence in place of originals.

(b) The department may issue subpoenas to require the attendance of witnesses or the production of documents or other evidence, administer oaths, and conduct hearings to aid in the investigation or inquiry into the complaint.

(c) As a result of the investigation by the department a finding of violation may exist the department shall

1. Seek assurances of voluntary compliance or,
2. Refer the findings to the Attorney General who may bring an action in the name of the state against the settlement agent found to be in violation of this chapter. The action may be brought in the superior court in the judicial district in which the settlement agent is doing business or the settlement agent's principal place of business in the state, or, with the consent of the parties, in any other judicial district in the state.

[note: the attempt is to allow an aggrieved person a process to file a complaint with some assurance that any alleged violation would be reviewed. The department's responsibility would be to review the complaint and determine summery findings. These findings could

1. Dismiss the complaint as unfounded
2. Work with the settlement agent to assure voluntary compliance
3. Refer the findings to the Attorney General's office for action (restrain by injunction)

Shirley
FYI

January 21, 1998

Norman:

After the L&C meeting on HB 247, I talked with Willis Kirkpatrick.

In addition to the written suggested changes, he indicated:

On page 3, lines 25-30. The Department needs to know what to supervise and what its remedies are. For example, can they issue a cease and desist order, fine or what. Without such language, they really don't know what to do.

Should they have the ability to issue cease and desist or fine and, if a fine, what range? How many cases are anticipated? (I reminded him that we provided him with information on the anticipated number of cases last year – the number was really low and that's why we have a zero fiscal note).

As to his written comment regarding Page 5, Section 4. He says that this 45.55.110(g) has nothing whatsoever to do with escrow agents and the whole section should just be deleted. If it is left in there, it will just be ignored and the revisor will drop it anyway. If Bannister wants to know more about this, he'll be glad to talk with her about it.

Janet

Official Business

COMMITTEE:

HOUSE LABOR AND COMMERCE
STANDING COMMITTEE

DATE: JANUARY 21, 1998

SIGN-IN

Subject of meeting:

HB 247 - REGULATION OF ESCROW ACCOUNTS

PLEASE PRINT!

NAME	ADDRESS (MAILING) & (ZIP)	PHONE	REPRESENTING	DO YOU WANT TO TESTIFY?
Willis Kirkpatrick	DCED	2521	Banking	Yes

John and Ann Ringstad
757 Illinois Street
Fairbanks, Alaska 99701
(907)456-8336
ringstad@polarnet.com

April 29, 1998

Representative Norman Rokeberg
Chairman
House Labor and Commerce Committee
Alaska State Legislature
Alaska State Capitol
Juneau, Alaska 99801

Re: HB 247 - Good Funds Legislation

Dear Chairman Rokeberg:

We support the most current version of HB 247 dated 4/29/98. This is a consumer protection issue. It closes a loophole in the escrow laws, protecting all parties involved in a residential housing transaction.

After a tremendous effort to negotiate the sale of our Anchorage home in December of 1994, we left the closing transactions in the hands of the settlement agent. In this case, both the buyer and the seller signed all the necessary documents and the escrow agent called the out-of-state lender to verify that the funds were indeed being wired. (This has been a very typical business practice in this state.) At this point, the sale documents were filed with the state recorder and the property was legally deeded over to the buyer.

The same day of recording, and after the buyer physically took possession of the property, the buyer called the out-of-state lender and convinced them to stop payment on the transaction. Now the property was in the name of the buyer, our mortgage was still in effect and we were liable for the property without any compensation.

We were told by numerous attorneys involved in this matter that if we took this case to court, it would probably take two years and $30,000 in legal fees to settle the matter. We decided to settle this case out of court, but it still took four long months to rectify the situation and get the property back from the buyers.

Needless to say, if the funds were actually receive prior to closing and recording, this situation would never have transpired. One day could have made all the difference.

I urge you and member of your committee to pass this legislation as quickly as possible to protect the consumers of this state.

Sincerely,

Ann Ringstad

Ann Ringstad

FIRST REGULAR SESSION

[INTRODUCED]

SENATE BILL NO. 148

89th GENERAL ASSEMBLY

S0693.02I

AN ACT

 To repeal section 381.412, RSMo Supp. 1996, relating to estate settlement agents, and to enact in lieu thereof one new section relating to the same subject.

BE IT ENACTED BY THE GENERAL ASSEMBLY OF THE STATE OF MISSOURI, AS FOLLOWS:

 Section A. Section 381.412, RSMo Supp. 1996, is repealed and one new section enacted in lieu thereof, to be known as section 381.412, to read as follows:

 381.412. 1. A settlement agent who accepts funds of more than ten thousand dollars, but less than two million dollars, for closing a sale of an interest in real estate shall require a buyer, seller or lender who is not a financial institution to convey such funds to the settlement agent as certified funds. The settlement agent shall record all security instruments for such real estate closing within three business days of such closing after receipt of such certified funds. A check:

(1) Drawn on an escrow account of a licensed real estate broker, as regulated and described in section 339.105, RSMo;

(2) Drawn on an escrow account of a title insurer or title insurance agency licensed to do business in Missouri; or

(3) Drawn on an agency of the United States of America, the state of Missouri or any county or municipality of the state of Missouri; shall be exempt from the provisions of this section. In addition, any fees paid to a federal agency, payments for premiums for private mortgage insurance, and payments to satisfy an existing deed of trust shall be exempt from the provisions of this section.

 2. No title insurer, title insurance agency or title insurance agent, as defined in section 381.031, shall make any payment, disbursement or withdrawal in excess of ten thousand dollars from an escrow account which it maintains as a depository of funds received from [the public] **any person, other than a financial institution, as defined in section 381.410,** for the settlement of real estate transactions unless a corresponding deposit of funds was made to the escrow account for the benefit of the payee or payees at least ten days prior to such payment, disbursement or withdrawal, or where such corresponding deposit of funds consisted of certified funds.

 3. If the director finds that a settlement agent has violated any provisions of this section, the

director may assess a fine of not more than two thousand dollars for each violation, plus the costs of the investigation. Each separate transaction where certified funds are required shall constitute a separate violation. In determining a fine, the director shall consider the extent to which the violation was a knowing and willful violation, the corrective action taken by the settlement agent to ensure that the violation will not be repeated, and the record of the settlement agent in complying with the provisions of this section.

Good Funds- IOTA Law

Effective 1-1-96

Sec. 1349.20. As used in Sections 1349.20 to 1349.22 of the Revised Code:

(A) "Banking Day" means any day on which the Federal Reserve Bank is open to the public for carrying on substantially all of its functions.

(B) "Check" means a negotiable instrument that is drawn on a Federally Insured Bank, Savings and Loan Association, Credit Union, or Savings Bank and contains an unconditional order or pay, on demand, a specified sum in money.

(C) "Escrow Account" means a checking account with a Federally insured Bank, Savings and Loan Association, Credit Union, or Savings Bank, which is used exclusively for the deposit of funds transferred electronically or otherwise, cash, money orders, or negotiable instruments that are received by the escrow or closing agent to effect an escrow transaction, but excludes an account of an Attorney that is used to hold client funds and an account maintained by a Real Estate Broker under division (A) (26) of Section 4735.18 of The Revised Code.

(D) "Escrow or Closing Agent" means a person who controls and effects in an escrow transaction, the delivery described in division (E) of this section, but excludes a Federally insured Bank, Savings and Loan Association, Credit Union, or Savings Bank that makes a loan as part of a Residential Real Property transaction and excludes a Real Estate Broker who, in a Fiduciary capacity, receives and deposits in an account maintained under division (A) (26) of Section 4735.18 of The Revised Code, cash, funds, checks, or negotiable instruments for earnest money or good faith or other purposes.

(E) "Escrow Transaction" means a transaction in which a person, for the purpose of effecting and closing the sale, purchase, exchange, transfer, encumbrance, or lease of an interest in Residential Real Property to another person, provides a written instrument or document, money, negotiable instrument, check, evidence of title to real property, or any other thing of value to an escrow or closing agent, to be held by the agent until a specified event occurs or until the performance of a prescribed condition, when it is to be delivered to a specific person by the agent in compliance with applicable instructions, whether by filing such written instrument or document in the public record or by direct tender or the appropriate person.

(F) "Negotiable Instrument" has the same meaning as in Section 1303.03 of the Revised Code.

(G) "Residential Real Property" means any real property improved or to be improved with a one to four family dwelling

Section 1349.21.

No escrow or closing agency knowingly shall make, in an escrow transaction, a disbursement from an escrow account on behalf of another person, unless the following conditions are met.

(A) The cash, funds, money orders, checks, or negotiable instruments necessary for the disbursement have been transferred electronically to or deposited into the escrow account of the

escrow or closing agent and are available for withdrawal and disbursement, or have been physically received by the agent prior to disbursement and are intended for deposit no later than the next banking day after the date of disbursement.

(B) The transfers or deposits described in division (A) of this section consist of any of the following:

(1) Cash or electronically transferred funds.

(2) Certified checks, cashier's checks, official checks, or money orders that are drawn on an existing account at a Federally insured Bank, Savings and Loan Association, Credit Union, or Savings Bank:

(3) A Check issued by the United States of this State, or by an Agency, instrumentality, or political subdivision of the United State or this State.

(4) A check drawn on the escrow account of a Title Insurance Company or Title Insurance Agent, provided the escrow or closing agent has reasonable and prudent cause to believe that sufficient funds are available for withdrawal in the account upon which the check is drawn at the time of disbursement.

(5) A personal check in an amount not exceeding One Thousand Dollars.

Section 1349.22.

Nothing in Section 1349.21 of the Revised Code prohibits an escrow or closing agent from advancing funds not exceeding One Thousand Dollars from an escrow account or otherwise on behalf of a part to an escrow transaction for the purpose of paying incidental fees, such as conveyance and recording fees, in order to effect and close the sale, purchase, exchange, transfer, encumbrance, or lease or Residential real property that is the subject of the escrow transaction.

Section 3953.01. As used in Sections 3953.01 to 3953.28, inclusive, of the Revised Code.

(A) "Title Insurance" means insuring, guaranteeing, or indemnifying owners of real property or others interested therein against loss or damage suffered by reason of liens, or encumbrances upon, defect in, or the unmarketability of the title to such property, guaranteeing, warranting, or otherwise insuring by a title insurance company the correctness of searches relating to the title to real property, or doing any business in substance equivalent to any of the foregoing.

(B) "The Business of Title Insurance" means:

(1) The making as insurer, guarantor, or surety, or proposing to make as insurer, guarantor, or surety, any contract or policy of title insurance;

(2) The transacting, or proposing to transact, any phase of title insurance including solicitation, negotiation preliminary to execution, execution of a contract of title insurance, insuring, and transacting matters subsequent to the execution of the contract and arising out of it, including re-insurance;

(3) The doing or proposing to do any business in substance equivalent to any of the foregoing.

(C) "Title Insurance Company" means:

(1) Any domestic title guaranty company and domestic title guarantee and trust company to the extent that they are engaged in the business of title insurance as defined in this section:

(2) Any domestic company organized under this chapter for the purpose of insuring titles to real property;

(3) Any title insurance company organized under the laws of another state or foreign government.

(4) Any domestic or foreign company having the powers and authorized to insure titles to real estate within this state on the effective date of this section and which meets the requirements of this chapter.

(D) "Applicants for insurance" includes all those, whether or not a prospective insured, who from time to time apply to a title insurance company, or to its agent, for title insurance, and who at the time as such application are not agents for a title insurance company.

(E) "Risk premium" for title insurance means that portion of the fee charged by a title insurance company, agent of a title insurance company, or approved attorney of a title insurance company, or any of them, to an insured or to an applicant for insurance, for the assumption by the title insurance company of the risk created by the issuance of the title insurance policy.

(F) "Fee" for title insurance means and includes the risk premium, abstracting or searching charge, examination charge, and every other charge, exclusive of settlement, closing or escrow charges, whether denominated premium or otherwise, made by a title insurance company; agent of a title insurance company, or an approved attorney of a title insurance company, or any of them, to an insured or to an applicant for insurance for any policy or contract for the issuance of title insurance, but "fee" does not include any charges paid to and retained by an attorney at law or abstractor acting as an independent contractor whether or not he is acting as an agent of a title insurance company or an approved attorney, or any charges made for special services not constituting title insurance, even though performed in connection with a title insurance policy or contract.

(G) "Approved attorney" means an attorney at law, who is not an employee of a title insurance company or of a title insurance agent, upon whose examination of title and report thereon a title insurance company may issue a policy of title insurance.

(H) "Title insurance agent" means a person, partnership, or corporation, authorized in writing by a title insurance company to solicit insurance and collect premiums and to issue or countersign policies in its behalf. "Title insurance agent" does not include officers and salaried employees of any title insurance company authorized to do a title business within the state.

(I) "Single insurance risk" means the insured amount of any policy or contract of title insurance issued by a title insurance company.

(J) "Foreign Title insurance company" means a title insurance company organized under the laws of any state or territory of the United States or the District of Columbia.

(K) "Alien title insurance company" means a title insurance company incorporated or organized under the laws of any foreign nation or of any province or territory thereof, not included under the definition of "Foreign Title Insurance Company."

(L) "Non-directed escrow funds" means any funds delivered to a title insurance agent or title insurance company with instructions to hold or disburse the funds pursuant to a transaction in which a title insurance policy will be issued, but without written instructions to either deposit the funds in an account for the benefit of a specific person, or to pay the interest earned on the funds to a specific person.

(M) "Business Day" means any day, other than a Saturday or Sunday, or a legal holiday, on which a Bank, Savings and Loan Association, Credit Union, or Savings Bank is open to the public for carrying on substantially all of its functions.

Section 3953.231.

(A)

(1) Each title insurance agent or title insurance company shall establish and maintain an interest-bearing trust account for the deposit of all non-directed escrow funds that meet the requirements of sections 1349.20 to 1349.22 of the Revised Code.

(2) The account shall be established and maintained in any Federally insured Bank, Savings and Loan Association, Credit Union, or Savings Bank that is authorized to transact business in this state.

(3) The account shall be in the name of the title insurance agent or company, and shall be identified as an "Interest On Trust Account" or "IOTA". The name of the account may contain additional identifying information to distinguish it from other accounts.

(4) The title insurance agent or company establishing the account shall submit, in writing, to the Superintendent of Insurance the name, account number, and location of the Bank, Savings and Loan Association, Credit Union, or Savings Bank in which the trust account is maintained.

(B) Each title insurance agent or company shall deposit all non-directed escrow funds that are nominal in amount or are to be held for a short period of time into the account established under division (A) of this section no later than the next business date after receipt.

(C) Each account established under division (A) of this section shall comply will the following:

(1) All funds in the account shall be subject to withdrawal or transfer upon request and without delay, or as soon as permitted by law:

(2) The rate of interest payable on the account shall not be less than the rate paid by the Bank, Savings and Loan, Credit Union, or Savings Bank to its regular depositors. The rate may be higher if there is no impairment of the right to the immediate withdrawal or transfer of the principal;

(3) All interest earned on the account, net of service charges and other related charges, shall be transmitted to the Treasurer of State for deposit in the legal aid fund established under section 120.52 of the Revised Code. No part of the interest earned shall be paid to the title insurance agent or company.

(D) The title insurance agent or company establishing an account under division (A) of this section shall direct the Bank, Savings and Loan Association, Credit Union, or Savings Bank to do both of the following: