The Future of Tip Credit – And The Businesses That Depend Upon It

Insights
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The U.S. Supreme Court is being asked to decide what amounts to the future of tip credit for many businesses – particularly in the hospitality industry. In short, the issue is whether an employer can continue to pay tip credit employees on a tip credit basis if they spend more than 20% of their work time on duties that did not produce tips.

Background
All employees must be paid the minimum wage under federal and state law. The FLSA allows employers to satisfy the minimum wage requirement by taking a "tip credit." For employees who regularly receive more than $30.00/month in tips, the tip credit provisions of the FLSA permit an employer to pay its tipped employees not less than $2.13 per hour in cash wages and take a "tip credit" equal to the difference between the cash wages paid and the federal minimum wage.

The tip credit may not exceed the amount of tips actually received and under the current minimum wage may not exceed $5.12/hour. Therefore, for example, under federal law an employer could pay a tipped employee $2.13/hr and take a tip credit of $5.12/hr, provided the tipped employee makes sufficient tips to cover the tip credit.

The use of tip credit, though simple in its concept, can also be complicated by state laws. Some states forbid the use of tip credit, while others impose significant recordkeeping and/or notice requirements on the use of tip credit.

The 20% Rule And *Applebee's*

On occasion, tipped employees are asked to perform duties that are not tip generating – such as rolling silverware, cleaning up at the end of the shift, etc. The law recognizes and permits tipped employees to perform some related non-tipped duties. But, federal law does not say how many "related non-tipped duties" an employee can perform and still be paid on a tip credit basis.

The U.S. Department of Labor has adopted the "20% rule." The DOL takes the position that an employer may not take a tip credit for time spent on non-tipped duties if the employees spend more than 20% of their time performing such non-tipped duties.

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In 2007, a federal court in Missouri adopted the DOL's 20% rule in a class action potentially involving more than 40,000 current and former tipped employees of Applebee's. The U.S. Court of Appeals for the 8th Circuit agreed. The Court concluded that the employer could not apply tip credit to time tipped employees spent performing non-tipped duties if those duties exceeded 20% of the employee's work time. So, if an employee spent 70% of his time serving customers and 30% of his time doing other tasks such as cleaning the store or answering phones, an employer would have to pay the employee at least minimum wage for the 30% of the time spent doing non-tipped duties.

The Practical Impact

These decisions, if upheld, will require employers to keep very careful track of not only the time tipped employees spent working, but also what tasks they were performing during that time. Additionally, a likely outcome of the decision is that many employers would be forced to pay tipped employees at two different pay rates: one for time spent performing tipped duties and minimum wage (or higher) for time spent performing non-tipped duties.

The *Applebee's* decision is causing heartburn for many hospitality employers who fear they face a future of percentage calculations and multiple wage rates for tipped employees. The decision has wound its way up through the court system for the past few years and Applebee's has now asked the US Supreme Court to decide. If the Supreme Court adopts the 20% rule, the decision could cause many hospitality employers to reevaluate the use of tip credit for tipped employees at all. That would significantly alter the way employers maintain payroll records, compensate tipped employees, and manage their business. For some, there may be no choice but to close their doors – meaning these tipped employees will not be paid at all.

What To Do Now

High-profile class actions regarding the compensation of tipped employees underscore the importance of carefully evaluating your payroll practices. The DOL, courts, and plaintiffs' attorneys are scrutinizing employers' use of tip credit, distribution of service charges, deductions from tipped employee wages, and tip pooling practices.

Despite the increased focus on the compensation of tipped employees, the law in the area is unsettled. As a result, hospitality employers are wrestling with many questions about the best practices for paying tipped employees. Of note, the court found that, based on Applebee's admissions, it had the ability to track and pay employees for non-tipped duties. Some businesses have already moved to this type of "split pay" process, paying tip credit only for tip-related duties and minimum wage for all other duties. While not practical for all types of tipped employees, this is likely the safest option until this issue is resolved.

Notwithstanding the outcome of the Applebee's decision, employers are advised to carefully review their policies and practices for compensating tipped employees to ensure compliance with the law. To best insulate your company from costly investigations and litigation, hospitality employers should explicitly and regularly communicate to employees and managers the importance of accurately recording hours worked and tips received, train managers and supervisors on the laws regarding compensation of tipped employees, and regularly audit time records. The failure to do so, could subject employers to costly litigation.

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