Tipping Point Of Confusion: Contradictions Abound In Tip Credit Rules

Insights
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Legal issues surrounding tip credits have been in the spotlight throughout much of 2017, from significant court decisions to announcements by the U.S. Department of Labor (USDOL). But rather than setting forth clear rules, these cases and statements have instead contributed to a sense of uncertainty among employers in the hospitality industry.

When is an employer permitted to exercise control over an employee's tips? Can a tipped employee perform non-tip-producing work, and, if so, to what extent? These were among the most notable issues in the spotlight this year. As we turn toward 2018, you should keep a close eye on these developments.

The Fundamentals
Before delving into the details, it is worth revisiting the fundamental rules governing the tip credit under the federal Fair Labor Standards Act (FLSA). The tip credit, at Section 3(m) of the statute, permits you to:

- Pay a tipped employee a direct cash wage of at least $2.13 per hour; and
- Take a credit against the employee's tips received that is sufficient to bring the total pay to at least the FLSA minimum wage.

Many incorrectly describe this lawful method for compensating employees as a "subminimum wage" or "tipped employee minimum wage." It is neither. The FLSA's minimum wage for tipped employees is precisely the rate as for all other nonexempt, non-tipped employees: $7.25 an hour at present. The $2.13 figure is simply the lowest cash wage that may be paid to a tipped employee so long as they also receive enough in tips to bring their wage to $7.25 an hour. Otherwise, you must pay the employee additional cash wages to meet the $7.25 minimum.

If you wish to rely upon the tip credit for your tipped employees, you must provide a notice (preferably written) informing employees:

- The amount of cash wages they are being paid, which must be at least $2.13;
- The amount claimed as a tip credit, not to exceed $5.12 (the difference between $7.25 and $2.13);

- That the tip credit may not exceed the amount of tips the employee actually received;
- That all tips received by the employee must be retained (except when used for a valid tip pool); and
- That the tip credit applies only to tipped employees who have been informed of these provisions.

Some employers choose to implement a tip pool, whereby tipped employees contribute some or all of their tips into a pot, which is then divided among all employees who customarily and regularly receive tips. There is no maximum or minimum contribution, but you must notify tipped employees if a tip pool contribution is required and the amount they must contribute. You may take a tip credit only for tips the employee actually receives (as opposed to amounts they donate to the pool) and you may not retain tips for any other purpose.

Whose Tip Is It Anyway?

Section 3(m) of the FLSA provides that you may not take the tip credit unless all tips received by the tipped employee *are retained by the employee*. The only statutory exception to this rule is if you divert the tips to a valid tip pool. But what if you do *not* take the tip credit? Take, for example, an employer who pays a cash wage of at least $7.25. Can it exercise control over some or all of an employee's tips under the FLSA? There is a developing split among the courts on this issue.

In 2010, the 9th Circuit Court of Appeals (which hears cases out of California, Washington, Nevada, Oregon, Arizona, Montana, Alaska, Hawaii and Idaho) ruled that employers can control tips – meaning they can retain some or all of the tips that are left by customers – if no tip credit is taken for the employee. In 2011, the Obama-era USDOL responded by promulgating a regulation declaring that "tips are the property of the employee *whether or not the employer has taken a tip credit*." In other words, according to USDOL, even the employer that doesn't take a tip credit cannot control or divert an employee's tips.

This regulation was controversial from the start, as it appeared to recognize a new cause of action under the FLSA, whereby an employee could sue their employer for misappropriation of tips absent any overtime or minimum wage violation. For this and other reasons, several federal district courts across the country declared that the regulation was not entitled to any deference.

Prior to 2017, the 9th Circuit was the only federal court of appeals to consider the regulation, and concluded it to be valid and proper. Then, this past summer, the 10th Circuit (Colorado, Kansas, New Mexico, Oklahoma, Utah, and Wyoming) and 11th Circuit (Florida, Georgia, and Alabama) reached conclusions contrary to the 9th Circuit, finding that an employer can control an employee's tips if it does not take the FLSA tip credit. Both courts specifically rejected the suggestion that the 2011 regulation somehow creates a new cause of action. This split among the federal appeals courts means that employers in some states can lawfully control tips under the FLSA when they don't take the tip credit, while employers in other states cannot.

Good News On The Horizon?

The latest development in this saga occurred several months ago, when the USDOL signaled its plan to reverse its own position. The agency first announced that it had instructed its wage and hour investigators to cease enforcement of the disputed portion of the 2011 regulation. In October, the agency issued a notice of its intention to propose a new regulation that would permit employers to control an employee's tips if no tip credit was taken. Of course, the fact that USDOL is not currently enforcing the provision leaves open the possibility that current or former employees can still seek to do so in their own FLSA lawsuits.

What does it all mean for hospitality employers? The recent developments suggest there could be a consensus developing under the FLSA that employers are permitted to control an employee's tips if no tip credit is taken for the employee. However, as of today, the USDOL has not issued a new regulation, nor has the U.S. Supreme Court addressed the circuit court split. Until the matter is further clarified in some comprehensive way, employers outside of the 9th, 10th, and 11th Circuits face continuing uncertainty on this issue. And, of course, compliance with applicable state laws relating to tip-retention practices is still required.

Incidental Time Leads To Unknown Results

Turning to a related topic, there has also been confusion regarding whether employees qualify as a "tipped employee" subject to the FLSA's tip credit. According to the statute, an employee must be working in an occupation that customarily and regularly receives tips, which, according to the FLSA, means at least $30 in tips per month. In other words, an employee cannot be paid via the tip credit if their position doesn't receive tips. While this rule may seem simple on its face, it is difficult to apply when an employee performs both tipped and non-tipped work, as do many in the hospitality industry.

For an employee who works two separate jobs – for example, their work is split between waiting tables and performing maintenance – the USDOL's regulations state that you may only take the tip credit for hours spent performing the tipped job. The regulation recognizes this is different, however, for those with dual jobs, such as an employee who only occasionally performs non-tipped work that happens to be incidental to their tipped job. Thus, when a waiter occasionally spends time cleaning tables and washing dishes, those duties may be incidental to their tipped job rather than an entirely separate job.

The USDOL interprets this regulation aggressively. In its "Field Operations Handbook" (an internal manual that articulates many of the Department's views on how the FLSA and related regulations are to be applied), the agency adopts an 80/20 rule, whereby "no tip credit may be taken for the time spent performing" non-tip-generating duties if they make up more than 20% of a tipped employee's work. To state the reverse, the USDOL says that a tipped employee must perform tip-generating work 80% of the time to be eligible for the tip credit for all hours worked.

Conflicting Court Cases Cause Confusion

In 2011, the 8th Circuit (Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, and South Dakota) deferred to and enforced USDOL's 80/20 interpretation. However, in September of this year, the 9th Circuit rejected the USDOL's position, stating that when a company has "hired a person for one job (such as a waitress or counterman), but that job includes a range of tasks not necessarily directed towards producing tips, the person is still considered a tipped employee engaged in a single-job so long as the person 'customarily and regularly receives at least $30 a month in tips.'" In rejecting the USDOL's position, the 9th Circuit held that the USDOL position effectively imposed new recordkeeping guidelines on employers to determine which tasks are tip generating and which are not. The court concluded that this would, in effect, create a new regulation inconsistent with the FLSA's dual job regulation.

So, yet again we have a circuit split. As a result, this issue may find its way to the Supreme Court in the coming years. In the meantime, unless your business is operating in the 8th Circuit (80/20 concept applies to FLSA claims) or the 9th Circuit (80/20 concept does not apply to FLSA claims), you are left with little guidance on how to proceed. If you are cautious, you may consider splitting non-tip generating work among all tipped employees, rather than falling upon a single employee.

Moral Of The Story: Confusion Abounds, Try To Avoid Costly Mistakes
Every tip credit case is different. Some turn on whether an employee actually received sufficient tips to reach the federal minimum wage, while others turn on whether employees were given the proper tip credit notice. Still others turn on whether a non-tipped employee participated in a tip pool.

Regardless of which type of lawsuit is filed, the results can be catastrophic. In the last few years, tip credit cases led to significant settlements and verdicts ($19.1 million against a national restaurant; $8.5 million for a national fast food chain; over $5 million against a national restaurant group).

And of course, this article covers only the application of federal law and the FLSA. Several states have decided to make their laws even more onerous for employers operating within their jurisdictions. So, while you attempt to wade through the morass and confusion that is the tip credit, make sure to do one thing – stay informed. Ignoring the old saying that all publicity is good publicity, no employer wants to become a headline when it comes to a tip credit case.

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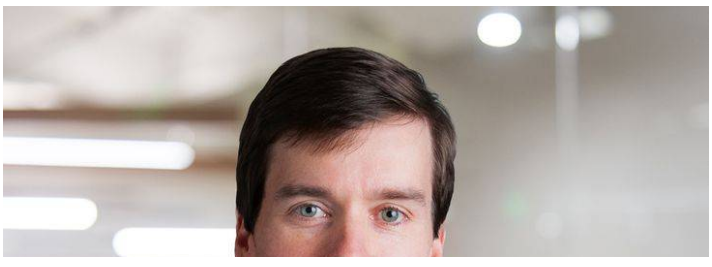

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