Labor Department Loosens Tip Pool Rules For Hospitality Employers

Insights
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The U.S. Department of Labor issued a long-awaited final rule right before Christmas addressing the issue of tipped employees. The final rule, released on December 22 but not effective until February 20, 2021, provides guidance for both employers who utilize a tip credit and also for how employers who pay at or above minimum wage may handle tip pools without running afoul of federal wage and hour law. A big question remains, though: how will the incoming Biden administration handle this issue? Employers in the hospitality sector will want to pay attention to this latest development – and stand by for potential further developments – as we head into 2021.

The "Tip Credit" Background

Many employers have employees who receive tips. Under the Fair Labor Standards Act (FLSA), a tipped employee is someone who customarily and regularly receives more than $30 per month in tips. The FLSA permits an employer to take a "tip credit" for the amount between the direct cash wage it pays to an employee (at least $2.13 per hour) and the federal minimum wage (currently $7.25). (Note: this describes current federal law. Some states prohibit a tip credit while other states require a higher direct cash wage.) Some employers do not utilize the tip credit but have employees who receive tips and participate in a tip pool.

Regardless of whether employers take a tip credit or pay employees at or above minimum wage for its employees who receive tips, the 2018 amendments to the FLSA prohibit an employer from keeping an employees' tips (See Section 3(m)(2)(B), which states that "an employer may not keep tips received by its employees for any purposes, including allowing managers or supervisors to keep any portion of employees' tips").

Last week, the Department of Labor (DOL) sought to clarify some of the confusion caused by the 2018 amendments and also provide a more flexible approach for employers and employees alike. The new final rule addresses a number of issues, including, but not limited to:

- For employers who take a tip credit, does the percentage of time spent on certain duties matter?
- For employers who utilize a tip pool and don't take a tip credit, who may participate in the pool and what recordkeeping requirements are applicable?

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- What is the proper test for determining whether an individual is a "manager" and who therefore may not participate in a tip pool or otherwise keep tips given by customers?
- What considerations will the DOL utilize in assessing civil money penalties for violations?

Say Goodbye To The 20% Rule For Employers Who Utilize The Tip Credit

For the better part of three decades, employers with tipped employees have struggled with USDOL's problematic "20% Rule." This rule purported to limit the amount of time that tipped employees could spend performing "related duties" – i.e. making coffee, filling salt shakers, cleaning tables – to 20% of the employee's work time or else risk losing the tip credit for the time spent on that work.

While the "rule" sounds simple in the abstract, applying it in reality is anything but. As one court put it, the rule purportedly required employers to "keep the employee under perpetual surveillance" to prevent an inadvertent violation of the 20%-time limitation. Employers were also left with inadequate guidance about which duties were "related" in the first place. For example, is sweeping under a table a "related duty"? Predictably, this "rule" spawned a cottage industry of lawsuits, made worse by the fact there is no basis for the 20% limitation in the FLSA itself.

No longer. Now, employers can take the tip credit for <u>all</u> time spent by an employee performing "related duties" provided that such duties are performed contemporaneously with the tipped duties or for a reasonable time immediately before or after performing the tipped duties. In other words, a server can now make a pot of coffee while their customer eats without the tip credit being jeopardized for the time spent performing that task.

Similarly, the final rule provides certainty to employers about the type of work that constitutes "related duties" in this context. Specifically, the final rule now supplements the related duties that are already listed in the "dual jobs" regulation with a reference to the Occupational Information Network (O*NET). Any task listed in a tip-producing occupation within O*NET is presumed to be a related duty.

For example, the O*NET website lists "rolling silverware and filling salt and pepper shakers" as tasks for the Waitress and Waiter position. Thus, employers can have servers perform such tasks, <u>without any time limitation</u>, provided that the tasks are performed contemporaneously with tipped duties or for a reasonable time immediately before or after performing the tipped duties.

New Rule Provides Clarity Regarding Tip Pool Participation And Recordkeeping Requirements

The final rule, consistent with the 2018 amendments to the FLSA, confirms that those employers that pay their tipped employees a direct cash wage of at least the full federal minimum wage and do not take a tip credit against their minimum wage obligations may include employees who do not customarily and regularly receive tips in a mandatory tip pooling arrangement. The final rule confirms that no employer may require employees to share tips with managers and supervisors

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(there is no distinction in this regard between employers who do and do not take a tip credit). Thus, even where an employer does not utilize a tip credit, a manager or supervisor may not participate in such a tip pool. However, administering a tip pool or excluding credit card processing fees from tips does not amount to "keeping" tips in violation of Section 3(m) of the FLSA.

The final rule imposes recordkeeping requirements on employers who do not use a tip credit but collect employees' tips to operate a mandatory tip pool. The final rule requires such employers to identify on their payroll records each employee who receives tips and to keep records of the weekly or monthly amount of tips received by each employee, as reported by the employee to the employer. The regulations already imposed recordkeeping obligations on employers who use a tip credit.

Finally, the final rule provides that an employer that collects tips to facilitate a mandatory tip pool must fully redistribute the tips no less often than when it pays wages to avoid "keeping" the tips in violation of section 3(m)(2)(B).

The "Executive" Exemption Duties Test Determines Whether An Individual Is A "Manager Or Supervisor"

As noted above, following the 2018 amendments, the FLSA explicitly prohibits "managers or supervisors" from keeping any portion of an employee's tips directly or indirectly, such as via a tip pool. However, the FLSA does not define "managers or supervisors" – which led to uncertainty about exactly which employees were covered by this prohibition.

The final rule eliminates the uncertainty by incorporating the job duties test from the FLSA's "executive exemption" to determine whether an individual is a "manager or supervisor." Notably, the "salary basis" requirement would not be a factor for determining whether an employee is a "manager or supervisor." This means an employee could be deemed a "supervisor" for purposes of determining their ineligibility to participate in a tip pool because of their job duties even though they would not qualify for the executive exemption because they were not paid on a salary basis.

Agency Clarifies Civil Money Penalties And "Willfulness"

The final rule clarifies that the DOL will only exercise its discretion to impose civil money penalties (CMPs), which can be up to $1,100 depending on the particular circumstances, when an employer has repeatedly or willfully violated section 3(m)(2)(B), as opposed to a first-time violation. This is consistent with how the DOL enforces other FLSA wage violations.

The final rule also provides guidance on how the DOL will determine if a violation is willful for purposes of assessing CMPs. The final rule provides that an employer's receipt of advice from WHD that its conduct was unlawful can be sufficient to show that the violation is willful but is not automatically dispositive. The law requires agency officials to examine all of the facts and circumstances surrounding the violation.

What Should Employers Do Now?

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Assuming the final rule is not changed by the incoming Biden Administration (more on this below), employers should consider whether to change any workplace policies. Employers that want to include back of house employees in a tip pool now have clarity about how to do so without inadvertently including someone who could be deemed a "manager or supervisor."

Employers with tipped employees should also analyze *when* those employees are performing "related duties" to ensure that such work is being performed contemporaneously with their tipped duties or immediately before or after such customer-facing work. Employers should avoid having their tipped employees perform related duties for long stretches of time when no other tipped work is being performed.

But Wait...

This final rule does not become effective for 60 days after it was released, meaning it will not be in place until February 20, 2021. As noted above, some states prohibit use of a tip-credit or require a higher cash wage for tipped employees, so it is important for employers to determine any state or local law variations.

Moreover, the final rule was not published in a vacuum. Soon, the DOL will be executing its policies under a new, Democratic administration, with new leadership and a new direction. It is possible, if not likely, that legal challenges to the final rule from worker advocates and other opponents are on the horizon seeking to block the rule from ever taking effect. How the Biden Labor Department will respond to such legal challenges is an open question.

It is also possible that the Biden DOL will seek to withdraw the final rule before it takes effect, or issue proposed changes of its own that undo changes from the final. In short, although the final rule implements regulatory changes that are based on a sound interpretation of the FLSA, political considerations cannot be discounted.

Employers should be aware that this final rule may not be the final word on these issues after all. We will monitor the situation and provide updates as appropriate, so you should ensure you are subscribed to Fisher Phillips' alert system to gather the most up-to-date information. If you have questions, please contact your Fisher Phillips attorney, or any attorney in our Hospitality Industry Practice Group or Wage and Hour Practice Group.

This Legal Alert provides an overview of a specific federal rule. It is not intended to be, and should not be construed as, legal advice for any particular fact situation.

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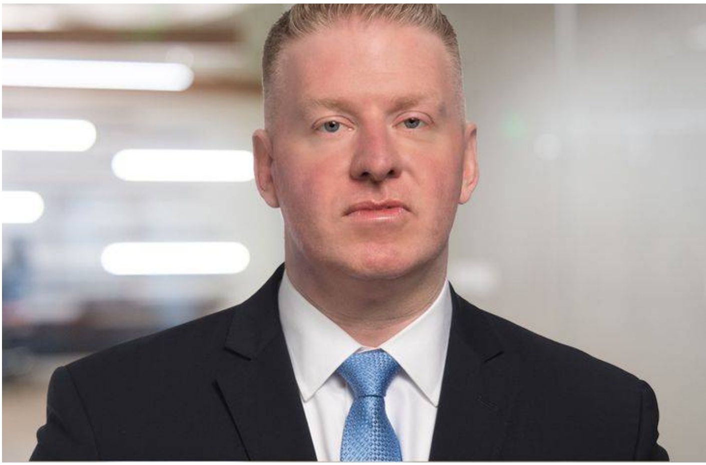

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