What To Know About Proposed Changes To Tip-Pooling Rule

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The U.S. Department of Labor plans to propose, sometime in August, a full rescission of the controversial tip-pooling restrictions that impact employers who pay tipped employees the full minimum wage directly, according to a regulatory agenda published July 20. This news should come as a welcome relief to employers in the hospitality industry, especially those operating in the 9th Circuit — which includes the states of California, Nevada, Washington, Arizona, Oregon, Idaho, Montana, Hawaii, and Alaska — where a divisive 2016 appellate court decision has operated the last several years to handcuff a substantial number of businesses.

While the announcement does not immediately change existing law, it sets into motion regulatory action that could aid hospitality employers across the country. This development will be worth monitoring in the coming months, and employers will want to stay abreast of this process and be prepared to adjust practices as warranted.

Brief Background on Tip-Pooling Rules

The current tip-pooling restrictions were originally promulgated by the Obama administration in 2011. They established that tips are the property of employees and could not be distributed to other workers or kept by the employer, even if the employer does not take a tip credit and pays tipped employees the full minimum wage.

The tip-credit provision of the Fair Labor Standards Act gives employers of tipped employees the option of paying a reduced hourly wage rate of $2.13 per hour so long as the employees receive enough tips to bring their hourly rate to the $7.25 federal minimum wage. If there are not enough tips, the employer must pay the difference; if there are more than enough tips, the employees get the excess. The U.S. Department of Labor regulations limit an employer's ability to use an employee's tips regardless of whether the employer takes a tip credit under Section 3(m) or instead pays the full FLSA minimum wage directly to the employee (See 29 C.F.R. §531.52).

Court Battles Have Tipped Both Ways

The 10th Circuit ruled last month that the regulation is invalid, holding the tip credit provision does not apply where an employer pays employees at least the $7.25 minimum, and in such situations the employer may thus retain the tips. The decision in Marlow v. The New Food Guy Inc. conflicts,

however, with a notorious 2016 decision by the 9th Circuit that upheld the regulation.

In Oregon Restaurant and Lodging Association v. Perez, decided in February 2016, the 9th Circuit held the FLSA is silent on the question of employers who do not take the tip credit, and this silence left a gap that the DOL was authorized to fill. More recently, in September 2016, a majority of judges on the 9th Circuit voted not to reconsider the decision, leading several judges to issue a blistering dissenting opinion labeling the action as a "constitutional and administrative law misstep."

Because the 10th Circuit found no such gap or ambiguity within the statute when it concluded the regulation was invalid (agreeing with decisions from other federal appellate courts in the 4th and 11th Circuits), the National Restaurant Association had asked the U.S. Supreme Court to hear an appeal of the 9th Circuit case. That request is currently pending. Many U.S. Supreme Court observers believed the issue was ripe for review and that it was all but assured that the justices would take up the case in order to resolve the circuit split. The new announcement may lead to any possible court review being judged as unnecessary.

What Does the DOL Announcement Mean?

The announcement by the DOL was fairly brief but its importance cannot be understated. "Section 3(m) of the FLSA, 29 U.S.C. 203(m), provides in part that an employer may take a partial credit (tip credit) against its minimum wage payment obligation to a tipped employee based on tips received and retained by the employee," the DOL said. "The Department's regulations limit an employer's ability to use an employee's tips regardless of whether the employer takes a tip credit under Section 3(m) or instead pays the full FLSA minimum wage directly to the employee. In this Notice of Proposed Rulemaking, the Department will propose to rescind the current restrictions on tip pooling by employers that pay tipped employees the full minimum wage directly."

The agenda reflects an agency's intentions to act in the next 12 months, and is subject to change. However, given the controversy swirling across the country regarding this matter, there is little doubt this announcement was not made lightly. Employers can expect swift action to set the wheels in motion to rescind the rules, although the rescission process itself could take some time.

For now, however, continued caution is advised with respect to tip policies. The announcement does not immediately change existing law, but merely sets the table for future action. Hospitality employers in the 10th Circuit (having jurisdiction over the states of Colorado, Kansas, Oklahoma, Utah, Wyoming and New Mexico), the 4th Circuit (Maryland, Virginia, West Virginia, North Carolina and South Carolina), and the 11th Circuit (Alabama, Florida and Georgia) that do not use the tip credit may continue to decide how tips are distributed, but must carefully consider the application of any state and local laws.

For example, Colorado law currently sets the minimum wage at $9.30 per hour and employers in Colorado still must comply with that law. State law also provides that in order for an employer to

Colorado still must comply with that law. State law also provides that in order for an employer to assert a claim to, right of ownership in, or control over tips, it must post a printed card of a certain size containing certain language in letters one-half inch high in a conspicuous location at the place of business. Employers who do business over the phone or by email may need to take additional steps to bring this message to patrons' attention before they leave a tip.

Employers in states outside of the jurisdiction of the 4th, 10th and 11th Circuits should abide by the regulation until it is rescinded, especially those in the 9th Circuit.

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