Jump On In: Five Steps to Set Up a Lawful Tip Pool in Kentucky

Insights
12.27.23

Tipping is everywhere: the coffee shop, the florist, and even the dry cleaner! This booming tip culture has led many employers that may not have traditionally established a tip pool to consider using one to ease the impact of ever-increasing labor costs. How can you stay compliant with wage and hour laws while setting up a new system? This list provides helpful guidance for employers in Kentucky on how to establish a lawful tip pool.

Step 1: Determine If the Tip Pool Is Voluntary or Mandatory

Historically, Kentucky was one of the outlier states that prohibited mandatory tip pools. But in 2022, the Kentucky Legislature loosened up the law, allowing employers to mandate tip pools with a few restrictions. Now, employers in the state have the option of mandating a tip pool or establishing a voluntary one. As a practical matter, a voluntary tip pool may cause an administrative nightmare because you'd have to keep track of which workers are participating and which are not. So, the first step in establishing a tip pool is to determine whether it makes more sense for your business to require it or make it optional.

Step 2: Decide Whether to Use the Tip Credit

After you've decided if the tip pool is required, you must next decide how you are going to pay employees. Are they "tipped employees" that work in an occupation in which they "customarily and regularly receive more than $30 a month in tips"? If so, you may take a tip credit for these employees – which allows you to pay them less than the minimum wage (but no less than $2.13 an hour), so long as they make up the difference in tips and certain other criteria are met. For more on that topic, check out this article.

If you decide to take the tip credit, this will impact who can participate in the tip pool. For example, if you take a tip credit for tipped employees, you cannot allow those tipped employees to participate in a mixed pool with non-tipped employees (such as back-of-house employees, like cooks and dishwashers).

On the flip side, you have more flexibility to pool tips when you pay at least the standard minimum wage. The U.S. Department of Labor (USDOL) states that "[a]n employer that pays its tipped employees the full minimum wage and does not take a tip credit may impose a tip-pooling arrangement that includes dishwashers, cooks, or other employees in the establishment who are arrangement that includes dishwashers, cooks, or other employees in the establishment who are not employed in an occupation in which employees customarily and regularly receive tips." Put simply: no mixed pools when you take a tip credit.

Step 3: Establish Eligible Participants

You now must consider the appropriate participants in the tip pool. As outlined above, if you are taking the tip credit, the pool must be limited to "tipped employees" such as servers and bartenders. If not — and the minimum wage is paid to participants — other workers can participate in the tip pool.

CAUTION – This does not mean owners, managers, or supervisors can participate in the tip pool. Federal and Kentucky law specifically prohibit them from participating or otherwise keeping employees' tips regardless of whether the tip credit is taken.

While managers and supervisors may contribute tips to a pool, they cannot receive distributions from the tip pool. Managers and supervisors are, however, permitted to keep tips they receive directly from customers for services they "directly" and "solely" provide. For example, if the manager receives a tip for serving a customer along with an employee, they did not "solely" provide the service. As another word of caution, a recent Dallas-area restaurant chain found themselves on the receiving end of an FLSA violation by allowing hourly managers to participate in their tip pool. The price tag for this mistake? The restaurant owed about $867,500 in unpaid tips and overtime premiums.

Keeping this prohibition in mind, you should ensure employees are properly excluded from the tip pool if they would be considered managers. Although the USDOL uses the "duties test" in the FLSA's executive exemption to determine who is a manager or supervisor, the tip-sharing rules do not require an employee be paid on a salary basis to be considered a manager. This means that assistant managers, team leaders, and shift runners could still be considered managers even without receiving a salary. Instead, "manager" can include an employee who has such duties as: *interviewing, selecting, and training employees; setting and adjusting their rates of pay and hours of work; directing the work of employees; disciplining employees; and planning the work*.

Step 4: Make a Plan for Distributions

Now that you've decided who will participate in the tip pool, consider how you will distribute these tips. Take a close look at your service model and where the tips are coming from. Do you run a full-service restaurant? Do you have a counter service model? Does one category of workers have more exposure to tipping patrons? These answers will impact the most effective way to distribute the tips.

If you have one set of workers that tends to get most of the tips, consider a tip-share program that allocates certain percentages to support workers, including server supports and runners. However, if you run a counter service model where the interaction is fairly consistent for all workers, consider distributing a pro rata share based on workers hours for the week. For example, Employee A worked 40 hours and Employee B worked 10. Employee A is going to get a larger share of the tip pool fund at the end of the week than Employee B because they worked more hours.

Step 5: Put It in Writing

You've made the hard decisions, and now you need to put it in writing. While written tip pooling agreements are not required under the law in Kentucky, we strongly recommend them. You will need to include the participants, method of distribution, whether it is mandatory or voluntary, and how to address concerns about the calculations. It's always a good idea to have employees acknowledge receipt so if there is ever any confusion in the future, you have a signed document. We encourage you to work with your employment counsel to draft and/or review your tip pooling agreement.

Conclusion

If your business utilizes a tip pool or takes a tip credit, you should review your practices for compliance with evolving federal and state wage and hour laws. Fisher Phillips has created the Tip Credit Toolkit with documents aimed at helping you ensure (and demonstrate) federal compliance. Fisher Phillips will continue to monitor these rules and provide updates as appropriate. Make sure you are subscribed to Fisher Phillips' Insight System to get the most up-to-date information. For further information, contact your Fisher Phillips attorney, the author of this Insight, any attorney in our Louisville office, or any member of our Hospitality Industry Team.

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