

Uncovering The Mysteries Of The Tip Wage
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So you've heard all the recent hoopla surrounding the "tip credit" and "tip pooling." Seems like we used to just agree that no one really fully understands the outdated regulations surrounding the tip credit and we could just leave it at that. But now we're inundated with all the wage and hour collective actions and "oh my goodness," what happened with that *Starbucks* Case!

With plaintiff's lawyers seeing dollar signs in the plethora of recent wage and hour collective actions, they were bound to start looking at tip credit and pooling issues. Advertisements from plaintiffs' lawyers seeking claimants for collective actions are popping up like we use to only see with the latest drug scare. To be sure, the Department of Labor's Wage and Hour Division (DOL) is beginning to focus investigations on tip wage related issues. Well, so much for burying your head in the sand and hoping you're handling tips correctly enough to at least avoid a DOL investigation. It's time to roll up your sleeves, boys and girls, and dig into those dusty DOL regulations.

Let's start with the basics. The Fair Labor Standards Act (FLSA) allows an employer to take a credit toward the minimum wage due its tipped employees on account of the tips received by those employees in the course of their work. For an employer to take a tip credit, the employee must (1) be an employee engaged in an occupation wherein he or she customarily and regularly receives more than \$30 dollars a month in tips; (2) be informed about the tip credit to be applied toward his or her wages; and (3) retain all the tips he or she receives, except for tips contributed to other customarily and regularly "tipped employees" via an appropriate tip pooling arrangement. See 29 U.S.C. § 203(m) and (t).

Prior to August of 1996, the amount of this tip credit was set at an amount not to exceed fifty percent of the minimum wage in effect or \$2.125 [Based on a minimum wage of \$4.25 per hour at that time]. *Id.* However, in the August of 1996 amendment to the statute, the focus of the statute was taken off the tip credit and placed on the tip wage to be paid by the employer. The statute set the wage amount to be paid by the employer to tipped employees at \$2.125 per hour and allowed a tip credit to be taken in an amount equal to the minimum wage in effect less the established tip wage of \$2.125 per hour. The effect of this change is that the allowed tip credit will increase with each increase of the minimum wage, while the amount paid by the employer remains \$2.125 per hour. Currently, therefore, with the recent increase in the minimum wage, the amount of tip credit allowed employers is \$3.725 per hour, and will increase on July 24, 2008, to \$4.425 and again increase to \$5.125 on July 24, 2009. See 29 U.S.C. § 206(a)(1).

Tips are defined as "a sum presented by a customer as a gift or gratuity in recognition of some service performed for him. It is to be distinguished from a payment of a charge, if any, made for the service. Whether a tip is to be given, and its amount, are matters determined solely by the customer, and generally he has the right to determine who shall be the recipient of his gratuity. ..." See 29 C.F.R. § 531.52. Thus, employer imposed service charges are generally not considered tips.

With respect to determining the regular rate for purposes of calculating employee overtime, tips applied as a tip credit toward the employees minimum wage are included in the regular rate. Tips that are not used toward the tip credit are excluded from the regular rate of a tipped employee. Thus, any tips received by the employee in excess of the tip credit need not be included in the regular rate. 29 C.F.R. § 531.60. Employers, however, are prohibited from multiplying the tip credit by time and a

half (1½) as a credit against overtime. Employers may only take the statutory tip credit limit for each hour worked, whether straight time or overtime.

As stated above, in order for an employer to utilize the tip credit, the employee must retain all the tips he or she receives, except for tips contributed to other “tipped employees” via an appropriate tip pooling arrangement. This means, of course, the employer cannot retain any portion of the tips received for its general payroll or otherwise. An individual worker more properly characterized as representing the interests of “the employer” such as a supervisor, is not eligible to take tips along with other tipped employees, and an employer will be liable for reimbursing its employees the full minimum wage that such employees would have earned, should the employer exercise control over a portion of employee tips in this manner. *See Chung v. New Silver Palace Restaurant*, 246 F.Supp. 2d 220, 230 (S.D.N.Y. 2002) and *Ayres v. 127 Restaurant Corp.*, 12 F. Supp. 2d 305 (S.D. N.Y. 1998).

In the case of *Jou Chou v. Starbucks Corporation*, the plaintiffs sued collectively on behalf of other similarly situated employees. *See Jou Chou v. Starbucks Corporation*, 2004 WL 5231950 (S.D. Ca. 2008). As a Barista, Plaintiff was regularly required to pool tips with supervisors. While this matter involved issues of federal and California state law, it is clear from the recent order requiring Starbucks to pay more than \$100 million dollars in back tips, that the use of the tip credit is further complicated when employers utilize a tip pooling arrangement. It is in this area that employers can truly find themselves subject to significant liability should they fail to properly utilize the tip pool. What makes the tip pool such fertile ground for liability is that should an employer incorrectly establish a tip pooling arrangement while utilizing the tip credit, the pool can be wholly invalidated and the employer will then be liable for back pay of all tip credit amounts taken. *See DOL Wage & Hour Field Operations Handbook*, § 30d01(b). When spread across an entire class of employees, the accumulated liability can be staggering.

As demonstrated by the *Starbucks* case, requiring tips to be shared with supervisors is apt to bring a challenge to an employer’s utilization of the tip credit because individuals such as supervisors can be considered equivalent to the employer, thus violating the prohibition against the employer retaining a portion of the tips. An individual can be considered an “employer” if he or she (1) has the power to hire and fire employees; (2) supervises and controls employee work schedules or conditions of employment; (3) determines the rate and method of payment; and (4) maintains employment records. *See Dole v. Continental Cuisine*, 751 F.Supp. 799, 802 (E.D.Ark. Sep 28, 1990); see also *Bonnette v. California Health and Welfare Agency*, 704 F.2d 1465, 1470 (9th Cir. 1983).

As stated, the requirement that an employee retain all tips does not preclude the pooling of tips among “employees who customarily and regularly receive tips.” It is important to understand that an employer may mandate its tipped employees to contribute to a tip pool. This is the case despite the DOL regulation indicating that such pools must be voluntary. The DOL is not enforcing its regulation prohibiting mandatory tip pooling. However, in order for a tip pooling arrangement to be valid by the DOL’s enforcement standards (1) it must only include employees who customarily and regularly receive tips; (2) it may not require employees to contribute a greater percentage than is “customary and reasonable;” and (3) it may include only those tips that are in excess of tips used for an employee’s tip credit. *See DOL Wage & Hour Field Operations Handbook*, § 30d04(b); *DOL Wage & Hour Field Operations Handbook*, § 30d04(d); *DOL Wage & Hour Administrator Opinion WH-468* (Sep. 5, 1978); and *DOL Wage & Hour Administrator Opinion WH-380* (Mar. 26, 1976).

In order to qualify as an employee who “customarily and regularly receives tips,” an employee need not receive tips directly from customers, but merely must customarily and regularly participate in a

tip-pooling arrangement under which he or she receives tips given to other employees by customers. *Davis v. B & S, Inc.*, 38 F.Supp.2d 707 (N.D. Ind. 1998). Thus, this may include bellhops, counter personnel, bus boys and girls, service bartenders and other employees who offer support to directly tipped employees such as waiters. See DOL Wage & Hour Field Operations Handbook, § 30d04(b).

The DOL limits the amount a tipped employee may be required to contribute to a tip pool. The DOL requires that such tip out amount be “customary and reasonable,” and the DOL considers that to be no more than a maximum of 15% of an employee’s gross tips received. The courts, however, have not accepted the DOL’s limitation on tip pool contributions. Courts have stated that no where within the FLSA is there any limitation requiring tip outs to be “customary and reasonable,” thus, this limitation will not be supported should an employer wish to exceed the DOL’s standard. See *Kilgore v. Outback Steakhouse of Florida, Inc.*, 160 F.3d 294, 302 (6th Cir. 1998). As a matter of practice, the DOL will not question contributions to a pool not exceeding 15% of the employee’s tips. However, an employer may find themselves subjected to a DOL investigation for requiring pool contributions in excess of 15%, despite the position of the courts on this issue.

The final requirement for a valid tip pool is that only tips in excess of those credited toward payment of the directly tipped employee’s minimum wage may be required for contribution to a tip pooling arrangement. Thus, employers must be alert to shortages in collected tips. Should an employee fail to have sufficient tips make to up the difference between the tip wage and the minimum wage and yet be required to contribute to a tip pooling arrangement, the tip pool could be invalidated and the a back wage liability for all tip credit taken could occur.

As we discussed, the use of the tip pool is fertile ground for wage and hour violations. Employers, both large and small, are regularly shocked and amazed to find out that the wage policies they have had in place for years without any problem are in fact illegal and that they are now looking at paying doubled back wages for a two-year and sometimes three-year period.

Generally, everything goes along well until one employee becomes disgruntled, possibly for some wholly unrelated reason, and starts thinking about how unhappy they are about some quirk is their employer’s pay policy. This inevitably leads to a call to the wage and hour division or even worse, a private attorney, to check on the appropriateness of the employers pay practice. Suddenly, the employer is facing a wage and hour investigation. Many times this is the first time an employer seeks the assistance of a labor and employment law specialist. Unfortunately, at this point the law violation is all too clear and there is no meaningful way to defend against the alleged violation.

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