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CLIENT ALERT: Department of Labor Restricts Employer-Directed Tip Distribution Even When Affected Employees Are Paid Above the Minimum Wage

The United States Department of Labor, Wage and Hour Division issued important new directives to its field investigators. These directives will impact employers who employ individuals who pool gratuities. The Wage and Hour Division's Field Assistance Bulletin No. 2012-2 rejects the ruling of a Federal appeals court and advises field staff that the department's 2011 Tip Credit Regulations, which went into effect on May 5, 2011, will be uniformly enforced nationwide. The bulletin affects governmental enforcement of tip regulations even in cases where employers pay tipped employees at an hourly rate above minimum wage.

Tipped Employees

The Fair Labor Standards Act ("FLSA") defines a "tipped employee" as a person who customarily and regularly receives more than $30.00 per month in tips. Under Federal law and in most states, employers may pay tipped employees a sub-minimum wage "service rate," which is less than the lowest applicable minimum wage. Employers may then credit gratuities received by the employee to make up the difference. Under the FLSA, employers are permitted to take a "tip credit" of up to $5.12/hour, which is the difference between the federal service rate of $2.13 and the federal minimum wage. The lowest service rate will vary depending on the applicable state minimum wage laws. In Massachusetts, the lowest service rate allowable is $2.63 per hour. Employers who elect to utilize the tip credit must ensure that their employees receive at least the minimum wage when tips and wages are combined, and will be required to make up the difference if this is not satisfied.

In order to use a tip credit, an employer must provide the following information to its employees:

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(1) the amount of cash wage the employer is paying a tipped employee (at least $2.13/hour; $2.63 in Massachusetts);

(2) the additional amount claims by the employer as a tip credit (cannot exceed $5.12/hour);

(3) that the tip credit claims by the employer cannot exceed the amount of tips actually received by the tipped employee;

(4) that all tips received by the tipped employee are to be retained by the employee (except for a valid tip pooling arrangement); and

(5) that the tip credit will not apply unless the tipped employee has been informed of these tip credit provisions.

Employers must notify employees who are being compensated based on the tip credit. Failure to provide notice will result in an employer being prohibited from utilizing the tip credit, and require it to pay the full minimum wage to employees, who will also be allowed to retain all tips.

Tip Pooling

Tip pooling is the practice by which the tips of regularly tipped employees are "pooled" together and then redistributed among all employees who customarily receive tips. Employees may voluntarily participate, or an employer may require them to do so. However, employees are not required to share tips with other employees who do not customarily receive tips, such as cooks, managers, and administrators. Massachusetts and several other states have laws that even more strictly regulate tip-sharing.

Regulations Cover Higher Paid Workers

The Tip Credit Regulations, which became effective on May 5, 2011, explain that tips are the "property" of the employee, and an employer may not share or take away any portion of an employee's tips, except in the limited circumstances. The regulations state, in relevant part, as follows:

> Tips are the property of the employee whether or not the employer has taken a tip credit under section 3(m) of the FLSA. The employer is prohibited from using an employee's tips, whether or not it has

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> taken a tip credit, for any reason other than that which is statutorily permitted in section 3(m): As a credit against its minimum wage obligations to the employee, or in furtherance of a valid tip pool.

29 CFR §531.52.

The Department of Labor guideline rejects a recent U.S. Court of Appeals decision, *Cumbie v. Woody Woo, Inc*., 596 F.3d 577 (9th Cir. 2010). In *Cumbie*, a group of tipped employees sued after their employer required them to participate in a tip pool which included employees who do not customarily receive tips (cooks and dishwashers). The Ninth Circuit ruled that when an employer has not taken a tip credit, the FLSA does not create limitations on the use of employees' tips, and employers are permitted to require employees to share their tips with back of the house employees. The recent regulatory Bulletin articulates a uniform standard under which tip distribution is permitted only in the limited circumstances described in Section 3(m).

Critics have questioned whether the DOL's informal rulemaking exceeds the agency's regulatory authority where an employer does not utilize the tip credit minimum, and wage is not affected by tip distribution. Nevertheless, the Bulletin serves as important reminder of the restrictions on employer-regulated tip pools, which now applies even where employees are paid an hourly rate above the minimum wage. Employers who distribute tips in a manner that is inconsistent with the new regulations (i.e., include employees who do not customarily receive tips), can now face substantial liability under the FLSA. Moreover, employers should also ensure they comply with state wage laws, which may have additional restrictions on tip pooling.

Employers should contact MBJ with questions about how these changes affect their business and how to properly structure a tip-sharing system.

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