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United States Department of Labor Issues Final Rule on Employee Tips

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The United States Department of Labor (DOL) issued a final rule (Final Rule) on December 22, 2020, addressing tipped employees and the Fair Labor Standards Act (FLSA). The Final Rule was implemented as a result of the Consolidated Appropriations Act of 2018 that, among other things, amended the tip credit provision to the FLSA. The Final Rule eliminates the confusing 80/20 Rule at the federal level, prohibits employers from keeping tips received by their employees, and forbids managers and supervisors from participating in tip pools and keeping any portion of employees' tips. Further, the Final Rule provides additional clarity on what constitutes a "tip" under the FLSA. However, the Final Rule does not eliminate New York's separate 80/20 Rule or other relevant state laws.

When Can an Employer Take a Tip Credit?

Under certain circumstances, the FLSA permits an employer to take a tip credit towards its minimum wage obligations for employees who customarily and regularly receive tips. The Final Rule clarifies that employers may only take a tip credit when the employer first informs the employee in advance of:

- The amount of the cash wage that is to be paid to the tipped employee;
- The amount of the tip credit that will be taken;
- The fact that all tips received by the employee must be retained by the employee except those that are contributed to a tip pool arrangement;
- The fact that if the employee's cash wage and tips do not equal the minimum wage for all hours worked, the employer will pay the difference; and
- The fact that a tip credit cannot be taken unless the employee has been informed of the above.

The Final Rule does not require that this information be in writing. However, it is prudent for employers to inform employees about the tip credit in writing to minimize claims that employees were never properly informed about the tip credit. Further, some states, such as California and Nevada, do not permit employers to take a tip credit under any circumstance. Other states, such as New York, require that additional information be provided to an employee before a tip credit can be taken. The Final Rule does not supersede such state law requirements.

The Final Rule, however, eliminates the federal 80/20 Rule, which stipulates that employers cannot take a tip credit if the employee spends more than 20% of the employee's time engaged in non-tip producing work. This created a lot of confusion – and litigation – over what work constituted "non-tip producing work," and what work was ancillary to tip-producing work. Now, all non-tipped work will be considered "related" to tip-producing work, and thus employees performing such work will be eligible for a tip credit to be taken, as long as the duty at issue is listed as a task of the tip-producing occupation in the Occupational Information Network (O*NET). Currently, O*NET lists the following duties as related to a tipped occupation:

- Setting up and cleaning tables;
- Making coffee; and
- Cleaning glasses or dishes.

However, employers should note that state 80/20 rules, such as those in New York, remain in place and are not impacted by the Final Rule.

The Final Rule also clarifies how to handle a tip credit when an employee has dual jobs – one that is tipped and one that is non-tipped. When the employee is engaged in the tipped job – such as, a busser – a tip credit may be taken (provided all of the other requirements to take a tip credit have been satisfied). When an employee is engaged in the non-tipped job – such as a porter – a tip credit may not be taken. However, the Final Rule expressly provides that an employer may take a tip credit for the time that an employee in a tipped occupation performs non-tipped duties that are either "contemporaneously with or for a reasonable time immediately before or after" performing tipped duties. The Final Rule eliminates the focus on the percentage of time spent on non-tipped duties and allows employers to utilize a practical, real-world approach to evaluating employee tasks when making determinations regarding the use of a tip credit.

This change is certainly a welcome relief to employers, who now how more flexibility (at least at the federal level) in applying a tip credit to tipped employees who may be required to perform some non-tipped work. Note, however, that state law may differ with respect to the 80/20 Rule, so employers should always consult with counsel before applying a tip credit to tipped employees who perform dual jobs.

Who Can Participate in a Tip Pool?

Under the FLSA, employers that claim a tip credit must ensure that their mandatory tip pool includes only employees who "customarily and regularly" receive tips. In other words, for an employer to claim a tip credit from their mandatory tip pool, the tip pool participants cannot include employees such as cooks or dishwashers as they do not "customarily and regularly" receive tips. Nevertheless, as the Final Rule clarifies, recent amendments to the FLSA eliminated such restrictions on an employer's ability to require tip pooling when it *does not* take a tip credit. Therefore, *if an employer does not take a tip credit* with respect to any employee who participates in the tip pool, then non-tipped employees, such as back-of-house staff, may participate in the tip pool. However, the Final Rule also clearly states that under no circumstances may managers or supervisors participate in the tip pool irrespective of whether a tip credit is taken.

As with the Final Rule's changes to when an employer can take a tip credit under the FLSA, state law may differ with respect to tip pool eligibility and restrictions. Accordingly, employers are advised to consult with counsel before including non-tipped employees in their tip pools.

What Constitutes a Tip?

The Final Rule provides additional clarity on what constitutes a "tip" under the FLSA. The Final Rule explains that compulsory service charges and "mandatory gratuities," such as an automatic 15 percent charge on a total bill imposed by a restaurant, is not a tip, even if distributed by the employer to its employees. Such monies cannot be counted as a tip or be used to determine whether the employee received enough tips to bring the employee up to the minimum wage. Indeed, the Final Rule state that for a "payment" to be deemed a "tip" the amount of the payment and whether there will be a payment must be in the sole discretion of the customer.

Additional Employer Considerations

The Final Rule provides welcome relief for many hospitality employers. However, employers are cautioned to pay close attention to their state-specific requirements regarding when an employer can take a tip credit, who can participate in a tip pool and what constitutes a tip, which may impose more stringent requirements than the FLSA.

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