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Tip-Related Claims Will Continue to Be Served Up as the Lawsuit du Jour Against the Hospitality Industry in 2015

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The hospitality industry is particularly fertile ground for a wide variety of wage and hour issues, which continue to plague management through steadily increasing federal and state department of labor investigations and enforcement actions and the seemingly endless onslaught of private wage and hour lawsuits filed by an overzealous plaintiffs' bar. Tip credit claims are government regulators' and plaintiffs' favorite, and there are no signs that such claims will abate in the coming year.

Employers may take a credit against the prevailing minimum hourly wage earned by employees performing tip-earning duties, such as servers, bartenders, bussers, hosts, housekeeping personnel, and bell staff. Before taking a tip credit, however, employers must comply with very specific federal and state tip credit laws, rules, and regulations, which form the basis of the various tip credit lawsuits commonly filed against employers in the hospitality industry.

Because of the prevalence of tip credit lawsuits in the hospitality industry, this edition of *Take 5* will address five of the most common tip-related wage and hour issues that are often the focus of litigation. They are as follows:

1. **Properly Providing Tip Credit Notice**
2. **Correctly Applying the Tip Credit Allowance**
3. **Properly Computing Tipped Employees' Overtime Pay**
4. **Ensuring That Tipped Employees Actually Perform Tipped Work**
5. **Complying with Tip Pooling or Sharing Requirements**

1. Properly Providing Tip Credit Notice

The Fair Labor Standards Act ("FLSA") states that an employer may not take a tip credit for its tipped employees without first providing notice to them. Federal regulations state that the notice, which may be oral or written, must set forth: (i) the amount of cash wage (subminimum wage) that the employer is paying a tipped employee; (ii) the additional amount claimed by the employer as a tip credit; (iii) that the tip credit claimed by the employer cannot exceed the amount of tips actually received by the tipped employee; (iv) that all tips received by the tipped employee are to be retained by the employee except for a valid tip pooling arrangement, which is limited to employees who customarily and regularly receive tips; and (v) that the tip credit will not apply to any tipped employee unless the employee has been informed of these tip credit provisions.

Employers must also be aware of certain state's wage laws that include enhanced tip credit notice requirements. For example, in New York, employers are required to provide written notice to each tipped employee, prior to the start of employment, which includes the employee's regular hourly pay rate, overtime pay rate, amount of tip credit, and regular payday and indicates that extra pay is required if tips are insufficient to bring the employee up to the basic minimum hourly rate. Employers in New York must then retain for six years an acknowledgement of receipt of the tip credit notice, which has been signed by each tipped employee.

Because taking a tip credit is common practice in the hospitality industry, employers often forget that they must provide notice of the tip credit to their tipped employees. This can be a costly error, however, because tip credit lawsuits often include a tip credit notice claim to recover the difference between the subminimum wage paid and the prevailing minimum wage, plus liquidated damages, under both the FLSA and state wage laws.

The best practice, regardless of where an employer's business operates, is to always provide written notice to each tipped employee, which the employee must sign as acknowledgement of receipt. Even if an employer is only required to provide oral tip credit notice (under the FLSA and certain states' laws), documented evidence of written notice provides a useful tool to help the employer defend against tip credit claims.

2. Correctly Applying the Tip Credit Allowance

Federal and state wage and hour laws prescribe the maximum dollar amount that an employer may take as a credit towards its tipped employees' hourly wages. The current maximum tip credit that an employer may claim under the FLSA is $5.12 per hour. Employers must therefore pay a $2.13 cash "subminimum" hourly wage to its tipped employees, which is the difference between the maximum tip credit and current $7.25 federal minimum wage.

Many states, however, prescribe minimum wage rates and maximum tip credit amounts that differ from the FLSA. For example, in New York, the current minimum hourly wage is $8.00 (which will be increasing to $8.75 on December 31, 2014). In addition, New York's maximum tip credit allowance varies, depending on whether the tipped employee is a food service worker (currently a $3.00 maximum tip credit), a

service worker (currently a $2.35 maximum tip credit), or a service worker in a resort hotel (currently a $3.10 maximum tip credit).

It is important for employers to ensure that they are not exceeding the maximum tip credit allowance. Even a small error could result in significant back wage liability, especially when defending against class and collective action lawsuits filed on behalf of multiple former and current employees, which has become commonplace in wage and hour litigation. Accordingly, employers should consult their inside or outside counsel to confirm the various maximum tip credit allowances in each state where they operate.

3. Properly Computing Tipped Employees' Overtime Pay

Another tip credit issue arises in computing overtime for tipped employees. Employers often make the mistake of computing an employee's overtime by multiplying 1.5 by the subminimum wage being earned. This is a common error that is frequently exploited by plaintiffs' attorneys.

Where an employer takes a tip credit, overtime is based on the full hourly wage, not the subminimum wage paid by the employer. In calculating the overtime rate for a tipped employee, the employer must multiply the prevailing federal or state minimum wage (currently $7.25 under federal law) by 1.5, which equals $10.875. Next, the employer must subtract from that amount the tip credit (currently $5.12 under federal law) to arrive at $5.755, which is then multiplied by the number of overtime hours worked in excess of 40 per week.

4. Ensuring That Tipped Employees Actually Perform Tipped Work

One of the most complex and elusive parts of the law pertaining to tip credits is the duties requirement. Federal regulations provide that employers may take a tip credit from employees only when they are engaged in "tip earning activities," or if they perform duties "related to their tip earning work." The U.S. Department of Labor ("DOL") explains in its Field Operations Handbook ("FOH") that "related" duties are incidental to the employee's regular tip-earning duties.

For example, according to the FOH, a server who spends some time cleaning and setting tables, making coffee, and occasionally washing dishes or glasses may continue to be engaged in a tipped occupation even though these duties are not tip-producing, provided that such duties are incidental to the regular duties of the server and are generally assigned to servers. The DOL prescribes limits, however, on the amount of incidental tip-related work that an employee may perform in order for the employer to take a tip credit for employees performing incidental work. According to the FOH (as well as a number of courts around the country that have interpreted it), no tip credit may be taken against wages of tipped employees who spend a "substantial amount" of time—in excess of 20 percent—performing work incidental to tip-earning duties. Furthermore, employers should consult state wage laws to confirm whether particular states maintain tipped duties requirements that are different or more stringent than the "20 percent rule" enforced by the DOL.

Another distinction about which employers in the hospitality industry should be aware is the difference between "incidental duties" and "dual jobs." According to the DOL, incidental duties related to tip-producing work are different from dual jobs. Federal regulations provide that where employees are employed in two distinct occupations, no

tip credit can be taken for an employee's work that is not tip earning, or incidental thereto. The DOL provides an example of this distinction in an interpretive Fact Sheet. According to that Fact Sheet, where an employee is employed as a maintenance worker and server, the tip credit is available only for the hours spent by the employee in the tipped server occupation.

Accurately distinguishing amongst tipped employees' tasks as tip-producing, incidental, or unrelated (a different job) can be an arduous exercise for employers. Even more challenging is quantifying the amount of incidental work that is performed by a tipped employee and ensuring that it does not exceed 20 percent of the employee's workload. Accordingly, the best practice for employers is to designate most, if not all, incidental and non-tip-related work to employees who are not paid a subminimum wage. If that option is not viable, closely track the amount of incidental work performed by tipped employees to ensure that no one individual spends more than 20 percent of any one shift (e.g., 48 minutes of a four-hour shift, or one hour and 12 minutes of a six-hour shift) performing such duties. In addition, employers may want to consider documenting their tipped employees' non-tip-producing duties by using sign-in sheets, time clocks, or other recordkeeping devices.

5. Complying with Tip Pooling or Sharing Requirements

"Tip sharing" occurs when directly tipped employees share their tips with other workers who provided direct customer service. "Tip pooling" occurs when directly tipped employees pool their tips, and those tips are redistributed among directly and indirectly tipped employees. Employers are permitted to adopt tip pooling or sharing practices as work place requirements for their tipped employees; however, there are specific requirements, which, if not followed, will invalidate the tip pool or share arrangement.

Employers are required to notify all tipped employees who participate in a tip pooling or sharing arrangement. When providing notice, the best practice for employers is to provide written notice of the pooling or sharing arrangement and require employees participating in the pool to sign as acknowledgement of receipt of the notice, even where such written acknowledgment is not required by law.

In addition, employers may only take a tip credit for the amount of tips that each tipped employee ultimately receives, as opposed to what any one employee initially received from his or her customers.

Another requirement, which is perhaps the most important one, is that employers may never retain any amount of an employee's tips.

Finally, only tipped employees may participate in tip pooling or sharing. Non-tipped personnel, including managers, shift supervisors, and back-of-the-house workers, may not share in tips pooled among employees engaged in tip-producing work.

It is important for employers to carefully consider their tip pooling and sharing practices to ensure strict compliance. Tip pooling and sharing rules can be easily overlooked, which can result in costly litigation.

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