Insight

IN-DEPTH DISCUSSION

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DOL Announces Intent to Rescind Rule Restricting the Allocation of Gratuities to Non-Tipped Employees When the Employer Does Not Take a Tip Credit

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Restaurants, hotels, and other businesses that employ tipped workers have long wrestled with a seemingly simple, but actually intractable, question: who is entitled to receive a share of a guest's gratuities? If an employer applies a tip credit towards a tipped employee's wages, the federal law is clear—the employer is not permitted to retain any of the tips and tips must be retained by the tipped employee, or shared among customarily and regularly tipped employees such as servers, bartenders and bussers. However, the answer becomes muddled for those employers that do not take a tip credit and instead pay all employees, even those who receive tips, at least the full minimum wage. As discussed in more detail below, the U.S. Department of Labor (DOL) and various courts have taken different approaches to this question and, as a result, there exist inconsistent guidelines across the country. Recent developments from the DOL, however, may finally result in some clarity and uniformity.

Brief History of the FLSA's Tipping Laws and Regulations Concerning Employers that do not Apply a Tip Credit

In 1938, Congress passed the Fair Labor Standards Act (FLSA) and set a national minimum wage rate for the first time. For the first 40 years that the FLSA was in effect, there was no differentiation between employees who received tips and those who did not. However, in 1974, Congress amended the FLSA and for the first time allowed employers to apply a tip credit towards the wages of employees who received gratuities. The tip credit allows employers to count a portion of an employee's tips as wages in order to satisfy the minimum wage requirements. In order to apply a tip credit, the statute required that the employer inform the tipped employee of the provisions of the law and also mandated that "all tips received by

such employee have been retained by the employee" subject to the creation of a lawful tip pool that allowed the splitting of tips among employees who customarily and regularly received tips.

Since the passage of the 1974 amendment, many courts interpreted the FLSA to prohibit the sharing of tips with non-tipped employees such as kitchen or maintenance staff. These courts also prohibited employers from keeping any portion of gratuities for themselves. In 2010, however, the tide began to change when the U.S. Court of Appeals for the Ninth Circuit, which covers Alaska, Arizona, California, Hawaii, Idaho, Montana, Nevada, Oregon and Washington, issued a decision in *Cumbie v. Woody Woo*, Inc., 596 F.3d 577, 581 (9th Cir. 2010), which held that section 203(m) of the FLSA does not restrict the tip-pooling practices of employers that do not apply a tip credit towards its employees' wages. In other words, the Ninth Circuit said that an employer that pays its employees at least the full minimum wage can mandate a policy where tips are shared among all employees, even those who do not regularly and customarily receive tips such as kitchen and maintenance staff.

In response to the Ninth Circuit's decision in *Woody Woo*, the DOL, in 2011, promulgated new rules to specify that tips are always the property of the employee. Specifically, the DOL revised 29 C.F.R. § 531.52 by replacing the sentence, "[i]n the absence of an agreement to the contrary between the recipient and a third party, a tip becomes the property of the person in recognition of whose service it is presented by the customer" with the following language "[t]ips are the property of the employee whether or not the employer has taken a tip credit . . . The employer is prohibited from using an employee's tips, whether or not it has taken a tip credit, for any reason other than that which is statutorily permitted in section [the FLSA], as a credit against its minimum wage obligations to the employee, or in furtherance of a valid tip pool."

Several appellate courts have analyzed the propriety of the 2011 regulation and held that the DOL exceeded its authority. These courts further held that the 2011 DOL regulation is invalid because it violates the express language of Section 203(m) of the FLSA. For example, the Tenth Circuit in Marlow v. New Food Guy, Inc., 861 F.3d 1157 (10th Cir. 2017) held that "[a]ll that § 203(m) does is permit a limited tip credit and then state what an employer must do if it wishes to take that credit." The Tenth Circuit covers Colorado, Kansas, New Mexico, Oklahoma, Utah and Wyoming. Likewise, the Fourth Circuit in *Trejo v. Ryman Hosp. Props.*, Inc., 795 F.3d 442, 448 (4th Cir. 2015) found that "§ 203(m) does not state freestanding requirements pertaining to all tipped employees, but rather creates rights and obligations for employers attempting to use tips as a credit against the minimum wage." The Fourth Circuit covers Maryland, North Carolina, South Carolina, Virginia and West Virginia. As a result of these holdings, employers located in the states covered by the Fourth and Tenth Circuits are allowed to retain tips or distribute tips to non-tipped employees, provided they do not take advantage of the tip credit and pay all staff the full minimum wage.

Ironically, the Ninth Circuit, which was the first court to hold that an employer that does not apply a tip credit can keep gratuities, has since reversed course. In *Oregon Rest. & Lodging Ass'n v. Perez*, 816 F.3d 1080, 1086–89 (9th Cir. 2016), the Ninth Circuit split with the Tenth and Fourth Circuits, finding that the DOL's regulation was entitled to deference, and that the practice of sharing tips with employees who are not customarily and regularly tipped is prohibited by Section 203(m) of the FLSA in all cases. The *Oregon. Rest. & Lodging Ass'n* case is currently on appeal to the United States Supreme Court.

The DOL Indicates it Will Rescind the 2011 Regulation

In what is likely an attempt to avoid the Supreme Court's review of the DOL's power to issue regulations, the DOL recently announced that it would begin the process of revoking the 2011 regulation that it adopted in response to the Woody Woo decision. In the meantime, the DOL has implemented a nationwide non-enforcement policy concerning the 2011 regulation. Accordingly, once the rule is revoked, under federal law, an employer that does not apply a tip credit towards tipped employees' wages will be able to keep tips, distribute tips to kitchen staff, or otherwise set the parameters for sharing tips in any way it sees fit.

Impact of the Announcement

The DOL's revoking of the 2011 regulation is welcome news to many employers that reside in jurisdictions that solely follow the FLSA. However, the DOL's announcement will have a limited impact in some jurisdictions that have adopted specific laws governing tipping and prohibit distribution of gratuities to non-tipped employees under any circumstances. For example, New York State has adopted laws and regulations that prohibit employers from retaining tips or requiring tipped employees to share tips with supervisory or non-service providing employees. Likewise, the Connecticut Department of Labor's Wage and Workplace Standards Division takes the position that only front-of-house employees who have regular guest interaction may participate in a mandatory or voluntary tip pool. California, too, only permits tip pooling where participants in the tip pool contribute to the patron's service. All employers should consult with an attorney to determine whether their state or locality adopts more stringent requirements than those promulgated by the FLSA.