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May 22, 2013



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Feeling Lucky?

The Potential Impacts of Tip Pooling On Minimum Wage Requirements

By Aaron J. Graf

For employers, engaging in the practice of tip pooling may sometimes remind them of a classic Dirty Harry line. In all the excitement of realizing they may be able to use a minimum wage tip credit, employers may lose count of the number of elements they need to meet in order to ensure they are properly utilizing tip pooling. And if employers are not careful when going about this, they've got to ask themselves one question: do they feel lucky?

Many employers, especially those in the service industry, use the minimum wage tip credit in compensating their staff. Generally speaking, the minimum wage tip credit allows an employer to pay an employee \$2.13/hour if the employee's tips bring the employee's hourly wage up to the federal minimum wage threshold - currently \$7.25/hour. (Many states have comparable provisions in their state wage and hour law that should also, of course, be consulted.) If the employee's wages do not rise to the level of the minimum wage after tips, then the employer is required to make up the difference.

The Fair Labor Standards Act ("FLSA") requires that three conditions be met before an employer can claim a tip credit on behalf of an employee:

(1) the employee must qualify as a "tipped employee"; (2) the employer must inform the employee of the statutory tip credit before it is taken; and (3) the employee must be allowed to retain the tips received. It is that third and final requirement - allowing the employee to retain their tips - that often causes problems because the improper pooling and distribution of tips can unknowingly lead to an invalidation of the minimum wage tip credit.

A "tipped employee" is defined as "any employee engaged in an occupation in which he customarily and regularly receives more than \$30 a month in tips." 29 U.S.C. § 203(t). Examples that immediately come to mind are servers and bartenders. However, other employees, such as bellhops and busboys, may fit within this category as long as they regularly and customarily receive tips at their job. *See, e.g.*, DOL Field Operations Handbook § 30d04(a). Employers should be wary of automatically assuming an employee is or is not a tipped employee simply based on job title. Courts will look to either the level of customer interaction of the employee or whether such a position traditionally participates in tip pools based on the custom and practice in the industry and the locality.

Second, an employer must inform the employee that the employee is subject to the minimum wage tip credit. Although courts have repeatedly rejected arguments that an employee's prior knowledge of "industry practice" is sufficient notice, courts have found that there is no magical language that must be used by an employer in informing the employee of the minimum wage tip credit, and employers are not expected to be experts on the law. The best practice is to inform every such employee in detail and in writing to avoid any future confusion.

As to the third and final element, and the real crux of the analysis of whether a tip pool may invalidate the use of the minimum wage tip credit, the employee must be allowed to "retain their tips." Despite this requirement that the employee be permitted to retain all tips, the FLSA also provides "that this subsection shall not be construed to prohibit the pooling of tips among employees who customarily and regularly receive tips." 29 U.S.C. § 203(m). The problem arises when the tip pooling is improperly done and, in essence, denies the employee the ability to "retain their tips."

The problem which most often rears its ugly head is where the tip pool is improperly distributed to non-tipped employees or members of management. Where tipped employees are required to pool their tips with non-tipped employees who do not regularly and customarily receive tips, courts have found that the minimum wage tip credit is defeated and the FLSA is violated. *See, e.g., Bonham v. Cooper Cellar Corp.*, 476 F. Supp. 98 (E.D. Tenn. 1979); *Martin v. Tango Rest., Inc.*, 969 F.2d 1319 (1st Cir. 1992). The rationale is that employers cannot require employees who are subjected to the minimum wage tip credit to share their tips with employees who already are receiving the full minimum wage as non-tipped employees.

Similarly, courts have invalidated tip pools where tipped employees are required to share their tips with members of management, regardless of whether these members of management are also tipped employees. This relates back to the requirement that the tipped employees be allowed to "retain their tips." By including members of management in a tip pool, courts find that the employer is retaining a portion of the tips through management, which may invalidate the tip pool (and defeat the minimum wage tip credit.) Employers should not fall prey to the fallacy that simply because an employee actually, in fact, receives the minimum wages that a violation of the minimum wage laws cannot occur. If the pooling of tips is improper, courts may still find a violation of the FLSA. *See, e.g. Bernal v. Vankar Enterp., Inc.*, 579 F. Supp.2d 804, 808 (W.D. Tex. 2008). Thus, employers may not rest easy merely because their employees have indeed received the minimum wage if a violation may have, nonetheless, occurred.

Of course, the final concern that arises is what damages or penalties might an employer be subjected to if an improper tip pool invalidates the use of the minimum wage tip credit. It appears there are two possible categories of damages and penalties that may be assessed against an employer in such a scenario. First, any tips that were distributed to non-tipped employees must be reimbursed and split among the eligible tipped employees. The purpose of this is to reimburse the employees for tips that were rightfully theirs. Second, as the employer has violated the minimum wage tip credit, the employer may have to disgorge the benefits of the minimum wage tip credit taken for each employee for every hour worked. The purpose of this is to prevent employers from benefiting from the minimum wage tip credit where it is not properly claimed. Needless to say, these damages can quickly accumulate given the compounding nature of such violations.

As these types of issues are highly fact intensive, no action should be taken without consulting legal counsel about your own specific circumstances and how they interact with the applicable law.

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