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Tips

Who, What, Why . . .

Who does it apply to: Employers who take the “tip credit” against wages of some or all of their employees.

What is the “tip credit”: Employees who earn tips may be paid a lower hourly rate than the standard minimum wage on the theory that they make it up in tips. Currently, employers may take a credit against minimum wage reducing the tipped employee’s pay to \$2.13 per hour (as opposed to \$7.25). As long as the tipped employee earns at least \$5.12 per hour in tips, the employer has no further obligation. If the employee falls short of this mark during any week, however, the employer is obligated to make up the difference.

Who does the credit apply to: Well, “tipped employees,” of course. A tipped employee is a person who receives more than \$20 per month from tips, retains all the tips (except for tips shared in a legitimate pool), and is employed in a job that customarily and regularly receives tips (not just holidays or special occasions). This includes employees like a busboy who may not receive the tip directly, but is awarded the tip as part of a legitimate “tip pool.” Tipped employees typically include: waiters, waitresses, bellhops, counter people who serve, busboys, service bartenders, and perhaps hostesses, seaters and greeters.

What is a “tip:” A tip is a monetary payment by a customer that is totally discretionary. It does not include service charges, i.e. a restaurant that automatically taps your bill for a certain amount on top of the food to pay for the service you receive. That said, the Department of Labor (“DOL”) does not consider the automatic gratuity charged by some restaurants for tables of 6 or more to be a service charge as long as the employee receives the tip.

How does prep time count: Prep time is dangerous for employers. Many restaurant owners, for example, have employees come in 30 minutes to an hour before their shift to set up tables and prep the restaurant. During this time they pay only the tip credit amount. Technically, this would be a violation because employees should only be paid the tip credit amount while they can be earning tips. The DOL has an informal rule that prep time is not an issue as long as it does not exceed 20% of the employee’s shift. Employers must be careful though, because any time during a shift may count toward this limit. It is very easy to run afoul of this rule.

Who has the burden of proof: Employers need to keep in mind that the burden to prove tips were handled properly is on them. Recordkeeping is, therefore, very important. After all, the consequence of losing the tip credit is to go back and make the employees whole at the full minimum wage rate.

What do I have to tell the tipped employees: Tipped employees must be placed on notice of their employer’s tip scheme, including the time and manner in which tips are paid. This notice does not have to be in writing, but it is recommended so that employers can prove to the DOL that the employee was on notice if it becomes an issue. Employees must also be placed on notice of any tip pool and its manner of tabulation.

How do tip pools work: A tip pool is simply the pooling of tips received from the service of a customer at a meal for the service staff. While the check is usually paid to the waiter or waitress and customers attribute the tip to their service, there are many employees involved in the process – including hostesses, busboys, and the like. To be legal, the pool must pay out to only those who customarily and regularly receive tips (see above). The tip pool cannot include the portion of the server’s tips that are required to cover the tip credit or take away more than what is customary and reasonable in that locale. DOL takes the position that the customary and reasonable deduction cannot exceed 15%, but there may be special cases. If instituted by the staff itself, however, a tip pool taken can be any amount. All participating employees must have advance notice of a tip pool.

Who pays the credit card company on tips: Employers can charge credit card companies’ fees against the tip portion of a customer’s total bill by payroll reduction or direct reimbursement at the time the tip is earned. Larger employers will likely have software to handle this calculation and employees will be charged only the precise amount that each credit card company charges on each transaction. That said, the DOL presently has a policy of challenging deductions only if they exceed 5% of the tip on any transaction.

Common Situations:

But I thought I got the tips: The front of house manager at Romeo’s Restaurant is annoyed at how much his waitresses are earning from tips. In a stroke of brilliance, he decides that he will collect all of the tips, take the tip credit on the waitresses,

and pay them back the difference to bring their wages up to minimum wage. Thus, all of the “profit” in the tips will go to him. Is this legal? No. An employer cannot take the tip credit and then give the employee back the tips they earn only to the point of minimum wage. That said, the manager could hire all of the wait staff at minimum wage to begin with and collect all the tips for the house – assuming anyone will take the job.

Tiping out the cooks: Bob’s Bar-B-Que decides that the food is truly the star of its restaurant and that customers are basing their tips, at least in part, on the skill of its cooks. To even things out, Bob institutes a tip pool and has the wait staff tip out the kitchen. The tip pool is handled correctly in all other respects. Is it legal? Nope. Tip pools may only include those employees who “customarily and regularly” receive tips. According to the DOL, this may include a busboy, but it does not include cooks, chefs, dish washers, laundry room attendants, or janitors.

Multi-tasking: Hotel Bizarre is just getting off the ground. Everybody that works there has more than one job. The day manager tends bar at night. The night doorman waits tables during the breakfast rush at the restaurant. How does the business handle the fact that these employees have one job for which they can take the tip credit and another for which they must earn at least minimum wage? The time must be segregated. When they work the tip credit position, they can be paid \$2.13, with tips. When they are in their other job, they must be paid at least minimum wage. Now, there is likely to be a lot of overtime in this situation. Unfortunately, resolving that issue requires a slide rule and a ream of paper. Contact your attorney to help you determine overtime in that situation.

What Should I do:

Good: Determine which employees are entitled to receive tips and monitor their tips on a weekly basis to be sure that they are receiving at least minimum wage for each hour worked. Make sure the employees are at least orally on notice of the tip system you employ.

Better: Put your tip system in writing and have new employees sign to receive notice. If you have a tip pool, put that in writing as well. Collect and keep records of all tips received by employees on a weekly basis. Maintain a credit card fee deduction of less than 5%. Watch out for prep time. I recommend employers pay employees minimum wage for any pre or post shift prep time in excess of 15 minutes on each side to be protective of the limitation.

Best: Invest in software that keeps all records regarding tips for perfect evidence to show the DOL in an audit. Pay all employees minimum wage for all prep time before and after shifts to be certain there can be no argument. This is a common basis for suit by employees.



Michael Kelsheimer focuses his practice on the employment law needs of Texas businesses and executive employees. He recognizes that the cost and expense of litigation make resolving employment disputes challenging. To help avoid these concerns, he utilizes his experience in and out of the courtroom to prevent or quickly resolve employment disputes through proactive employer planning and timely advice. When a dispute cannot be avoided, Michael relies upon his prior experience as a briefing attorney for the United States District Court and his extensive experience in employment and commercial lawsuits to secure favorable resolutions for his clients.

This guide is one in a series. For more information, or to receive the entire collection contact Michael Kelsheimer by email at mkelsheimer@grayreed.com or by phone at **469.320.6063**