Is Your "Tip Credit" A Time Bomb?

By John E. Thompson

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Section 3(m) of the federal Fair Labor Standards Act allows a portion of the employee's FLSA-required minimum wages to consist of tips. Unfortunately, it is all-too-common for employers to make expensive mistakes where tips are concerned.

Fundamental Rules

Tipped employees are those engaged in occupations in which they customarily and regularly receive more than $30 a month in tips. Tips they actually receive may be counted as FLSA wages up to a current maximum of $5.12 per hour; the employer must pay them at least $2.13 an hour in addition to tips. The FLSA requires an employer to tell each tipped employee about the law's tip-credit provisions in advance. And, as we reported in May, the U.S. Labor Department now says that other notifications are also required.

The employee's creditable-tips-plus-wages total must come to at least the current minimum wage of $7.25; the employer must make up any shortfall. Employees must be allowed to keep their tips, except that they can be required to contribute to a tip-pool participated in only by other employees who customarily and regularly receive tips.

Pitfalls and Misconceptions

Among the typical problems are:

♦ Failing to provide the necessary tip-credit notification;

♦ Not ensuring that the total of an employee's hourly wage plus his or her creditable tips equals at least the minimum wage; or

♦ Not being able to document that employees actually received enough in tips to cover the credit taken.

Employers also find themselves facing liability for:

♦ Taking the tip-credit for hours a "dual function" employee spends in non-tipped work (learn more here);

♦ Calculating overtime at 1.5 times only the employee's $2.13-per-hour cash wage;

♦ Taking a larger tip-credit for overtime hours than for non-overtime ones;

♦ Withholding uniform costs, shortages, breakage, "walk-outs", and so on from an employee's tips; or

♦ Maintaining invalid tip-pools.

Trouble can also result from lumping both tips and service charges under the catch-all term "gratuity". An FLSA tip-credit "tip" is a payment *the patron decides* whether to make, and as to which *the patron decides* how much to give and to whom to give it. No tip credit may be taken for a compulsory service charge imposed by the employer. What's more, service charges paid to employees must be included when figuring any FLSA overtime pay they are due.

What About Other Laws?

Some states do not permit taking a tip-credit, while others allow one but restrict the amounts in ways which are different from the FLSA's provision. Also, an increasing number of states and other jurisdictions prescribe what employers may, may not, and must do where sums representing tips and service charges or fees are concerned.

Employers should immediately check to see whether tips and tip-credit matters are being handled in the proper way. Even if things used to be fine, management is not always aware of changes in the law or in day-to-day procedures that can lead to major problems.