Compliance Overview

Highlights

Employers can consider the following best practices to comply with the FLSA's tip regulations:

- Providing tipped employees with written notice;
- Ensuring tip pools are structured properly;
- Treating service charges as wages;
- Tracking tipped and nontipped duties for tipped employees;
- Maintaining accurate records;
- Conducting internal audits;
- Training managers and supervisors; and
- Complying with state and local laws.

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Best Practices for Complying With FLSA Tip Regulations

Tipped employees are common in restaurants, hotels, salons and other service industries. The Fair Labor Standards Act (FLSA) imposes specific wage and hour rules that apply only to tipped workers. These rules include specific requirements for calculating minimum wage and overtime pay for tipped employees, restricting which workers may share in tip pools and addressing mandatory service charges.

Tip-related violations are a frequent source of administrative investigations and private lawsuits. Failure to comply with the FLSA's tip requirements can lead to costly investigations, civil penalties, back wages and liquidated damages liabilities, and reputational harm. Establishing best practices can help employers reduce legal risks and stay compliant with the FLSA's wage and hour requirements for tipped workers.

This HR Compliance Overview provides employers with a general overview of the FLSA's tip regulations and outlines best practices to help them develop and maintain compliant employment practices.

Links and Resources

- The FLSA's tip regulations
- The DOL's guidance on tip regulations under the FLSA
- The DOL's Fact Sheet #15: Tipped Employees Under the FLSA

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Overview of the FLSA's Tip Regulations

Tipped Employees

The FLSA's requirements for tipped wages apply to tipped employees. **Tipped employees** are those engaged in occupations in which they customarily and regularly receive more than $30 a month in tips, whether they are full-time, part-time, permanent or temporary employees. A **tip** is a sum presented by a customer as a gift or gratuity in recognition of service performed for the customer, rather than as payment for the service. Tipped occupations commonly include waiters, bellhops, taxicab drivers, barbers, beauty operators, counter personnel who serve customers, bussers and service bartenders.

In addition to federal regulations for tipped workers, employers must be mindful of state laws that may offer greater protections.

Tip Credit

The FLSA allows employers to take a tip credit toward their minimum wage and overtime obligations for tipped employees. This credit allows employers to pay their tipped employees cash wages equal to the difference between the minimum wage rate and the tip credit. An employer that claims a tip credit must ensure that the employee receives enough tips from customers and cash (or direct) wages per workweek to equal at least the minimum wage and overtime compensation required under the FLSA.

The FLSA requires that employers pay tipped workers at least $2.13 per hour. An employer can take an FLSA tip credit equal to the difference between the cash wage it pays directly to the tipped employee and the federal minimum wage, which is currently $7.25 per hour. The maximum tip credit an employer can currently claim is $5.12 per hour. Only tips actually received by the employee count when determining whether the employee is a tipped employee and when applying the tip credit. If an employee's tips combined with their cash wages do not equal the minimum hourly wage of $7.25 per hour in each workweek, the employer must pay the difference to ensure the employee receives at least the federal minimum wage rate. Many states set a higher minimum cash wage. When state law differs from the FLSA, employers must comply with the standard that is most protective for employees.

Notice to Tipped Employees

Before employers can claim a tip credit under the FLSA, they must provide the following information to tipped employees:

- The amount of the cash wage the employer is paying a tipped employee;
- The additional amount claimed by the employer as a tip credit;
- The tip credit claimed by the employer cannot exceed the amount of tips actually received by the tipped employee;
- All tips received by the tipped employee are to be retained by the employee except for a valid tip pooling arrangement; and
- The tip credit will not apply to any tipped employee unless the employee has been informed of these tip credit provisions.

Employers that fail to provide this notice cannot claim the FLSA's tip credit and must pay tipped employees the full minimum wage, regardless of tips received.

Tip Pooling

Tips belong to the employee who receives them. However, the FLSA permits employers to require employees to share, or "pool," tips with other eligible employees. Pooled tips are considered the property of the employees who ultimately receive them, not of the employees who contribute the tips to the pool. Under the FLSA, the rules governing tip pools depend on whether the employer pays tipped employees a cash wage equal to the full minimum wage.

Traditional Tip Pooling

Under "traditional" tip pooling, an employer that takes a tip credit can require tipped employees to contribute tips only to a tip pool limited to employees in occupations in which they customarily and regularly receive tips. An employer that implements a traditional tip pool must notify tipped employees of any required tip pool contribution amount. Employers cannot require employees to contribute any part of their tips that the employer is counting as a tip credit or that causes an employee to earn less than the minimum wage. Employers may not receive tips from such a tip pool and may not allow managers and supervisors to receive tips from the pool.

Other Tip Pooling

When an employer pays its employees a cash wage at least the federal minimum wage, the employer may impose a mandatory tip-pooling arrangement that includes employees who are not employed in an occupation in which they customarily and regularly receive tips. This is sometimes known as a "nontraditional" tip pool. For example, an employer that implements a nontraditional tip pool may require tipped employees, such as servers, to share tips with nontipped employees, such as dishwashers and cooks. Employers may not receive tips from such a tip pool and may not allow managers and supervisors to receive tips from the pool.

Service Charges

Mandatory service charges, such as an automatic gratuity added to a customer's bill for parties of 10 or more individuals, are not considered a tip under the FLSA. They are the property of the employer. If an employer distributes any portion of a service charge to employees, that amount is treated as wages and may be used to satisfy the employer's minimum wage and overtime pay obligations under the FLSA. These sums are part of the employee's total compensation and must be included in the regular rate of pay for computing overtime. If an employee receives tips in addition to the compulsory service charge, those tips may be considered in determining whether the employee is a tipped employee and in the application of the tip credit.

Dual Jobs

Some employees routinely engage in both tipped and nontipped occupations. These are known as dual-job situations. In such a situation, the employee, if they customarily and regularly receive at least $30 a month in tips for their work in a tipped occupation, is a tipped employee only with respect to their employment in that occupation. However, no tip credit can be taken for their hours worked in their nontipped occupation. This situation is distinguishable from that of a server, who spends part of their time cleaning and setting tables, toasting bread, making coffee and occasionally washing dishes or glasses. According to the U.S. Department of Labor (DOL), such related duties in a tipped occupation need not, by themselves, be directed toward producing tips.

Credit Cards

Under the FLSA, when tips are charged on customers' credit cards and the employer can show that it pays the credit card company a percentage on such sales as a fee for payment using a credit card, the employer may pay the employee the tip, less that percentage. For example, where a credit card company charges an employer 3% on all sales charged to its credit service, the employer may pay the tipped employee 97% of the tips without violating the FLSA. However, the employer cannot reduce the amount of tips paid to the employee by more than the credit card company's transaction fee,

regardless of whether it takes a tip credit. Additionally, the transactional fee may not reduce the employee's wage below the required minimum wage, including any tip credit claimed. Under federal law, the amount due the employee must be paid no later than the regular payday and may not be withheld while the employer is waiting for reimbursement from the credit card company. Some states may have more protective laws regarding tips charged to credit cards, which do not allow the employer to deduct credit card fees from employees' tips.

Recordkeeping

Employers that take a tip credit must keep records of the following:

- Each employee whose wage is determined in part by tips;
- The weekly or monthly tips received by each employee;
- The amount by which the wages of each tipped employee have been deemed to be increased by tips, as determined by the employer;
- Hours worked each workday in any nontipped occupation and the total daily or weekly straight-time payment made by the employer for those hours; and
- Hours worked each workday in any tipped occupation and the total daily or weekly straight-time earnings for those hours.

An employer that does not take a tip credit but operates a mandatory tip pool must keep records of each employee who receives tips and the weekly or monthly amount of tips each employee receives. Under the FLSA, employers must maintain payroll records for three years.

Enforcement and Penalties

The DOL's Wage and Hour Division enforces the FLSA's tip regulations. Violations can result in back wages and an equal amount in liquidated damages. Employers may also be subject to civil penalties for repeated or willful violations. Generally, there is a two-year statute of limitations for the recovery of back wages and liquidated damages and a three-year statute of limitations in cases involving willful violations. FLSA remedies may be recovered through administrative procedures, litigation and criminal prosecution. Employees who sue their employers for FLSA violations may recover attorney fees, court costs and any other amount a court sees fit to impose in addition to unpaid wages and liquidated damages.

Best Practices for Complying With FLSA Tip Regulations

The FLSA requires employers that take a tip credit to comply with certain notice, recordkeeping and other requirements. Establishing effective practices to comply with these requirements not only satisfies legal obligations but also protects organizations during audits and disputes. To comply with the FLSA's tip regulations, employers can consider implementing the following employment practices.

Provide Tipped Employees With Written Notice

Before claiming any tip credit, employers should provide each tipped employee with a written notice containing the required information, including the cash wage rate, the tip credit amount and their rights to retain tips. While the notice does not need to be in writing, the DOL encourages employers to provide it in writing. Employers can also have employees sign an acknowledgment that they have received and understand the tip credit notice. In addition, employers should provide tipped employees with a written notice any time the cash wage or tip credit changes.

Ensure Tip Pools Are Properly Structured

Prior to implementing a tip pool, employers should decide if the pool will be traditional or nontraditional. Employers that implement a traditional tip pool should notify tipped employees in writing of any required tip pool contributions and restrict participation to employees who customarily and regularly receive tips. Employers with a nontraditional tip pool should ensure that all employees participating in the pool are paid at least the federal minimum wage. In workplaces with any type of tip pool, employers should ensure that the employer, managers and supervisors are excluded from the pool, regardless of whether they perform tipped duties.

Treat Service Charges as Wages

If employers require customers to pay mandatory service charges, they must decide whether to distribute any portion of those charges to employees. If employers distribute service charges to employees, they should categorize and document these payments as wages rather than tips. Employers should include any portion distributed to employees as part of their regular rate of pay for overtime calculations.

Track Tipped and Nontipped Duties for Tipped Employees

For dual-job employees, employers should track the hours employees perform tipped and nontipped duties and ensure they do not take a tip credit for hours tipped employees spend working in their nontipped occupations. If employees regularly perform work in a separate, nontipped occupation, employers should ensure that they are paid at least the full minimum wage for that time. Employers should also consider creating job descriptions for each tipped position, identifying the core duties of each tipped occupation and separating duties that directly produce tips from those that do not.

Review Credit Card Tip Deductions

If employers deduct credit card fees from employee tips, they should ensure that the deduction matches the actual fee charged by the credit card company. In addition, employers should ensure that the deducted amount does not reduce a tipped employee's hourly wage below the minimum wage. Employers should also ensure that tip amounts due to employees from credit cards are paid by the next regular payday, even if the employer is waiting for reimbursement from the credit card company.

Maintain Accurate Tip and Time Records

Maintaining accurate tip and time records is essential for complying with the FLSA. Detailed records of hours worked, wages and tips paid, and amounts claimed as tip credit are essential for verifying an employer's compliance with the FLSA's minimum wage and overtime requirements. Accurate records can help employers demonstrate their compliance and protect themselves against penalties and civil litigation. In addition, employers should ensure that their recordkeeping policies and practices align with the FLSA's recordkeeping requirements.

Conduct Internal Audits

Establishing compliant policies and practices for tipped employees is essential to prevent FLSA violations. Conducting regular audits of tip credit, tip pooling, employee notice, and service charge practices and policies helps ensure these systems and policies are operating properly. Audits can help employers catch and correct errors before they become legal issues.

Train Managers and Supervisors

Employers can better ensure compliance with the FLSA's tip regulations by training managers and supervisors. Employers can train managers and supervisors on tip credit requirements, tip pools, dual-job requirements and documenting an employee's nontipped duties. Managers and supervisors should know how to identify potential tip credit issues and how

to report them. Employers should train managers and supervisors regularly on FLSA tip credit regulations, but at a minimum, at the time of hire and once per year thereafter. Employers can consider providing managers and supervisors with resources to enhance their understanding of the FLSA's tip credit regulations.

Comply With State and Local Laws

Many states and localities impose additional or different tip regulations on employers. Several states do not permit a tip credit, while others allow a tip credit but establish a higher minimum wage rate or apply their own notice, certification or recordkeeping requirements. Therefore, employers should ensure that their policies and procedures related to tipped employees comply with the jurisdiction where they are located.

Employer Takeaway

Employers that fail to comply with the FLSA's tip credit regulations can be exposed to significant legal and reputational harm. Accordingly, employers should ensure they understand their obligations under the FLSA's tip regulations and implement best practices to comply with the law.