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## Tip Pooling May Change Under DOL Proposal

**Publication — 01/04/2018**

The Wage and Hour Division (WHD) of the U.S. Department of Labor (DOL) seeks to rescind a 2011 tip-pooling regulation that prohibits sharing of tips among employees who are not customarily tipped employees. Under a Notice of Proposed Rulemaking issued in early December 2017, the WHD proposes to eliminate restrictions on the sharing of customer tips in certain circumstances.

### 2011 Tip-Ownership Regulation

Revised in 2011, the DOL regulation at issue limits what employers may and may not do with tips. That regulation states:

Tips are the property of the employee whether or not the employer has taken a tip credit under section 3(m) of the FLSA. 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 3(m): As a credit against its minimum wage obligations to the employee, or in furtherance of a valid tip pool.

29 C.F.R. § 531.52 (2011).

In essence, this provision means that even if an employer pays its tipped employees the mandatory minimum wage (currently \$7.25 per hour federally), the employer may not keep any of the tips for itself or set up a tip pool that includes employees who are not regularly tipped.

### Proposal To Eliminate Tip Ownership Rule When Employer Pays Full Minimum Wage

The WHD intends to remove the limitations on an employer's use of tips, but only when the employer pays its tipped employees a direct cash wage of at least the full minimum wage. In other words, if an employer pays its tipped employees at least \$7.25 per hour (or a higher applicable state or local minimum wage) for all hours worked, then the employer may reallocate tips as it sees fit. This would allow employers to include non-tipped workers, such as dishwashers and cooks, in a tip pool. It may even allow employers to keep tips for itself.

Notably, the proposed change does not apply to employers who take a tip credit. Under the Fair Labor Standards Act (FLSA), employers of "tipped employees" may pay a reduced federal hourly wage of \$2.13 per hour as long as those employees receive sufficient tips to raise their earnings to the \$7.25 hourly minimum. Employers who take advantage of this tip credit to pay a lower cash wage to its tipped employees would still be subject to

the limitation on the sharing of tips under the tip-ownership regulation.

### **Courts Have Invalidated The 2011 Limits on Tip Ownership**

Following the 2011 tip-ownership regulation, employers and employees have been litigating various tip pooling and tip retention arrangements, resulting in numerous courts ruling that the DOL exceeded its authority in enacting the regulation or incorrectly interpreted the FLSA when placing the tip ownership restrictions on employers who paid the full minimum wage. A recent case from the Tenth Circuit Court of Appeals (whose decisions apply to Colorado, Wyoming, Utah, Kansas, New Mexico, and Oklahoma) illustrates the issue. In that case, employer Relish Catering regularly added customer gratuities to the customer's final catering bill. Relish retained those tips for itself rather than passing them along to its employees who worked at the events. Relish paid its employees \$12 per hour for all hours up to forty hours per week, and \$18 per hour for overtime, and did not rely on any sort of tip credit to meet the minimum wage.

The Tenth Circuit ruled that the FLSA tip-credit provision does not require that employers turn over all tips to employees in all circumstances. Instead, it held that when an employer does not take the tip credit, the tip-credit provision imposes no restrictions on what the employer may do with tips as long as it pays an hourly wage above the \$7.25 minimum. The Court found nothing in the FLSA that directed the DOL to regulate the ownership of tips when the employer does not take the tip credit. Because the FLSA limits the tip restrictions to employers who take the tip credit, the Court ruled that the DOL lacked the authority to regulate otherwise. [Marlow v. New Food Guy, Inc.](#), 861 F.3d 1157 (10th Cir. 2017).

### **State And Local Laws May Regulate Tips Too**

Just as states and municipalities may set a minimum wage that is higher than the federal minimum, they also may establish rules or ordinances addressing an employer's ability to claim a tip credit, establish tip pools, or retain tips for the employer's own use. The proposed change in the federal regulation would not preempt or otherwise diminish the effect of those state or local laws. Consequently, any employer who has tipped employees must review all applicable tip laws carefully.

### **Wages and Withholding**

Tips are included as gross compensation and are subject to income tax withholding. Employers must collect income tax, employee social security tax and employee Medicare tax on tips reported by employees. An employer can collect these taxes from an employee's wages or from other funds he or she makes available. Employers must ensure that the total tip income reported during any pay period is, at a minimum, equal to 8% of the total receipts for that period. The proposed change may lead to lack of transparency and could impact the reporting requirements.

### **Next Steps**

The DOL is accepting public comments on the proposed change to the tip-ownership regulation until February 5, 2018. Interested parties may submit their comments online at [www.regulations.gov](http://www.regulations.gov). After the comment period closes, it will likely take a few months for the DOL to publish its final rule, which may change from the proposal based on comments received. We will keep you posted on any developments.