Legal Update Article

Labor Department Issues Final Rule on Tip Pooling Amendments, Elimination of '20%' Dual Jobs Rule

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The U.S. Department of Labor (DOL) has issued its long-awaited Final Rule addressing who may share tips under the Fair Labor Standards Act (FLSA) and the circumstances under which employers may use a tip credit.

The Final Rule will be effective 60 days after publication in the Federal Register.

Summary of Final Rule

The Final Rule implements a 2018 amendment to the FLSA that permits tipped employees (*e.g.*, servers in the restaurant industry) to pool tips with non-tipped workers (*e.g.*, cooks and dishwashers), so long as the employer does not take a "tip credit" (*i.e.*, paying tipped employees a direct wage below the minimum wage) and, instead, pays such workers a direct wage equal to or greater than the minimum wage. Many commenters have argued that permitting only servers to receive tips, which in many restaurants can be very lucrative, yet prohibiting the kitchen staff, who prepare the food, from receiving tips was unfair.

The Final Rule will permit both groups to receive tips, so long as the employer does not take a tip credit. Due to variances in state law, the Final Rule's expansion of tip pooling may not apply in some states.

However, the Final Rule also explains that employers, including managers and supervisors, are prohibited from keeping any tips received by employees, regardless of whether the employer takes a tip credit. The Final Rule defines those who qualify as a "supervisor" or "manager," and therefore are excluded from participating in a tip pool, by reference to the FLSA's "duties" test for the executive exemption.

The Final Rule also codifies, with minor changes, the DOL's previous guidance eliminating the so-called "20%" or "80/20" Rule. That Rule limited the percentage of time (*i.e.*, 20%) a tipped worker could spend performing allegedly non-tipped duties and still take a tip credit. By contrast, the Final Rule provides that, so long as tipped employees perform duties related to their tipped occupation, either contemporaneously or for a reasonable period before or after their tipped duties, an employer is permitted to pay using a tip credit, regardless of whether the duties directly generate a tip.

The Final Rule also provides guidance on what duties are considered "related" to tip generating duties, to assist employers in determining whether the tip credit rate applies to that work. Again, state law may limit the application of the federal rule, depending on the state at issue, subject to arguments regarding possible preemption.

20% Rule is Eliminated

The 20% Rule first appeared in a DOL Field Operations Handbook (FOH) in 1988. It required employers to pay tipped employees the full minimum wage, rather than the lower cash wage applicable to tipped employees, if an employee spends more than 20% of their

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time performing allegedly non-tipped duties. The 20% Rule had become increasingly problematic for employers because the DOL never defined what constituted "non-tipped" duties, and it implemented the Rule without any notice or public comment.

During the past two decades, employers across the country, particularly those in the restaurant and hospitality industries, faced an ever-increasing number of lawsuits, mostly class or collective actions, asserting that those businesses improperly took a tip credit for employees who should have been paid at least the standard federal minimum wage for hours worked performing "non-tipped" duties. As the DOL acknowledged in the October 2019 Notice of Proposed Rulemaking (NPRM) preceding the Final Rule, the 20% Rule "has proven difficult to enforce and [has] resulted in widespread compliance issues; it has also generated extensive, costly litigation."

The DOL initially withdrew the Rule in a November 2018 Opinion Letter and reaffirmed that withdrawal in a February 2019 FOH amendment. Nevertheless, the vast majority of courts asked by defendant-employers to apply the DOL's latest position refused to do so, concluding the Agency's turnabout from the long-standing 20% Rule did not warrant deference under the so-called *Auer* doctrine. However, with the Final Rule having been implemented through the notice-and-comment procedure, challenges to it will be subject to deference under the standard set forth in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). Under *Chevron*, a court must defer to an agency's interpretation of a statute that the agency is charged with enforcing, unless such interpretation is unreasonable — even if the court concludes that a different interpretation also is reasonable, and perhaps even better, than that reached by the agency.

Replacing the now-defunct 20% Rule, the Final Rule provides that "an employer may take a tip credit for any amount of time that an employee in a tipped occupation performs related, non-tipped duties contemporaneously with, or within a reasonable time before or after, his tipped duties."

A non-tipped duty will be considered as "related" to a tip-producing occupation if the duty is listed as a task of the tip-producing occupation in the Occupational Information Network (O*NET). Examples of such "related" duties include setting up and cleaning tables, making coffee, and occasionally cleaning glasses or dishes. The Final Rule, however, clarifies that the O*NET is not the definitive and exclusive source of tip-related duties; rather, duties included in that source are merely *presumed* to be tip-related. This change from the proposed rule was in response to criticism that incorporating O*NET by reference could become problematic if O*NET is modified so that duties that were included are eliminated or others added. Some commentators argued that this would result in the regulation being amended without notice and comment. The change to create merely a *presumption* that such duties are related duties responds to that concern and permits additional duties that do not appear on O*NET to also be considered "related" duties.

In explaining the rationale for the elimination of the 20% Rule, the Final Rule states, "[A]n employer of an employee who has significant non-tipped related duties which are inextricably intertwined with their tipped duties should not be forced to account for the time that employee spends doing those intertwined duties. Rather, such duties are generally properly considered a part of the employee's tipped occupation, as is

consistent with the statute."

Congressional Changes to Tip Pooling Formalized

The Final Rule implements the changes on tip pooling set by Congress in the Consolidated Appropriations Act (CAA) of 2018. The CAA prohibits employers, managers, or supervisors from keeping employee tips, including those from a tip pool, regardless of whether the employer takes a tip credit under the FLSA. On the other hand, under the CAA, employers may mandate participation in a tip pool that includes both traditionally tipped positions (*e.g.,* servers and bartenders) and non-tipped positions (*e.g.,* cooks and dishwashers) *if* the employer does not pay the tipped employees using a tip credit (that is, the employee is paid the full minimum wage without any credit for tips). The employer must fully redistribute tips at least as often as it pays wages and must align its policy of paying credit card- and cash-based tips.

This change may increase the compensation for back-of-the-house workers (such as cooks), who will now be able to share in the sometimes-lucrative tips received by servers. It also addresses what many believe was an unfair system that rewarded servers with tips but ignored those who worked to enable servers to generate tips. This is particularly true in states that do not permit a tip credit. In states that permit a tip credit, employers will have to weigh the cost of giving up the tip credit against the ability to have additional employees share in tips (and possibly reduce payroll costs). In states whose laws or regulations prohibit the sharing of tips between tipped and non-tipped workers, the Final Rule will have little impact. DOL estimates that this expansion of approved tip pools potentially could result in a transfer of $109 million, taking into account the possibility that some employers might offset a portion of the resulting increase in total compensation received by back-of-the-house workers by reducing the direct wages they pay those workers.

As to who constitutes a "supervisor" or "manager," and is thus excluded from accepting tips from a tip pool, the Final Rule explains that the duties test (but *not* the salary basis or level requirements) applicable to the "white collar" executive exemption will control who meets these definitions under the tip-pooling rules. Under the executive exemption, an employee must have management as their primary duty, must customarily and regularly direct the work of at least two employees, and must have the authority to hire or fire other employees or provide recommendations regarding employment status that are given particular weight. Moreover, an employee who owns a 20% equity interest in the business at issue and who is actively engaged in its management also would be considered a manager or supervisor.

While not addressed in the NPRM, the Final Rule also reaffirms the DOL's long-standing position that employers may reduce the tips paid to employees by the amount of (and no more than) the transactional fees associated with credit card payments without running afoul of the prohibition on employers sharing tips. "By deducting transactional fees, the employer exerts only the amount of control necessary to liquidate the tips to cash and distribute them to employees," the Final Rule notes, adding, "[c]redit-card processing fees are not an imposition by the employer on the employee; they are the price of converting credit obligations to cash. The same fees would be imposed upon servers themselves if they collected their tips through credit payments separate from the customer's payment to the establishment." The Final Rule reiterates, however, that employers may neither deduct more than the actual transactional fee charged by the

credit card company attributable to liquidating the credit card tip nor reduce the amount of tips paid to the employee to cover other credit card-related costs, such as installation of a point-of-sale (POS) system. Some state laws prohibit employers from assessing such credit card transaction fees against employees, so employers need to ensure they comply with the applicable state laws and regulations where they operate.

In addition, the Final Rule clarifies that managers or supervisors may keep tips that they directly receive from a customer and for which they were the only ones who provided the relevant service. The Final Rule provides as an example a salon manager who is tipped by customers whose hair they personally style. To formalize this position, the DOL is adding the following language in Section 531.52(b)(2) of the FLSA regulations: "A manager or supervisor may keep tips that he or she receives directly from customers based on the service that he or she directly provides."

Takeaway

The elimination of the 20% Rule and its replacement with a Final Rule that provides a concrete list of the types of duties qualifying as tip-related will provide much-needed clarity to employers and employees. Additionally, some employees will benefit from the Final Rule now that tips are not the sole property of servers and can be shared with kitchen staff, who are just as important to the customer's experience.

If you have any questions about the Final Rule, tip regulations in general, or any other wage and hour development, please contact a Jackson Lewis attorney.