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THE TIP-CREDIT CONUNDRUM: HOW THE DOL'S PROPOSED TIP-CREDIT AMENDMENTS WILL POSE COMPLIANCE CHALLENGES FOR EMPLOYERS

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When can an employer take a tip-credit for an employee's work? It is a simple question without a simple answer. The Department of Labor's June 21, 2021 proposed amendments to the tip-credit regulations purport to provide clarity; but will almost certainly make the tip-credit more difficult to administer in practice. To understand why, a recent history of the tip-credit is in order.

The Fair Labor Standards Act – which requires non-exempt employees to be paid at least "minimum wage" – allows an employer to satisfy a portion of its minimum wage obligation to any "tipped employee" by taking a partial credit known as the "tip credit" toward the minimum wage obligation based on tips the employee receives. An employer that elects to take the "tip credit" must pay the tipped employee a direct cash wage of at least $2.13 per hour, but can take a credit against its wage obligation for the difference – up to $5.12 per hour – from the employee's tips. If the employee's tips are not sufficient to bring the employee's wages up to at least minimum wage, the employer must make up the difference.

The DOL's current regulation states that employees in tipped occupations can perform duties related to their tipped occupation that are not "themselves . . . directed toward producing tips," such as, for example, a server "who spends <u>part of her time</u>" performing non-tipped duties, such as "cleaning and setting tables, toasting bread, making coffee and <u>occasionally</u> washing dishes or glasses." So how much is "part of her time" and how much time is "occasionally"? Asked another way, how much time can an employer have an employee perform related duties which are no[illegible]cted at producing tips and still take the tip credit?

The regulation is conspicuously silent, but in 1988, the DOL attempted to answer these questions by introducing the so-called "80/20 Rule" through its internal Field Operations Handbook (FOH); a document designed to guide DOL investigators. The 80/20 Rule stated that an employee was no longer a "tipped employee" if they spent more than 20% of their time in a workweek performing tip supporting, but non-tip-generating work. There were two issues with the 80/20 Rule. First, this "Rule" was not a rule at all because it was never formally promulgated as a regulation by the DOL. Instead, it remained in the realm of "guidance" which appeared in opinion letters and internal DOL administrative directives. So even the intrepid employer who scoured the DOL's regulations would be unaware that the 80/20 Rule even existed. Second, the 80/20 Rule has proven exceptionally difficult to administer in practice. Consider the DOL's example of the server. How was her employer to know what percentage of time the server spent cleaning tables, toasting bread, making coffee, or washing dishes during a shift? In the often chaotic setting of a restaurant, the server may do one or more of these tasks between seating customers and waiting on tables. Short of obsessively watching and recording the minutes (or seconds) the server was engaged in such non-tip-generating work, the employer had no way of knowing whether the server cleared the 20% threshold that transformed them into a non-tipped employee.

These issues had significant real world implications for employers. In the last decade, numerous lawsuits were brought under the FLSA claiming that tipped employees (frequently servers at restaurants) spent more than 20% of their time engaged in non-tip-generating "side work." Thus, the lawsuits argued, employers violated the FLSA's minimum wage requirement because they paid only the cash-wage of $2.13 per hour rather than the full minimum wage of $7.25 per hour. Despite the protests of employers that no regulation set a 20% ceiling on such side work, courts frequently deferred to the DOL's "guidance" and applied the 80/20 Rule. Equally troubling, because it was practically impossible to track employee time in this way, employers had little in the way of evidence to rebut the employee's personal estimates that they frequently performed more than 20% of their time doing non-tip-generating work. Because these lawsuits provided for liquidated (double) damages, attorneys' fees for the employees, and were often brought as collective and class action claims, the potential liability for employers was massive.

In response to this trend, in 2018, the Trump administration's DOL began backing away from the 80/20 Rule and, in December 2020, issued a new regulation that would have eliminated the 80/20 Rule. The new regulation would have allowed employers to take the tip-credit if the employee performed related, nontipped duties as long as they were performed contemporaneously with, or for a reasonable time immediately before or after the tip-generating duties. The regulation directed employers to look to the DOL's Occupational Information Network (knows as "O*NET") to determine whether a tipped employees non-tipped duties related to the tipped occupation. Unfortunately for employers, the Biden administration "de[illegible]" the effective date of the rule multiple times, and has now proposed an entirely new one. [illegible]e proposed rule has three significant components:

1. The 80/20 Rule will now be promulgated as an actual rule. Thus, an employer will lose the tip credit if an employee spends more than 20% of their weekly hours performing tip supporting (but not tip-generating) work.
2. The proposed regulation will add an additional limitation onto tip supporting but non-tip-generating work. An employer can lose the ability to take a tip credit for any employee who performs any non-tip generating work for more than 30 minutes for a continuous period of time. This is a significant change. Previously, an employer could take a tip credit if all time spent in tip supportive work during the entire workweek was less than 20% of their total hours. Now, employers must prohibit having tipped employees do any tip supportive work for 30 minutes or more at a time.
3. Lastly, the proposed regulation would eliminate reference to O*NET as a resource for employers to determine whether a task constitutes work which directly supports tip-generating work. This removes an important resource for employers to determine what is considered tip supporting duties to tip-generating work.

The DOL's proposed rule is not effective yet, and interested parties have 60 days (until about August 23, 2021) to submit comments. However, it is unlikely that comments will significantly change the three items referenced above. Thus, employers who take the tip-credit would be well-advised to begin planning how to comply with the foregoing provisions in their operations. The DOL Notice of Proposed Rulemaking estimates employers will "spend, on average, 10 minutes per week on management costs in order to comply with this proposed rule." Employers may well determine that estimate is far too low, so they should begin to develop policies and practices to ensure compliance. For employers who take the tip credit, the conundrum of how to comply continues.

The St. Louis employment attorneys at McMahon Berger have been representing employers across the country in labor and employment matters for over sixty years and are available to discuss these issues and others. As always, the foregoing is for informational purposes only and does not constitute legal advice regarding any particular situation as every situation must be evaluated on its own facts. The choice of a lawyer is an important decision and should not be based solely on advertisements.