

Client Alert

No More Tipping? – Potential Changes in Compensation Practices for the U.S. Hospitality Industry

October 20, 2015 – Traditionally, Americans associate a no tipping policy with European vacations. Tipping in the range of 15%-20% has long since become the norm here in the United States, with many restaurants providing its customers with a tip calculator on the check. Given the prevalence of, and increase in wage and hour litigation in recent years, however, employers are being more mindful of their payroll policies to ensure that they remain in compliance with all applicable wage and hour laws. For businesses in the hospitality industry, this means reconsidering the U.S.-style system of tipping. Implementing such changes may not be so foreign considering tipping policies have long been a legal landmine for U.S. hospitality employers, with an active plaintiffs' bar which views tipping practices as an endless source of recovery.

For example, here in New York, the State Department of Labor (“DOL”) regulations dictate which employees are eligible to participate in a tip sharing or tip pooling arrangement. Many restaurant employees, especially those who work in the “back of the house,” *i.e.*, the kitchen staff, are ineligible to share tips or participate in a tip pooling arrangement. The DOL also mandates how much of a tip credit an employer may take against the required minimum wage for tipped employees in the hospitality industry. Effective December 31, 2015, minimum wage increases to \$9.00 per hour and the tip credit employers are permitted to take will be reduced to \$1.50 per hour for all tipped employees. Accordingly, the minimum cash wage amount for tipped employees will increase to \$7.50 per hour. This is a significant increase from just two years ago when the minimum wage was \$7.25 and the tip credit was \$2.25, allowing employers to pay their service employees only \$5.00 per hour.

The continuing development of the DOL’s hospitality industry regulations—in New York, among other jurisdictions,—and the constant threat of litigation, have created significant uncertainty for employers. As a result, some employers in the restaurant industry have recently considered adopting a no tipping policy. An obvious and significant benefit of a no tipping policy would be avoiding the administrative burdens of complying with the DOL’s tip sharing/pooling regulations and the legal consequences that flow from non-compliance. A no tipping policy, which essentially removes gratuities as a partial means of compensating restaurant service personnel, however, would also preclude employers from taking a tip credit against such

employees' wages. In other words, without a tip credit, as of December 31, 2015, all employees, including wait staff, must be paid the minimum hourly rate of \$9.00. Again, this is a significant increase in the cost of labor, which will undoubtedly be passed on to the consumer in some fashion.

Some restaurants may consider increasing menu food prices and others may consider implementing an "administrative fee" or "service charge" on the bill to offset these increased labor costs. If restaurants choose the latter option, however, the DOL has advised employers that because a "service charge" or "administrative fee" on a food bill could reasonably be interpreted by a customer as a gratuity to be disbursed to wait staff or other service personnel, restaurants must include clear and unambiguous language on the bill which explains that such charge is not a gratuity. If the necessary explanatory language is missing from the bill, the charge will likely be deemed by the DOL to be a gratuity and therefore must be distributed pursuant to its tip sharing/pooling regulations. The risks of using a "service fee" or "administrative fee" are quite significant if the charge is ultimately deemed to be in violation of DOL regulations, so employers should take great care to ensure clarity and compliance when implementing such policies.

Whether hospitality employers choose to take a tip credit or adopt a no tipping policy, all employers should revisit their wage and hour practices on an ongoing basis. Some key changes for New York employers starting on December 31, 2015 include:

- For all employees (including employees outside the hospitality industry), the minimum wage rate will increase to \$9.00 per hour. The corresponding overtime rate will thus increase to \$13.50 per hour.
- For all employees in the Hospitality Industry, the maximum tip credit employers are permitted to take will be reduced to \$1.50 per hour. The minimum cash wage rate for any tipped employee will increase to \$7.50 per hour. The corresponding overtime rate for such tipped employee will increase to \$12.00 per hour.
 - The overtime rate is calculated by multiplying the full minimum wage rate of \$9.00 per hour by 1.5 (\$13.50) and then subtracting the hourly tip credit of \$1.50 (\$13.50 minus \$1.50) = \$12.00. Employers often miscalculate the overtime rate for tipped workers by multiplying the cash wage (\$7.50) by 1.5 instead of using the actual minimum wage rate (\$9.00).

The DOL has also eliminated the distinctions between food service workers, service workers and hotel employees for purposes of employing the tip credit.

- For employees of fast food establishments, which are part of a chain of at least 30 outlets (and who, by the nature of their work, generally don't receive tips), the New York State Commissioner of Labor recently issued an order increasing the minimum wage for all fast food workers to \$15.00 per hour to be implemented in stages over the next few years. The first increase takes effect on December 31, 2015, increasing the minimum wage for fast food workers in New York City to \$10.50 and to \$9.75 in the rest of the state.

Based on these regulations, all employers should coordinate with their payroll personnel or payroll provider to ensure that the above-referenced changes are implemented by December 31, 2015. Hospitality industry employers should also consider whether it makes sense to alter their tipping policies based on these new regulations or simply based on commercial business practices accordingly. If you require any additional information about your compensation practices or policies, or any other employment-related issue, please contact:

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