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Tip Credit and Tip Pooling Provisions of the Fair Labor Standards Act

Introduction

The Fair Labor Standards Act (FLSA), enacted in 1938 (P.L. 75-718), is the federal legislation that establishes the general minimum wage that must be paid to all covered workers. At present, the vast majority of workers are covered by the minimum wage provisions of the FLSA. These provisions have been amended numerous times since 1938, typically for the purpose of expanding coverage or raising the wage rate. The most recent change was enacted in 2007 (P.L. 110-28) to increase the minimum wage to $7.25 per hour by July 2009.

Tipped Employees under the FLSA

Employees are covered by the minimum wage and overtime provisions of the FLSA unless they are specifically exempted. The act allows employers of certain groups of employees to pay less than the statutory minimum wage. In the case of employees who regularly earn tips as part of their work, two provisions of the FLSA—tip credit and tip pooling—permit a different pay structure than applies to non-tipped workers.

FLSA Tip Credit Provisions

As part of the 1966 amendments to the FLSA that expanded minimum wage coverage to include restaurant and hotel employees (P.L. 89-601), Congress added a tip credit provision to the minimum wage provisions. Under Section 203(m) of the FLSA, a "tipped employee"—a worker who customarily and regularly receives more than $30 a month in tips—may have his or her cash wage from an employer reduced, as long as the combination of wages from the employer and tips equals the federal minimum wage. That is, the "credit" is the amount from employee tips that an employer may count against its liability for the required payment of the full federal minimum wage.

Tip Credit Components

The FLSA tip credit provisions are comprised of two components—"the employer cash wage" and the "tip credit."

- The employer cash wage is the minimum amount that an employer is required to pay a tipped worker. Currently, the FLSA sets this at $2.13 per hour, which is 29% of the current federal minimum wage of $7.25 per hour. An employer of a tipped employee, just like an employer of any FLSA-covered employee, is ultimately responsible for payment of the full minimum wage to that employee.

- The tip credit is the amount of earnings from tips that an employer may count against its liability for the full minimum wage. Under current law, and at the current federal minimum wage rate of $7.25 per hour, the maximum tip credit is $5.12 per hour, which means employers may take a credit of up to 71% of their required obligation to pay a minimum wage. A higher tip credit means that an employer may count more in tips toward the employer liability for the minimum wage. A lower tip credit means that an employer must provide a greater share of an employee's compensation in direct cash wages. No tip credit means that an employer must pay direct cash wages equal to the prevailing minimum wage and the tipped worker does not have to credit any tip income toward the total minimum wage.

Thus, the existence of a tip credit means that the two components of the minimum wage for tipped workers—the employer cash wage and tips—must equal the required minimum wage. The tip credit does not create a subminimum wage from the standpoint of a tipped worker but it changes the composition of earnings from solely employer-paid to a combination of employer wages and tips. The exact mix of those two earnings components depends on the prevailing minimum wage, the tip credit allowance, and the amount received in tips.

The size of the tip credit has changed over time. Prior to 1996, the amounts for the minimum employer cash wage and tip credit were set as a percentage of the federal minimum wage, ranging from 40% to 55%. That is, during the 30-year period from 1966 to 1996, employers of tipped employees could take a credit from tip earnings of between 40% and 55% of the minimum wage against their liability to provide the minimum wage to their employees. The 1996 FLSA amendments (P.L. 104-188) set the employer's statutory minimum cash wage at $2.13 per hour (rather than a percentage of the minimum wage) and the size of the tip credit became dependent on the value of the minimum wage (i.e., the tip credit after 1996 equals the minimum wage minus $2.13).

FLSA Tip Pooling Provisions

Prior to 1974, the pooling or sharing of tips was not addressed in the FLSA and was typically a matter worked out between employees and an employer. Congress amended the tip credit provisions of the FLSA in 1974 (P.L. 93-259) to clarify that the tip credit may only be used to satisfy the minimum wage requirement if the tipped employee retains all tips received, except that this provision did not "prohibit the pooling of tips among employees who customarily and regularly receive tips." Stated differently, the 1974 amendments provided that tipped employees must be allowed to keep 100% of their tips, but could be required to participate in mandatory (i.e., employer-imposed) tip pools among tipped workers only. A tip pool was

considered valid only if it was limited to tipped employees. Voluntary (i.e., employee-determined) tip pools were permissible in any instance and could include both tipped and non-tipped employees. The FLSA does not address limits on tip pool contributions from employees, and the Department of Labor's (DOL's) past attempts to set maximum tip pool contribution percentages have been prohibited due to a lack of statutory authority.

DOL's 2011 Rule on Tip Pooling

In 2011, DOL issued new regulations that addressed tip pooling, codifying three main provisions: (1) tips belong to employees receiving the tips; (2) the only permissible employer uses of employee tips are for the tip credit allowed by the FLSA or a valid tip pool (i.e., tipped employees only); and (3) even if an employer pays the full federal minimum cash wage and does not utilize the tip credit, the employer could not require tip pools that included non-tipped workers. In other words, the provisions in the 2011 rule specify that in no instance may employers mandate a tip pool that involves non-tipped employees.

DOL's 2017 Proposed Rule on Tip Pooling

In 2017, DOL issued a Notice of Promised Rulemaking (NPRM) indicating its intent to change portions of the 2011 rule. Specifically, the 2017 NPRM would maintain the permissible uses of employee tips—a tip credit against the minimum wage obligation and valid tip pools. However, the 2017 NPRM would permit the reallocation of pooled tips to both tipped and non-tipped workers in cases in which the employer paid at least the full federal minimum cash wage rather than using the tip credit provisions. The NPRM did not specify which non-tipped employees would be eligible for participation in tip pools. A final rule based on the NPRM has not yet been issued.

The Consolidated Appropriations Act, 2018

The Consolidated Appropriations Act, 2018 (P.L. 115-141, Division S, Title XII, Section 1201) amended the FLSA to further clarify the use of employee tips. First, the act provided, in part, that employers, managers, and supervisors are prohibited from keeping any portion of employee tips, regardless of whether or not the employer uses the tip credit. Second, the act indicated that certain provisions of the 2011 rule will have "no further force or effect" until "future action" on tip pooling by DOL. Specifically, the act suspends the provisions from the 2011 rule that prohibited tip pooling in instances when employers do not use the tip credit against their minimum wage obligation. In guidance issued following enactment of P.L. 115-141 (Field Assistance Bulletin No. 2018-3), DOL confirmed that employers paying the full federal minimum wage (i.e., not using the tip credit) are not prohibited from allowing non-tipped employees to participate in tip pools, but in no instance may managers or supervisors participate in such pools. **Table 1** provides a summary of which employees are permitted to participate in tip pools based on their employer's use of the tip credit.

Table 1. Participation in Tip Pooling under the FLSA

	Employer's Use of Tip Credit	
Employee	**Tip Credit**	**No Tip Credit**
Tipped	Yes	Yes
Non-Tipped	No	Yes

Source: CRS analysis of P.L. 115-141, and Bryan L. Jarrett, *Field Assistance Bulletin No. 2018-3*, U.S. Department of Labor, Wage and Hour Division, Washington, DC, April 6, 2018.

Interaction with State Laws

Because several states have minimum wage rates that are different (mostly higher) than the federal minimum wage and different tip credit and tip pooling provisions, the impact of changing federal tip credit and pooling provisions would vary across states.

Tip Credit

In general, where there are conflicting minimum wage provisions, the higher standard (e.g., higher wage rate) prevails. That is, where the minimum wage or tip credit provisions are more beneficial to employees, they prevail. As of 2018

- seven states—Alaska, California, Minnesota, Montana, Nevada, Oregon, and Washington—do not allow a tip credit; employers must pay the full statutory state or federal minimum wage (whichever is higher);
- 26 states and the District of Columbia require a minimum employer cash wage that is greater than the federal rate of $2.13 per hour; and
- 17 states require a minimum employer cash wage of $2.13 per hour, required either by state law or by reference to federal law.

Tip Pooling

There is wide variation across states in tip pooling provisions, with different state requirements not being easily classifiable. Several states do not address employer access to tips outside of the tip credit context, similar to the FLSA prior to P.L. 115-141. Some states, such as Kentucky, prohibit mandatory tip pools but allow voluntary agreements among employees. Other states, such as North Carolina and Delaware, allow mandatory tip pools but limit the amount of tips that may be diverted into a tip pool. Following the changes to the FLSA in the 2018 appropriations act, in states that do not permit a tip credit, employers may require tip pools that include tipped and non-tipped employees, unless state law otherwise prohibits such actions.

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