

March 29, 2019 Publication

Topics

Wage & Hour

Related People

Priya B. Vivian
vivianp@lanepowell.com

Per Jansen
jansenp@lanepowell.com

Related Practices & Industries

Business
Food, Beverage & Hospitality
Labor, Employment & Benefits
Litigation
Wage & Hour

Tipoff: New Washington State Guidance on Tips, Gratuities and Service Charges

Wage & Hour Legal Update

Tips, gratuities and service charges increasingly have become the subject of employment disputes and the focus of government enforcement, litigation, and legislative and administrative rule-making across the nation. In light of administrative policy recently released by the Washington State Department of Labor and Industries (“L&I”), employers in the restaurant and hospitality industries should take steps to ensure their policies and practice are legally compliant.

Tips and Gratuities

L&I’s new Tips, Gratuities, and Service Charges Administrative Policy^[1] broadly defines a tip or gratuity as “amounts freely given by a customer to an employee.” An employer must pay its employees all tips and gratuities. If their employer fails to do so, employees may file a complaint with L&I under the Wage Payment Act. This may result in an investigation and enforcement action against the employer.

Tip Credits. Importantly, in Washington state, tips and gratuities do not count towards the state minimum wage, and may not be credited towards it. In other words, employers may not take a “tip credit” to reach the minimum wage. Instead, Washington employers must pay the full state minimum wage, in addition to any tips or gratuities, to tipped employees.

If a city has set a minimum wage higher than the Washington minimum wage, the employer must pay the higher city wage. Some Washington cities, such as Seattle, allow smaller employers (those with 500 or fewer employees worldwide) to use a tip credit towards Seattle's higher minimum wage, at least until 2025 when the credit sunsets. Other cities, such as SeaTac, do not allow the tip credit to be used. Washington employers wishing to use the tip credit towards any city's minimum wage statutes should carefully review local laws, which may have more specific requirements.

Tip Pools. L&I's administrative policy confirms that employers may implement mandatory tip pooling among employees who are non-exempt from the Washington Minimum Wage Act. The guidance acknowledges that Washington law is silent on what types of non-exempt employees may participate. According to L&I, employers may include both front-of-the-house and back-of-the-house non-exempt employees in a mandatory tip pool. For example, this means that participating employees may include waiters in the front of the house, and dishwashers and cooks in the back of the house.

However, these tip pools must exclude employees who are exempt from Washington minimum wage requirements, such as some managers and supervisors. These exempt employees may, however, accept tips for services they directly provide. Local ordinances may exclude other employees from mandatory tip pools. For example, Seattle prohibits supervisors with hiring and firing authority, among other things, to participate in a mandatory tip pool, regardless of exempt status.

An employer may agree to help administer a tip pool system established by employees (i.e., a voluntary tip pool) at its employees' request.

Employers implementing mandatory tip pools or administering voluntary tip pools should have a clear, written policy explaining the process and distribution to employees.

Service Charges

Some hotels and restaurants have begun adding service charges to customers' bills instead of accepting tips.^[2] L&I defines a service charge as an automatic charge to a bill for services related to food, beverages,

entertainment or portage. A service charge is a separately-designated amount collected from a customer; it must be described in such a way that a customer would reasonably believe the charge relates to the service provided by an employee. The presence of this charge may seem to replace or discourage a tip, and may also be called a “mandatory gratuity,” “delivery charge” or “porterage charge,” or an automatic charge for gratuity for a party of a certain size at a restaurant.

Like the tip and gratuity rules, service charges do not apply towards meeting minimum wage requirements in Washington. L&I has authority to investigate complaints relating to service charges.

Disclosure Requirements. Establishments must disclose the amount of any service charge on both an itemized receipt *and* on any menu. This disclosure must state the percentage of the service charge the establishment retains and the percentage of the charge that is paid to employees directly serving the customers, which the L&I describes as servers, bussers, banquet attendants, banquet captains, bartenders, barbacks, porters and bellpersons (referred to as the “employee portion”). This description excludes back-of-the-house employees, such as dishwashers and cooks. Therefore, employers who wish to allocate a portion of the service charge to back-of-the-house employees must do so from the establishment portion, not the employee portion.

Any amount that is not clearly designated as being retained by the establishment *must* be paid to employees directly serving the customers. One example of an approved disclosure is:

“A service charge of __% / \$__ will be added to your bill. __% of this service charge is paid to the employee or employees who served you today.”

Other Guidance

- Recordkeeping.* Tips, gratuities and service charge money must be paid at the same time an employee earns their wages. These payments are subject to record-keeping requirements. For instance, employers must retain employee tip reports, withhold income taxes based on wages and tips, and report the information to the IRS.[\[3\]](#)

- *Processing charges.* When tips, gratuities and the employee portion of service charges are charged to a credit or debit card, employers may deduct a pro-rated percentage of the amount charged by a third-party payment processor, such as a credit card company. However, employers may not further reduce the amount paid to an employee in any amount greater than the prorated transactional fee. For example, assume a customer pays a \$10.00 tip with a credit card and the credit card company charges a 2% fee for this transaction. The employer may pay the employee 98 percent of the tip, or \$9.80.
- *Impact on sick time.* L&I also clarified that the normal hourly compensation for the purposes of paid sick leave does not include tips, gratuities and service charges. However, because city ordinances may have different rules, employers should check local ordinances to determine how tips and gratuities impact paid sick time. The guidance leaves intact prior guidance that tips and gratuities are not included in overtime calculations.

What Should Washington Employers Do Now?

L&I's administrative policy provides helpful guidance on Washington state law. Restaurant and hospitality establishments operating in Washington state should review their policies and practices on tips, gratuities and services charges to ensure that they are complying with state law, along with federal and local laws, such as minimum wage ordinances in Seattle, Tacoma and Sea-Tac.

This can be a confusing area for employers, particularly when laws conflict, so employers should keep in mind that they must comply with all laws. Employers should consider seeking the advice of experienced counsel, particularly when implementing new tip, gratuity or service charge policies.

[1] Wash. Dep't of Labor & Indus., *Tips, Gratuities, and Service Charges*, Administrative Policy No. ES.A.12, (Mar. 6, 2019), available at http://www.lni.wa.gov/WorkplaceRights/files/policies/esa12.pdf?utm_medium=email&utm_source=govdelivery.

[2] But note that an employer may not confiscate or fail to remit a tip given to an employee, even if the employer has a policy against accepting tips.

[3] Int. Rev. Serv., *Tip Recordkeeping & Reporting*, (Mar. 19, 2019), available at <https://www.irs.gov/businesses/small-businesses-self-employed/tip-recordkeeping-and-reporting>.