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Opinions

Is eliminating gratuities the next hospitality trend?

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"No-tipping" policies could be the new trend in hospitality, but at what cost will it affect patrons and former tipped employees?

By Jessica Travers

Due to the federal Fair Labor Standards Act, many hotel and hospitality workers are paid a reduced minimum wage, plus tips. FLSA permits an employer to take a tip credit towards its minimum-wage obligation for workers who meet the FLSA definition of a "tipped" employee.

The federal tip credit equals the difference between the required cash wage (which must be at least $2.13 per hour under federal law) and the federal minimum wage (currently $7.25 per hour). The maximum tip credit that an employer can claim under the FLSA is $5.12 per hour ($7.25 minus $2.13). Several cities and states, however, have their own laws that increase the required minimum wage for both tipped and non-tipped employees, or entirely eliminate the tip credit. For example, California requires employers to pay the full state minimum wage ($10 per hour) before tips.

The momentum to increase minimum wage and improve working conditions has resulted in a bona fide trend in the hospitality industry to eliminate gratuities. Most notably, New York restaurateur and CEO of Union Square Hospitality Group Danny Meyer announced in 2015 that he would be eliminating gratuities at all the restaurants in his empire.

Restaurant employers also are looking at "no-tipping" policies as a way to potentially limit their wage and hour liability. The U.S. Department of Labor's Strategic Plan for 2011-2016 specifically lists hotels and motels as a "high-risk" industry and focused its investment initiatives accordingly. For example, the Department of Labor's enforcement statistics show that in 2015, the agency handled 981 cases with violations, resulting in $3,610,343 in back pay to 6,675 affected individuals. Department of Labor enforcement action is separate from private lawsuits, which can be pursued on a collective basis and be very costly to defend.

Of course, ensuring wage and hour compliance and managing labor costs at the same time is not as simple as just eliminating gratuities. The elimination of tipping and tip credit will increase an employer's labor costs with respect to all tipped employees and tip-pool participants. More often than not, these additional costs must be passed on to the customer either in the form of higher prices or reduced offerings. Customers can vote on these changes by dining elsewhere. Further, employers that don't "match" the new direct hourly wage with what a tipped employee customarily made per hour with tips will likely lose some of their best talent.

As a result of the need to retain customers and talent, as quickly as some hospitality companies adopted these changes, most seem to have reinstated gratuities. Thus, while no-tipping policies may eliminate the complex administrative work associated with utilizing a tip credit and reduce potential wage and hour liability for noncompliant tip practices, it may not be popular among guests and the formerly tipped staff.

Another alternative is imposing a mandatory service charge. The relevant regulation, 29 C.F.R. §531.55, states, "[a] compulsory charge for service, such as 15% of the amount of the bill, imposed on a customer by an employer's establishment, is not a tip." Under federal law, employers can choose how, or if, to distribute these mandatory charges to their employees so long as their employees earn at least the minimum wage.

Some state laws, however, regulate how and to whom service charges must be distributed. Service charges paid to an employee are wages, and must be included when determining the regular rate for purposes of overtime pay. Thus, service charges also increase labor costs.

Furthermore, the IRS also treats these service charges paid out to employees as wages subject to payroll taxes, which are not eligible for the FICA tip credit. Thus, a service charge could result in higher tax liability for the employer than an equal amount in tips.

Tipping is a social norm. It's risky to raise prices to accommodate the change or to include a service charge when other competitors are not charging a similar fee and customers are price-sensitive.

But a "no tipping" policy would eliminate the need to litigate certain common FLSA issues, such as whether an employee counts as a "tipped employee" based upon the amount of non-tip-generating work performed, whether an employer properly took a tip credit or whether the employer has a legal tip-pooling arrangement. Of course, this change would not entirely eliminate the potential for wage and hour compliance issues. However, employers are wise to stay informed on the "hospitality included" trend to determine whether adopting such a practice could improve working conditions without too great an impact on the bottom line.

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