Season 3, Episode 14:
"Tips From the Tip Jar: Tipping in the State of New York"
Speakers: Lee Jacobs, Barclay Damon

[Lee Jacobs]: Hello, and welcome. My name is Lee Jacobs, and it's my pleasure to welcome you to Barclay Damon's latest episode of the Labor & Employment Podcast. This episode is entitled "Tips From the Tip Jar: Tipping in the State of New York." In this episode, we're going to dive into topics relating to tipping in the hospitality industry and specifically about the tip credit. For those listeners who aren't in the hospitality industry and therefore cannot avail themselves of the tip credit, you might think this episode isn't for you. However, I encourage you to stay tuned. While we'll be focusing on the rules related to utilizing the tip credit in the hospitality industry, the principles of tipping, tip pooling and tip sharing agreements, and others can apply to you as well.

[Lee]: So stay tuned and listen along. But before we jump into it, let's set the stage and discuss where we've been and where we're going. In our last couple of episodes, my esteemed colleague Rosemary Enright, who was unable to join me for today's discussion, she and I talked about overtime and the nuanced topics of ensuring that our employees are paid correctly when they work more than 40 hours in one work week. One of the questions that Rosemary asked me was, how do you calculate overtime when someone has a tip credit? So let's break down that concept before we go into anything else. So, the first question is: what is a tip credit? In New York a tip credit only applies to hospitality employees. These are employers that fall under the Hospitality Wage Order, which falls under the hospitality industry.

[Lee]: Here in the state of New York. Think of it. It's exactly as it sounds like. These are bars, restaurants, cafeterias, bakeries—businesses that are engaged in food service. When you have a hospitality employee who is tip credit–eligible, it means that the business does not have to pay this employee the full minimum wage. Now minimum wage as of the recording of today's episode—August 5, 2024—in New York City, Long Island and Westchester is $16 an hour. Everywhere else in the state of New York, it's $15 an hour. So let's use the $15 minimum wage because it's frankly just easier; round numbers. So if an employee in upstate New York is tip credit–eligible, while minimum wage states that they should be paid $15 an hour, meaning $15 an hour comes out of their employer's pocket and into the employee's pocket when they're tip credit–eligible, the employer only has to pay them $10 an hour, provided that the employee is making $5 an hour in tips.

[Lee]: Now, to clarify, to be very clear here, you're still paying them $15 an hour, but you're paying them $15 an hour with a $5 tip credit for an effective rate of $10 an hour. By thinking of it this way, we ensure that we're calculating overtime properly. Which comes to that question that Rosemary asked me in one of our prior episodes. So when we do $15 an hour with a $5 tip credit for an effective rate of $10 an hour, overtime would be $15 an hour times one and a half to come to $22.50 an hour minus the $5 tip credit, resulting an effective rate of $17.50 an hour.

[Lee]: I'll repeat that again. When you have an employee that is tip credit–eligible, we are paying them $15 an hour with a $5 tip credit for an effective rate of $10 an hour. When that employee is working overtime, more than 40 hours in one work week, we achieve their overtime rate by applying the tip credit at the end. So here it would be $15 times one and a half to come to $22.50 minus $5 or their overtime rate is $22.50 with a tip credit of $5 for an effective rate of $17.50. Now, a common mistake that employers make is jumping straight to that “how much they pay out of pocket,” that $10 an hour. And so therefore, since I only have to pay $10 an hour, then that means, okay, my overtime rate is one and a half times that: $15.

[Lee]: And that’s just unfortunately wrong. And it gets so many employers into trouble. So again, when we have an employee that’s working overtime and they are tip credit–eligible, it is $22.50 minus $5 to come to $17.50 an hour. So another question that’s baked into Rosemary’s question to me about how do we pay an employee who has a tip credit overtime, I think it’s important to ask the question, what is a tip? So a tip is a sum of money given by a customer to an employee for the service they provided. It’s a way for customers to express their appreciation for good service. Tips are a significant part of income that many hospitality workers receive, and it can be given in various forms.

[Lee]: Customers might leave cash directly on the table, add it to the check, or include it as part of the total amount when paying for a credit card. Tips can also be added to catering bills or large group reservations, and tips are—and we’re not going to really focusing that in today’s episode—but tips are not service charges. Service charges that a restaurant, a bar or a caterer or the like, but they assess on a bill for food and beverage, if it is properly worded that this is not a tip and will not be going towards those that have served you and your... in today’s catering event or dinner or whatever it may be, that service fee will be kept by the house, by the business, but if that service fee language is not properly worded correctly and proper notifications are not given to the customer, then that service fee may be also included in an additional tip, but that’s not really a topic here for Labor & Employment podcast, but listen for an additional episode upcoming in the near future, where I welcome one of my partners, Scott Rogoff, who works primarily with hospitality clients in the food and food service industry, where we’ll dive into this topic with even more precision.

[Lee]: But just know that a tip is something that a customer leaves for those that are providing service to them. Now, what is a “tip credit”? So the tip credit as we’ve discussed allows businesses to pay their employees in an effective rate, in this case $10 an hour for upstate New York. This is a $5 per hour savings, and it adds up quickly for a business. Think about that: $5 an hour for every employee that’s working. That’s, it could be a huge chunk of money. However, in order to avail yourself of this tip credit... to actually pay your employees below minimum wage, think about that for a second. What other profession...what other job in the state of New York allows you to pay an employee below minimum wage?

[Lee]: Only those that receive tips, and specifically only those that receive tips in the hospitality industry. Therefore, in order to get this extreme benefit to allow a business to pay an employee below minimum wage, you must meet strict requirements to take advantage of the tip credit. The first is that the business must give notice of the tip credit to the employee. The easiest way to accomplish this is on the LS 50 form. A document that we’ve discussed many times on this podcast. It’s the wage notification given to every employee at the start of their employment, and I’m going to be sharing my screen in a moment. For those of you that are watching through YouTube or Spotify or whatever the other means you may be hearing and listening to us from... (by the way, we love your feedback. Please continue to send us your questions, comments, and whatever else you may have about what we are discussing here, because your feedback helps control literally what we produce and present to you.) So for those of you that can’t see it, I’m about to share my screen with the LS 54. Now the LS 54 is the wage notification and in the middle column right here, it states at the top the employee’s rate of pay.

[Lee]: Here this number on number three should never be below minimum wage in your geographic jurisdiction. Again, this should never be below minimum wage in your geographic jurisdiction. $15 an hour everywhere but New York City, Long Island and Westchester, where it is $16 an hour. And then on the line for allowance is taken, you would check the box for tips and then input the name amount per hour of the tip credit being taken. In this instance, we’re working with upstate New York, where upstate New York, the tip credit is $5 an hour. So we would check the box and then if $5 per hour and then number seven at the bottom, our overtime pay would be one and a half times number three, minus number four, which would yield $22.50. So the first step is to give notice of the tip credit being taken.

[Lee]: And that notification is primarily and easiest given to your employees by giving them an LS 54. Now, in addition to having to give notice to your employees, you need to let them know that there are actually… how the pay stub affects. Excuse me, how the tip credit affects their pay. That means on their pay stub, it needs to show that there is a tip credit being taken against their hourly wage. In a perfect world, your pay stub would show five hours at $15 an hour, $75 and five hours at $5 an hour for a negative $25 for the tip credit coming to $50 being paid. Now, I know that in some payroll companies are unable to consider a tip credit as a deduction, and so therefore just cannot do the math. But what is crucial here is, is that however your pay stubs and up, the pay stubs must do the math for their employees. Remember your employees, if you filled out the LS 54 correctly, they believe they're being paid $15 an hour. The law says that they are actually being paid $15 an hour, and then you get to take a $5 an hour deduction or credit against their minimum wage. So the pay stub must show that. Whether it is in a perfect world where it shows again, five at 15, five at negative five for -25, or it shows something along the lines of five times 10 with an asterisk, and then a note on the pay stub stating that in New York, minimum wage in our geographic jurisdiction is $15 an hour, a $5 an hour tip credit is being taken against your minimum wage.

[Lee]: In short, we have to give a notice to our employees and our employees need to know how they got paid. We have to do their math for them. If we don't give them notice at the beginning, and if we don't give notifications in the in the pay stub at the end, then the employee may no longer be tip credit–eligible. Now, what is the problem with that? What happens when someone loses their tip credit eligibility? It's a simple solution really. We have to pay them $5… we have to refund them the tip credit for every hour that it was inappropriately taken. So if we never gave notification to an employee or our pay stubs are wrong, or both, for every hour that that employee worked for us, we owe them back the tip credit that we were then, now, the law would be saying illegally or improperly taking. Just as I said a few minutes ago, how quickly the benefits of the tip credit can be for a business. They're saving $5 an hour for every tip-eligible employee. Now they'd have to refund that money. We'd have to pay them back to the employees $5 for every hour that they worked when they could not be taking the tip credit, just because the business did not do its paperwork properly. In addition, just another crazy notice. Not notice, but crazy idea to think about. Presume you have that employee, a server, and that server is making hundreds and hundreds of dollars per night in tips. They're making more… a heck of a lot more than $5 an hour in tips.

[Lee]: It does not matter if you did not get the notification or they don't have the proper pay stubs, you will still have to refund them. Give them back $5 an hour for every hour that they worked where you did not meet the rules. The paper-keeping rules of the tip credit. I know… a lot, but let's jump into it a little bit further. So now we've discussed who you know, what a tip is, what a tip credit is. And so now the next question would be is: when is an employee eligible to take the tip credit? So we've discussed about the paperwork requirements. Now let's talk about the actual job requirements of the employee. So in order to take the tip credit… to avail yourself of the tip credit, an employee must be tip-eligible and to be tip-eligible in New York, that means they must meet the 80/20 rule, which means that an employee must spend at least 80% of their shift doing customer-facing duties to be, to be tip credit–eligible.

[Lee]: So in order to take that $5 credit to pay someone effectively $10 an hour, the employee, as we said, has to spend at least 80% of their shift doing customer-facing duties. These are our front of house employees the servers, the bussers, the bar backs, the bartenders, and food runners and others. They must be engaging with customers for 80% of their shift.

[Lee]: So, for example, at a five-hour shift, 80% is four hours, 20% is one hour. So if an employee is spending five hours of their shift on the floor serving customers, no problem. But what about that employee who comes to work on that slow day, and their manager sends that employee down to the stockroom to stock and to make sure everything is in order downstairs. That same five-hour shift is now turned into two hours downstairs in the stockroom, and three hours on the floor. This employee now has a problem because they no longer meet the 80/20 ratio, and this means they are no longer tip credit–eligible. That means we have to pay them the full

$15 an hour for that shift, and it doesn't matter how much they made in tips during that shift, it doesn't matter if our paperwork was right during that shift.

[Lee]: If you fall below that 80/20 ratio, you must pay your employees the full amount for the entirety of their shift. And further to that, a little nuance in New York, if you spend more than two hours on any given day, regardless of how long your shift is, working in a non-tipped occupation, then you are tip credit–ineligible for the entirety of that day.

[Lee]: So let's say, for example, you have someone who's working 12 hours in a given day. They're just a very good workhorse of the employee... or that employee actually does two jobs for you. They spend two hours, one hour in the morning and one hour at night in the back of the house doing dishes. But then they spend 10 hours on the floor as one of your servers. Here they meet...they clearly meet the 80/20 ratio, because they're spending eight hours on the floor, two hours in the back of the house. But New York says if you spend two hours, regardless of the entirety of how long your shift is, you become tip credit–ineligible for the entirety of that shift. Here too, again without regardless of how good your paperwork is or how much money you've paid your employee, if they work more than two hours in a given day and a non-tip eligible job, then you are unable to take the tip credit for that employee for the entirety of that shift. I know this is a lot of information coming at you fast and quick. Please feel free to reach out with any questions, like and subscribe. Send us an email, answer the questions in our poll, which I'm going to be coming to in a moment. But you know, where are we? What have we gotten to in about this last 20 minutes of conversation? Here we've talked about what is it tip, what is a tip credit and what are the circumstances for when someone is tip credit–eligible.

[Lee]: Meaning, when can the business save that $5 an hour? Again using upstate New York numbers. But most businesses in the hospitality industry pool and collect their tips into one pot of money and then redistribute them out to everybody else. So if you have a tip scenario where your workers receive tips directly from their customers and they are not required to share those tips with anybody else, that money is theirs. Your employees'. All you have to do for that employee is make sure your paperwork is correct and that their 80/20 ratio is correct, and then you continue to take the tip credit and make sure that any tips that you hold on their behalf, like in credit cards or from catering or other special events, are tracked and paid appropriately on a pay stub.

[Lee]: But most businesses in the hospitality industry, what they do is, as I said before, is they pool, they share their tips together. So what is a tip pool and what is a tip share? A tip pool is a system where tips collected by staff are pooled together and redistributed among tip-eligible employees, based upon a predetermined agreement. This ensures that all team members who contribute to the customer experience, including those who might not directly receive tips, like bussers and food runners, are compensated fairly. So what does this mean for tip pooling? In order to be a member of the tip pool, you have to be tip pool tip credit tipping–eligible. That means an employee needs to, one, meet the 80/20 ratio that to be tip credit–eligible and therefore able to participate in the tip pool. If an employee is in the tip pool that does not meet that 80/20 requirement, then the tip pool is tainted.

[Lee]: And hold your thought as to what happens when the tip pool becomes tainted, because there are other scenarios of what happens that can compromise the tip pool. Another way that that tip pool can be compromised is not just by that one employee who's now part of the tip pool, who is tip credit–ineligible, tip tipping-ineligible because their 80/20 ratio is off. It's when we look to everybody else that can be in the tip pool, because everyone that's in the tip pool needs to be tip credit–eligible. So if we have a non-tipping person in the tip pool, like the back of the house, that taints the tip pool. It does not matter how hard or how good the your back of house workers are working. It does not matter that the air conditioner went out and they're in the back of the house sweating. It does not matter that your front of house employees want to give their tips to the back of the house. Back of house employees are not allowed in the tip pool. By having a back of house employee, a non-customer–facing employee in the tip pool, it taints the entire tip pool. And the third and most common way that a tip pool's integrity is destroyed is by having owners, supervisors or managers also share in tips.

[Lee]: Think about this. When you are customer sitting at a restaurant and you leave a tip, do you leave that tip for an owner? Of course not. You leave that tip for the person who is serving you the food, making your drinks, bussing your table, and running you your food. But what if that. What if an owner is working the floor?

[Lee]: Do you leave the tip for the owner ? Even if you want to personally, unfortunately, the law says no, you don't. The tips are not to be left for an owner. So if an owner is covering a shift, covering an employee and they're on the floor working the working the floor and they're receiving beaucoup bucks in tips, they don't get a penny of those tips into their pocket. And if they do, it taints the tip pool. And the third and most common way that I see the tip pool being tainted is by having supervisors or managers in the tip pool. Now, traditionally, I see this happen where someone on a Monday is a manager or a supervisor meaning they set the schedules. They're in charge of hiring, maybe even firing and discipline and training.

[Lee]: But in order to pay them enough money in order to get this person to continue to work for you—because they're just making minimum wage, they have to have the busy shifts on Friday night or Saturday night to get the good tips. And that's a problem because these employees, while cloaked with the authority of management and supervision on a Monday or Tuesday night, can never take that cloak off on a Friday night or a Saturday night when they are just coworkers with other employees. Once someone controls the financial destiny of someone else, they can no longer share in tips. So this means if you have employees setting schedules, doing discipline, and being part of hiring or firing or more importantly, when you're not there and your head bartender cuts employees, for example, to go home early when the business is slow, those employees can never take off their management hat.

[Lee]: They can't be uncloaked from their supervisor shield, and they can't share in tips with regular hourly employees. And if they do, the tip pool is tainted. And so what is the remedy for a tainted tip pool? So the remedy for a tainted tip pool is the following: Every employee who participated in that tip pool now must have their tip credit refunded to them. Because one of the things that is in part of the law that allows you to pay an employee below minimum wage, is, one, that all of your paperwork is correct, the notifications and the pay stubs, and, two, that you are properly administering the tip pool, which means that everyone in the tip pool is allowed to be there.

[Lee]: So if you have someone who works in the back of the house, someone who's 80/20 ratio, who is normally in front of house worker drops below that 80/20, or if you have a manager, owner or supervisor in the tip pool, then you can no longer take the tip credit for anyone who was in the tip pool when it was tainted. So that means $5 an hour for every employee who was ever in the tip pool when it was ever tainted. Remember what we said when we started this conversation of how great, great savings this can be for a business? By allowing an improper person into the tip pool, those savings can turn into catastrophic penalties. So in addition to having to refund that $5 an hour, regardless of how much money your employees actually did make in tips, you still have to give that $5 an hour back. You also have to redistribute the tips that were redistribute that were distributed to the improper persons.

[Lee]: So say you have that supervisor who a bartender on a Monday or Tuesday, and the only way you could get that bartender to continue to work for you as your head bartender and set your schedules and contribute to the hiring and firing decisions, was to give them the good shifts on Friday night and Saturday night so they got lots and lots of money and tips? Well, it turns out over a four-year period over. Excuse me. Turns out over a three-year period after a New York State Department of Labor audit, that that bartender had made $35,000 in tips. So in addition to having to refund $5 an hour to everyone who worked in the tip pool at the same time as that supervisor, that $35,000 needs to be paid back to the people who would have otherwise received it when it was illegally taken from them and given to that supervisor.

[Lee]: Now, the law won't take the money out of that supervisor bartender's pocket. The law will take it, unfortunately, out of your pocket. So in addition to having to refund the tip credit, you'll now also have to refund tips that were improperly shared. Again, the damages continue to pile up and this does not matter, no matter how good your paperwork was and your notices and your pay stubs, and how much money your people actually make in tips.

[Lee]: And so the third thing to be aware of when we're doing tips and making sure we're doing it appropriately and to protect ourselves, is to make sure that our tipping and our tip pools and our shares, how we redistribute the money… that we are doing it equitably and we're keeping track of it. So ensuring correct an equitable distribution of tips among eligible employees is paramount… most places use something called a point system that's based on roles and responsibilities, which helps achieve fairness. Now, I advise my clients to regularly review their tip distribution practices because they can identify discrepancies and help maintain employee trust. Proper documentation, such as a written notice and formal agreements outlining the tip pool terms, protects employees and the business.

[Lee]: Not only is it a protection, it's a requirement. And in addition to having that tip pool sheet, that agreement that says two points to the bartender, five points to the server, a half a point to the busser, etc., etc., there should be detailed records of tip distributions that should be maintained using spreadsheets or other dedicated software. Documents that show money that comes into the tip pool, and how money went out of the tip pool to your various employees.

[Lee]: And those records are to be made available on demand to your employees. So I say you either print them all out at the end of the week and put them into a binder, and then you have the binders available for your employees to review, or you keep them electronically in a share, and then you have a computer or a tablet that your employees can access these sheets because remember, this money is not yours. This money that you are holding and redistributing and taking from the customers, you're doing it all on behalf of your employees. They have every right under the law to know how much money came into the pool and how much money went out of the pool, and more importantly, who and where and why it went to.

[Lee]: So as we conclude this episode of "Tips from the Tip Jar," let's briefly recap what we've discussed. Tips are money that either your employees receive directly from customers, or you are holding it on their behalf. In order to take the tip credit—$15 an hour with a $5 tip credit for an effective rate of $10 an hour over time $22.50 with the $5 tip credit for $17.50 for an effective rate—in order to take a tip credit for your employees, the employees must receive notification of the tip credit both in their pace on their wage notification and their pay stub. And to take the tip credit, the employee has to be tip credit–eligible, meaning they have to be a front of house worker whose ratio of time engaged with customers is 80% or more of their tip. And when an employee works more than two hours, regardless of the length of their shift in a non-tipped occupation, you cannot take the tip credit at all for them for that entirety of their day. And when we pool all of the tips together that all of our front of house employees received during the course of a shift, and then we redistribute that back out to all of our front of house employees, we have to make sure that when we're doing that, that our tip pool is appropriately comprised and administered correctly. So that means only front of house workers who are tip credit–eligible (80/20 ratio applies) are in the tip pool with no owners, no managers, and no supervisors. And then there has to be records. Proper records that show money in and money out from the tip pool. And in addition to that, there should be a line on the pay stub, a pay stub that says "tips." Now your employees may say to you, and you may think that you're doing them a solid by not including tips on their pay stub, how much tips they actually receive. But that is a no-no. One, they may say to you they don't want to know how much tips.

[Lee]: They don't want to be tracked for tips, whether it be for financial reasons, child support reasons, support from the government reasons or whatever it may be. But the point is, you need proof that your employees were paid their tips. How do we do that? We do that through the tip sheets, the tip pooling documents and a line on their pay stub that says how much in tips were received for that particular pay period. It's the only way to do this right, and it's the only way that you as your business can protect yourself.

[Lee]: So to wrap up, we've covered ensuring the right people are in the tip pool, that we're distributing it correctly, that we're maintaining proper paperwork, we're calculating overtime right. And we've discussed the severe consequences for noncompliance. And mind you, if it's a DOL audit, in addition to having to pay the tip credit back and redistributing the tips, you are also going to be suffering from penalties, interest, and liquidated damages. Liquidated damages that can range from an additional 25% to 200% of the untimely paid monies. Just do it right the first time I, I hate to put it that way, but so many of the things that we do in the labor and employment world, particularly as it relates to how we pay our employees, if we do it right the first time, that we're going to be able to defend ourselves from any challenge that anyone, whether it be from the Department of Labor or from a private lawsuit, anyone can bring against us.

[Lee]: Regularly reviewing your typical practices is essential to ensure fairness and compliance. Staying informed and proactive can help you avoid costly mistakes and maintain a positive work environment. So in short, the biggest tip from this tip jar: just do it. So if you found this episode helpful, subscribe! Reach out to us, send us an email, visit our website for additional resources, and feel free to contact us for any assistance you may need. Now, before you go, we'd love to hear from you. So we've got some questions for you. Some follow-up the... to have some engagement. The first one is: do you currently have tipped credit eligible employees? A, yes. B, no.

[Lee]: Reach out to us again. Share us with your stories. Connect with us on social media. We're here to help. Thank you for joining me on this episode of "Tips from the Tip Jar." I'm Lee Jacobs, and I look forward to our next discussion. Until then, stay compliant and keep those tips flowing fairly. Thanks so much everyone.

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