

Tip Credits – Striking Down the Federal Rule & Massachusetts Ballot Question

BY DANIELLE JUREMA LEDERMAN • SEPTEMBER 11, 2024

On August 23, 2024, the United States Court of Appeals for the Fifth Circuit struck down the Department of Labor's ("DOL") 80/20/30 Rule, which set parameters for how employers can use tip credits under the Fair Labor Standards Act (FLSA). By vacating the Rule, the Fifth Circuit voided the provision nationwide. Tip credits are also on the ballot this November in Massachusetts, where voters will decide if the minimum wage for tipped workers will be increased to the state minimum wage, effectively eliminating tip credits.

WHAT IS THE 80/20/30 RULE?

The FLSA allows employers to take a "tip credit" equal to the difference between the wage it pays directly to the tipped employee (the federal minimum wage for tipped workers is $2.13/hour) and the federal minimum wage ($7.25/hour). Historically, the DOL permitted employers to use a tip credit, so long as the employee did not spend more than 20% of their hours performing work that was not tip-producing. This was commonly referred to as the 80/20 Rule.

In 2021, the DOL issued regulations that expanded upon the 80/20 Rule by identifying three categories of work: (1) "tip-producing work," such as waiting tables; (2) work that "directly supports" tip-producing work, such as bussing tables, and (3) work that is "not part of the tipped occupation," such as cleaning the restaurant kitchen or bathroom (the 80/20/30 Rule). Under the 80/20/30 Rule, employers were also prohibited from taking a tip credit if an employee spent more than 30 minutes continuously performing work that "directly supports" tip-producing work, and for any time spent performing work that was not part of the tipped occupation.

THE COURT'S RULING

In *Restaurant Law Center v. U.S. Department of Labor*, the Fifth Circuit determined that the 80/20/30 Rule was invalid because (1) it was inconsistent with the text of the FLSA and (2) it was arbitrary and capricious, in violation of the Administrative Procedures Act ("APA"). More specifically, the Court concluded that the Rule created an arbitrary distinction between tip-producing and tip-supporting work, in contrast to the legislation established by Congress.

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In striking down the DOL's Rule, the Fifth Circuit relied upon the Supreme Court's recent decision in *Loper Bright* (discussed in detail in this Client Alert), which invalidated 40 years of legal precedent whereby courts were required to defer to federal agencies' "reasonable" interpretations of law when making decision related to administrative agency (commonly referred to as *Chevron* deference). With the eradication of *Chevron* deference, we expect to see similar challenges by the courts to administrative action in the future.

It is unclear if the DOL will appeal the Fifth Circuit's decision to the United States Supreme Court. For now, the Rule is invalid, and employers may use tip credits as provided in the FLSA without having to track the type of work being performed by tipped workers. While employers are no longer required to follow the DOL Rules for FLSA compliance, employers still need to comply with state and local laws regarding tip credits and wages.

TIP CREDITS ON THE BALLOT IN MASSACHUSETTS

The continued use of tip credits is up for consideration in Massachusetts in the coming election. On the ballot this November is an initiative for a "Law Requiring the Full Minimum Wage for Tipped Workers with Tips on Top" (summarized here). The initiative ultimately seeks to eliminate tip credits entirely by gradually raising the minimum wage for tipped workers in Massachusetts (currently $6.75/hour) over the course of five years, until it reaches the state minimum wage (currently $15/hour). If voters approve the initiative, the minimum wage for tipped workers would increase according to the following schedule:

- 64% of the state minimum wage on January 1, 2025;
- 73% of the state minimum wage on January 1, 2026;
- 82% of the state minimum wage on January 1, 2027;
- 91% of the state minimum wage on January 1, 2028; and
- 100% of the state minimum wage on January 1, 2029.

In addition to receiving the full state minimum wage, tipped workers would remain eligible to receive tips. The initiative also permits the expansion of tip pools to include non-tipped employees. Sharing tips with managers and supervisors would remain prohibited.

If approved by voters, the initiative will increase the minimum wage for tipped workers to $9.60/hour, effective January 1, 2025. Employers with tipped workers should begin planning now by examining their payroll process, to ensure timely compliance if the initiative is passed. Employers should also examine their business plan and strategy to account for the potential increased labor costs.

If you have any questions about this alert or any other employment-related matters, please contact your Bowditch employment attorney.

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