

Restaurant's Mandatory Service Charge Wasn't a Tip



Audra Hamilton
ahamilton@mwlaw.com
(501) 688.8801

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In the current battle to hire and retain good workers, employers have developed creative ways to balance employees' increased compensation expectations against the costs of running a business. In addition, restaurants using the tip credit have the extra administrative difficulties of making sure their tipped employees are being paid enough in tips to meet the Fair Labor Standards Act's (FLSA) minimum wage and overtime requirements. A recent federal appeals court opinion reviewed one restaurant's creative tactic to address the challenges by paying tipped employees their wages from monies collected as part of a mandatory service charge.

Steakhouse uses mandatory service charge to pay employees

Nusret Miami, LLC, is an upscale Miami steakhouse owned by Nusret Gokce, a celebrity chef also known as "Salt Bae." Since opening in 2017, the restaurant has added a mandatory 18% "service charge" to customers' bills.

Nusret used the service charges to pay some of its employees. In so doing, the restaurant believed it had complied with 29 U.S.C. § 207(i) of the FLSA (we'll call it the "207(i) exemption" in this article), which exempts payment of overtime for retail or service establishments if:

- The regular rate of pay is in excess of one and one-half times the employee's minimum hourly rate; and
- More than half of the employee's compensation is based on commissions for goods or services.

Nusret met the exemption's facial requirements. Its payments to the tipped employees ranged from \$23.68 to \$51.58 per hour, far exceeding one and one-half times the minimum wage in Florida for the time period, which ranged from \$8.10 to \$8.46 per hour.

A group of tipped employees was dissatisfied with the arrangement, however, and claimed the "service charges" were actually "tips" under the FLSA. They filed a collective action against Nusret Miami for unpaid minimum wage and overtime compensation, liquidated damages, and a return of tips wrongfully taken.

Court's rulings

By claiming the service charge was actually a tip, the disgruntled employees argued it couldn't be used in calculating the wages paid to employees for the 207(i) exemption. They also alleged dispersing the funds received from the service charge among several employees created an improper "tip pool." As a reminder, generally, tips belong to the tipped employee and, apart from facilitating valid tip-sharing arrangements, may not be collected by the employer.

The appeals court first noted tips can't be used in calculating the first requirement of the 207(i) exemption (i.e., the employees are paid in excess of one and one-half times their regular rate of pay). In other words:

- If the service charge was actually a tip, then the amounts an employee was paid from it didn't count toward the regular rate of pay; and
- Nusret wasn't exempt from the overtime requirements and might have had some problems showing minimum wage for some of the employees.

Therefore, the fundamental question of whether the service charge was a tip was key, and the court found it was *not* a tip. In so doing, it relied on U.S. Department of Labor (DOL) regulations stating the critical feature of a "tip" is that whether to give it and in what amount is solely the customer's decision, not the restaurant's.

Nusret's service charge was mandatory in both fact and amount (18%), and the customer had no discretion on whether to pay it. The court further found the service charge fit squarely within a DOL regulatory example of monies received that aren't tips, which stated a "compulsory charge for service, such as 15 percent of the amount of the bill, imposed on a customer by an employer's establishment is not a tip."

The employees argued, however, the service charges shouldn't be considered for the 207(i) exemption because Nusret Miami hadn't included them in its gross receipts for tax purposes. The court didn't find the argument persuasive. Another factor influencing the court was that the service charges were brought into the point-of-sale system and then distributed to the employees on a pro rata basis, rather than being paid directly to them.

Case's impact in Arkansas and elsewhere

What does a case out of Miami have to do with Arkansas? The FLSA applies to employers in Arkansas as well as Florida, though the interpretation of the law may differ among the federal courts.

Nusret's case was decided by the U.S. 11th Circuit Court of Appeals, which governs federal courts in Florida, Georgia, and Alabama. While the 11th Circuit doesn't govern the federal courts in Arkansas, it joined the 4th Circuit (which is over the federal courts in Maryland, North Carolina, South Carolina, Virginia, and West Virginia) in its interpretation of the particular federal regulations and the 207(i) exemption.

While neither opinion is binding on Arkansas federal courts, they provide guidance on factors the courts will consider when looking at the same statutory and regulatory sections. *Compere v. Nusret Miami, LLC*, 28 F.4th 1180 (11th Cir., 2022).

Practice pointers

Be aware cases like *Nusret Miami* often turn on individual facts. If, for example, the service charges had been paid directly to the tipped employees, the 11th Circuit noted the outcome might have been different.

Here are some of Nusret Miami's actions that helped its case:

- It paid employees well above the minimum wage using the service charge (up to six times more), and the court noted some workers even made \$100,000 per year.
- The restaurant made the service charge mandatory for customers.
- It didn't pay the employees directly with cash from the 18% service charge. Instead, it brought the money into its point-of-sale system and then paid the workers on a pro rata basis.

One other action it wasn't clear the restaurant had taken but that might have helped its case: Be able to show you included the service charge in your gross receipts for tax purposes. It's worth talking to a tax adviser about how to treat those kinds of wages (and other income) for tax purposes.

And one final practice pointer that wasn't directly at issue in Nusret Miami's case but the court noted would have been relevant would have been if the service charge had been found to be a tip: If you have a valid tip-pooling or tip-sharing policy, be sure no managers, supervisors, or owners are pocketing any of the tips!

Audra Hamilton is an attorney with Mitchell Williams in Little Rock. You can reach her at ahamilton@mwlaw.com.

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