

Wage & Hour**Should Restaurants Deduct Credit Card Transaction Fees From Server Gratuities?**

**W**hether restaurants and other service establishments can deduct credit card fees from workers' tips depends on state wage laws, but employers should also consider whether it makes good business sense, employment attorneys told Bloomberg BNA in interviews the week of April 11.

"Restaurants tend to operate on a very narrow margin, so the swipe fee could be greater than the owner's profit," Mallory Duncan, general counsel for the National Retail Federation, told Bloomberg BNA.

Credit card fees charged for the gratuity portion of a bill are often paid by the restaurant's owner as a cost of doing business, and the effect makes the total transaction fee to the owner even higher, Duncan said.

Saru Jayaraman said the fees shouldn't be passed on to servers. "Servers are already earning below the standard minimum wage, and now these fees are being deducted on top of that," said Jayaraman, director of the Food Labor Research Center at the University of California, Berkeley.

"It's one of those half legal and half employee-relationship issues, and I think we'll see more litigation in this area," Carolyn D. Richmond, a management attorney, told Bloomberg BNA. Richmond is co-chair of the labor and employment department and the hospitality practice group at Fox Rothschild LLP in New York.

**Deductions Permitted Under FLSA.** Wage and hour litigation under the federal Fair Labor Standards Act and similar state laws has been on the rise in recent years and is expected to continue soaring through 2016 (227 DLR A-8, 11/25/15).

A hotly disputed FLSA issue is employer use of the "tip credit," which allows businesses to pay tipped employees less than the standard minimum wage so long as they comply with certain requirements, attorneys said.

Under the tip-credit provision, an employer may pay tipped employees as little as \$2.13 an hour if they make enough in tips to reach the \$7.25 minimum wage. But employers must provide either oral or written notice to the applicable employees.

The FLSA permits the use of tip pools, but tipped workers can't be forced to share their gratuities with

management or employees who don't customarily receive tips, such as kitchen staff (29 U.S.C. § 203(m)).

Credit card fee deductions are a subset of the tip credit provision. And employers will want to look at state and local laws, as well as the company's culture and operations, when considering whether to deduct these fees from tips, attorneys said.

The Labor Department has stated, including in a 2006 opinion letter, that employers may deduct credit card transaction fees from the gratuities customers charge to credit cards without violating the FLSA.

But those deductions can't exceed the total fees charged and can't reduce workers' pay to a rate below minimum wage.

**Fees Can Be Aggregated.** "An interesting thing that was acknowledged in the DOL's opinion letter is that every credit card company has a slightly different fee," Richmond said.

In *Myers v. Copper Cellar Corp.*, 192 F.3d 546, 5 WH Cases2d 975 (6th Cir. 1999), the U.S. Court of Appeals for the Sixth Circuit said credit card fees may be deducted without violating the FLSA if the employer shows by a preponderance of the evidence that "in the aggregate, the amounts collected from its employees, over a definable time period, have reasonably reimbursed it for no more than its total expenditures associated with credit card tip collections."

The U.S. District Court for the Northern District of Illinois in 2006 cited to *Myers* and held for the first time that deducting credit card fees from servers' tips is permissible under the Illinois Minimum Wage Act (*Gillis v. Twenty Three East Adams St. Corp.*, 2006 BL 151374, 11 WH Cases2d 766 (N.D. Ill. 2006)) (60 DLR A-9, 3/29/06); (174 DLR A-5, 9/9/99). The court held that a restaurant may deduct an amount no greater than the actual amount of the processing fee.

Although the DOL and some courts allow employers to average the fees, a bigger issue can be whether the percentage deducted from tips is correct, Richmond said. "It's nearly impossible for a restaurant to deduct the exact amount because there could be a different rate for the majority of transactions in a night," she said.

She advises clients who choose to make the deduction to err on the low side rather than attempt to take an exact average. "If a client tells me the average is 2.4 percent, I may tell that client to take 1.9 percent," Richmond said.

**State Laws Vary.** State and local laws fall into several buckets, Richmond said. Some state laws simply track the FLSA's language, and others specifically permit credit card fee deductions, she said.

In addition to Illinois, New York state law allows employers to deduct credit card fees from charged tips. But other states, such as California and Colorado, forbid employers from passing on this cost to workers.

California Labor Code Section 351 states that an employer must pay workers the full amount of any tips left on credit cards.

Colorado Wage Order 22 provides that the "deduction of credit card processing fees from tipped employees, shall nullify allowable tip credits towards the minimum wage."

Jayaraman said her organization, the Food Labor Research Center, worked with city council members in Philadelphia to get a local law passed that prohibits credit card fee deductions.

Some state wage and hour laws—such as in New Jersey—are silent on the issue, but the language of those laws is different enough from the FLSA to make it riskier for employers to take the deduction, Richmond said.

Employers that operate in multiple jurisdictions must check the law jurisdiction by jurisdiction, she said.

Even where the practice is permitted, deducting credit card fees from workers' tips could still lead to tip credit violations, attorneys said.

"The potential liability for employers who get it wrong could be staggering," Louis Pechman of Pechman Law Group PLLC in New York told Bloomberg BNA. Pechman is the founder of [waiterpay.com](http://waiterpay.com), a website dedicated to New York wage and hour issues.

"In some cases, we see employers taking more than they are entitled to take for credit card fees," he said. "For example, if the credit card fee is two percent and the employer takes four percent, that's going to invalidate the tip credit."

Richmond said employers should also consider the issue from an employee morale perspective. "If someone

is opening a new restaurant, it's a lot easier to deduct the fees from the beginning," she said.

The practice should be disclosed in the employee handbook and other policy documents, she added.

**Cash Preferred.** "Ideally, there would be one clear national minimum wage," Jayaraman told Bloomberg BNA.

"If there is a two-tier wage system and all wages go up except in one class, then naturally it creates a perverse incentive for employers to have tipped employees do more work that was traditionally performed by non-tipped workers," Jayaraman said.

"I don't think employers should have to change this on their own," she said. "I think policy has to change. Customers are outraged when a tip they think is going to a worker is going to something else, like credit card processing fees."

"It's important for people to understand that the affected workforce is mostly female and has a median wage, including tips, of \$8.50 an hour," Jayaraman said. "These women are trying to feed a family by working at IHOP or Applebees, not a fancy steakhouse."

Customers should pay tips in cash if possible, Duncan of the National Retail Federation said. "We also try to encourage people to use debit cards because the fees are generally lower."

Credit card processing fees are frustrating for restaurant owners, Duncan said. "Restaurant owners need to buy land or rent space, purchase food and pay taxes," he said. "They typically only make a few dollars on a \$100 bill and then there could be a \$2.50 credit card fee."

"Everyone is looking for ways to pinch pennies," Richmond said. "I expect that this issue is going to start percolating again."

By LISA NAGELE-PIAZZA

To contact the reporter on this story: Lisa Nagele-Piazza in Washington at [lnagele@bna.com](mailto:lnagele@bna.com)

To contact the editor responsible for this story: Susan J. McGolrick at [smcgolrick@bna.com](mailto:smcgolrick@bna.com)

To request permission to reuse or share this document, please contact [permissions@bna.com](mailto:permissions@bna.com). In your request, be sure to include the following information: (1) your name, company, mailing address, email and telephone number; (2) name of the document and/or a link to the document PDF; (3) reason for request (what you want to do with the document); and (4) the approximate number of copies to be made or URL address (if posting to a website).