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Tipped Over: Fifth Circuit Vacates the DOL's Rule for Tipped Employees

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September 03, 2024

The United States Court of Appeals for the Fifth Circuit issued a ruling on August 23, 2024, vacating a 2021 Final Rule of the Department of Labor (DOL), which limited the circumstances under which employers can claim a "tip credit" for "tipped employees" under the Fair Labor Standards Act (FLSA). This decision is likely one of many to come following the Supreme Court's earlier decision to overturn the *Chevron* doctrine, which often required federal courts to defer to federal agencies, such as the DOL.

The FLSA permits employers to take a "tip credit" when paying any "tipped employee" – a term defined by the FLSA as "any employee engaged in an occupation in which he customarily and regularly receives more than $30 per month in tips." *See* 29 U.S.C. § 203(t). Employers may initially pay tipped employees an hourly cash wage of $2.13, which is well below the federal minimum wage of $7.25, with the expectation that the employee will make up the deficit in tips. Of course, if the employee's tips do not adequately reconcile the deficit, the FLSA requires the employer to pay the difference to ensure that the employee's wages never fall below the minimum wage requirement.

Over several decades, the DOL has provided fluctuating guidance on how employers are to determine whether an employee qualifies for a tip credit. The DOL's most recent stance, which was reflected in its 2021 Final Rule, granularly focused on each discrete task an employee is required to carry out during any given shift, requiring a determination of whether each task fell within one of several categories created by the DOL: (1) directly tip-producing work; (2) directly supporting work; or (3) work not part of the tipped occupation. The Rule then required a person-by-person assessment of the length of time each employee spent on each task and an ultimate determination on a week-by-week basis of whether the proper percentage of time was spent between these various categories of work.

This Rule was ultimately challenged in court by a restaurant group in Texas, which then made its way to the Fifth Circuit. In vacating the Rule, the Fifth Circuit found that it fails the Administrative Procedure Act "twice over," because it is inconsistent with the FLSA's clear statutory text *and* because it imposes an arbitrary and capricious standard. In reaching this conclusion, the Fifth Circuit recognized that the dispute turned on the meaning of the statutory terms "engaged in" and "occupation," neither of which the FLSA defines. Applying the ordinary meaning of these terms in 1966 when Congress added the tip credit to the FLSA, the Fifth Circuit found that "engaged in an occupation" essentially means "employed in a job." The Fifth Circuit was critical of the Final Rule's overly granular interpretation of the phrase "engaged in an occupation" to mean being "engaged in duties that directly produce tips, or in duties that directly support such tip-producing duties (but only if those supporting duties have not already made up 20 percent of the work week and have not been occurring for 30 consecutive minutes) and not engaged in duties that do not produce tips" which required divvying up every component task that an employee carries out during a shift and considering the quality of the activity in terms of whether it falls into one of the DOL's contrived categories of work. The language in the FLSA, according to the Fifth Circuit, is much plainer: it simply requires that an employee be employed in a job that customarily receives more than $30 a month in tips.

Significantly, the Fifth Circuit made clear that its decision does not overturn the DOL's "dual-jobs" regulation. In fact, the Court emphasized that its interpretation of "engaged in an occupation" is entirely consistent with the dual-jobs regulation, as it simply clarifies that the tip credit applies to occupations, rather than the entire employment relationship in which the employee may perform the work of more than one occupation. The Court further distinguished the 2021 Final Rule from the dual-jobs regulation, noting that the dual-jobs regulation is not tied to any artificial percentage-based limitations as the 2021 Final Rule was. Summarizing another fundamental problem with the Final Rule which the Fifth Circuit described as "inconsistent treatment of supporting work based only on the work's duration," the Court explained: "The Final Rule ties the tip credit not to the *character* of the[] [employees'] various duties as integral to their respective occupations, but to the amount of *time* that these duties take."

What does this decision mean for employers with "tipped employees," whether within the Fifth Circuit's footprint (Texas, Louisiana, and Mississippi) or elsewhere in the United States? It is a favorable ruling for employers, but its immediate impact outside of the Fifth Circuit (beyond Texas, Louisiana, and Mississippi) is unclear. Unlike remedies that are specific to a party – like an injunction – vacating a rule, as the Fifth Circuit did, deprives the Rule and corresponding regulations of legal force. This would mean that the Rule is not enforceable, regardless of whether within or beyond the Fifth Circuit. However, there remains the likely possibility that the DOL will challenge the decision either by seeking a rehearing before the Fifth Circuit or by asking the Supreme Court to review the decision. In other words, the litigation is not yet over. Also, there remains the likely possibility that other courts may decide the issue differently, potentially leading to inconsistent rulings across the country. In the meantime, employers should proceed with caution when allocating duties and responsibilities to tipped employees, especially those employers with worksites outside of the Fifth Circuit (beyond Texas, Louisiana, and Mississippi). Any change in practice or policy should be made in consultation with your HR representatives and legal advisors.

For additional information about these issues or questions you may have regarding your tipped employees, please contact the authors, Zachary B. Busey and Emily Olivier Kesler, or any member of the Labor & Employment Group.