Tips, Tipping, and Tip Pooling

A lot of service employees -- from waiters, waitresses, and bartenders to gardeners, cleaning staff, movers, and counter people -- receive tips from satisfied customers. In fact, some employees earn more money in tips than in wages.

If you receive tips as part of your compensation, you should know your legal rights. For example, employers in most states can take a tip credit: They can pay you a lower minimum wage because you receive tips. And, you may be required to "tip out" or pool your tips with other employees. Here's what you should know.

### Tip Basics

The basic rule of tips is that they belong to employees, not the employer. Employees can't be required to give their tips or any part of them to the company, except as part of a valid tip pooling arrangement (see "Tip Pooling," below) -- and even then, the tip pool must be divided only among certain other employees. The employer can't be part of the pool.

It's not as easy as you might think to figure out exactly how much of what a customer pays is a "tip." Take, for example, bills paid by credit card: If the employer has to pay the credit card company a processing fee, some states allow the employer to subtract a proportionate amount of the designated tip to cover its expenses. Other states -- most notably, California  -- say that the employer has to give the employee the full tip indicated by the customer and pay the fee itself.

### Mandatory Service Charges

What about those mandatory service charges often tacked on to bills for large tables of diners, private parties, and catered events? Under federal law and in most states, this isn't considered a tip. Even if the customer thinks that money is going to you and doesn't leave anything extra on the table, your employer can keep any money designated as a "service charge." The law generally considers this part of the contract between the patron and the establishment, not a voluntary acknowledgment of good service by an employee. Many employers give at least part of these service charges to employees, but that's the employer's choice -- employees have no legal right to that money.

A couple of states have different rules, however, intended to make sure customers know what they're paying for. For example, New York's highest court recently found that companies have to give all mandatory service charges to their employees unless they make it clear to customers that the company is keeping the money. And, the state of Washington requires companies to tell customers -- on menus and receipts -- what portion of a mandatory service charge goes to the employee who served the customer.

### Tip Credits

Under federal law and in most states, employers may pay tipped employees less than the minimum wage, as long as employees receive enough in tips to make up the difference. This is called a "tip credit." The credit itself is the amount the employer doesn't have to pay, so the applicable minimum wage (federal or state) less the tip credit is the least the employer can pay you per hour. If you don't earn enough in tips during a given shift to bring your total compensation up to at least the applicable minimum wage, your employer has to pay the difference.

Although most states allow employers to take a tip credit, some don't, including California, Minnesota, and Oregon. To find out what's allowed in your state, see our page State Minimum Wage Rates.

### Tip Pooling

Many states allow employers to require tip pooling. All employees subject to the pool have to chip in a portion of their tips, which are then divided among a group of employees. An employee can't be required to pay more into the pool than is customary and reasonable, and the employee must be able to keep at least the full minimum wage (that is, the employee can't be required to pay any part of the tips the employer is counting towards the minimum wage into a tip pool).

Only employees who regularly receive tips can be part of the pool. Employees can't be required to share their tips with employees who don't usually receive their own tips, like dishwashers or cooks. And no employers are allowed in the pool: Tips from a tip pool can't go to employers or, in some states, managers or supervisors.