

FLSA-896

February 8, 1985

This is in reply to your letter of October 22, 1984, asking whether a client's proposed methods of compensating certain of its employees comply with the Fair Labor Standards Act (FLSA). You are specifically concerned with how your client's distribution to these employees of money received from customers for certain services would be treated for the purposes of sections 7(e)(5), 7(h), and 7(i) of FLSA.

You state that your client, a hotel, generally charges a customer a fixed amount for specific functions or services, such as a banquet. The hotel also collects an additional amount from the customer. In a telephone discussion with a member of my staff on November 6, in which you provided further information concerning your inquiry, you asked us to assume that the additional amount collected from the customer is a compulsory service charge. Your client distributes this service charge in a variety of ways to certain hotel employees.

The distribution formula is as follows:

One-third of the service charge is paid to full-time waiters who work at these functions. These waiters receive over one-half of their income from these service charge distributions. You state that their average hourly rates of pay are more than one and one-half times the minimum wage required by FLSA.

Your client distributes another one-third of the service charge to full-time housemen who work at these functions and whose average hourly rates of pay are also more than one and one-half times the minimum wage required by FLSA. However, only occasionally do these employees earn more than one-half of their income from these service charge distributions.

Some of the service charge also goes to coatcheck employees who work at these functions outside their normal working hours. Your client uses this portion of the service charge distribution to pay a premium rate of \$10.00 per hour to these employees for these working hours. During their normal working hours, they are paid \$4.20 an hour and one and one-half times that rate for hours worked in excess of 40 in a workweek. The remainder of the service charge is distributed to the banquet department and banquet manager for funding purposes.

We wish to point out that it is our position that compulsory service charges which are added to customers' bills are not considered to be tips from the customers to the employees. They are gross receipts to an employer and may be used by the employer in any way he or she chooses, including using the service charges to pay employees. Pursuant to your request, we will presume that the amount of money your client distributes to these employees for working at these functions is funded only by service charge revenue.

You present five questions concerning the application of sections 7(e)(5), 7(h), and 7(i) to the methods of compensation your client wishes to implement for the employees involved in this service charge distribution.

Your first question asks whether the full-time waiters who receive more than one-half of their wages from this distribution and whose average hourly earnings are more than one and one-half times the minimum wage required by FLSA are exempt from overtime premium pay pursuant to section 7(i) of FLSA.

Under section 7(i) of FLSA an employee of a retail or service establishment who is paid in full or in part on a commission basis may be exempt from the Act's overtime pay requirement in a workweek if (1) the regular rate of pay of such employee in that workweek is in excess of one and one-half times the minimum wage (currently \$3.35 an hour), and (2) more than half of the employee's compensation for a representative period (not less than one month) represents commissions on goods or services. In determining the proportion of compensation representing commissions, all earnings resulting from the application of a bona fide commission rate shall be deemed commissions on goods or services without regard to whether the computed commissions exceed a draw or guarantee. A discussion of the application of this exemption is contained in sections 779.410 through 779.421 (copies enclosed) of 29 CFR Part 779.

A service charge levied on a customer by an establishment, such as a hotel, motel, or restaurant, for services rendered by waiters, waitresses, or other such service employees may qualify as a commission under section 7(i). Such a service charge is keyed to sales bearing a direct relationship to the goods or services sold by the establishment, and is usually a specific percentage of the customer's bill. Tips are not commissions for the purpose of section 7(i).

Section 7(i) was enacted to relieve an employer from the obligation of paying overtime compensation under section 7(a) to certain employees of a retail or service establishment paid wholly or in greater part on the basis of commissions. Section 7(i) contemplates a situation where the employee is regularly or permanently employed on a commission basis. In addition, an employer's use of section 7(i) may occur only after the representative period has demonstrated that the compensation received by an employee is primarily from commission earnings.

On the basis of the information you provided, it is our opinion that the full-time waiters who work at these functions may qualify for the section 7(i) exemption, provided a representative period is established (see sections 779.417 and 779.418).

Your second question asks whether housemen who average more than one and one-half times the minimum wage required by FLSA for each hour of work, but who only occasionally earn more than one-half of their wages from the service charge distribution, are exempt from overtime premium pay pursuant to section 7(i). You indicate that housemen are those individuals who do not have customer contact, however, they set up and take down dining room settings before and after banquets.

The representative period referred to in section 7(i)(2) for determining that more than one-half of an employee's earnings are from commissions is the one prior to the pay period for which the exemption is sought. You advised us on November 6, that the housemen would receive more than one-half of their wages from the service charge distribution only during the month of December of each year. If we were to assume that the representative period for these housemen is a monthly one, the section 7(i) exemption would be applicable to these employees only in the pay periods for which that representative period applies.

Your third question concerns the portion of the service charge distribution paid to coatcheck employees who work at a function outside their normal work hours. It is our understanding that the portion of the service charge distribution paid to such employees is in the form of an hourly premium pay rate of \$10.00. You ask whether, pursuant to section 7(e)(5) of FLSA, this hourly premium pay rate qualifies as a premium payment which may be excluded from the "regular rate" of pay computation for overtime premium pay. You also ask whether, pursuant to section 7(h) of FLSA, your client may credit this premium payment against any other overtime premium pay which may be owed to these coatcheck employees.

As explained in section 778.308 of 29 CFR Part 778, the overtime rate, like the regular rate, is a rate per hour. In order to qualify as overtime premium payments under section 7(e)(5) of FLSA, the extra compensation for overtime hours must be paid pursuant to a premium rate which is likewise a rate per hour. Further, as explained in section 778.202 the extra compensation must be paid because such hours are worked in excess of eight in a day or 40 in a week, or in excess of the employee's normal or regular working hours.

Based on the information you provided, it is our opinion that part of the \$10.00 per hour payment to coatcheck employees working at a function outside their normal working hours is bona fide extra compensation within the meaning of section 7(e)(5) of FLSA. As you explained on November 6, the coatcheck employees are normally paid \$4.20 an hour for each hour of work. The amount which is in excess of that wage rate is the amount that qualifies as the extra compensation to which section 7(e)(5) applies. In this case that extra compensation is \$5.80 (\$10.00- \$4.20). That amount may be excluded from the regular rate of pay computation pursuant to section 7(e)(5) of FLSA. In addition, pursuant to section 7(h) of FLSA, that extra compensation may be credited against any overtime premium pay otherwise due the coatcheck employees.

Your fourth question asks whether the distribution of a portion of the service charge to hotel departments and management would affect the applicability of sections 7(e)(5), 7(h), and 7(i) of FLSA.

The method of distributing the service charge funds to these groups and departments would not affect any of our responses. As explained earlier, compulsory service charges are gross receipts to an employer and may be used by the employer in any way he or she chooses.

Your fifth question asks whether the service charge distribution system, when it is viewed in its entirety for compliance with sections 7(e)(5), 7(h) and 7 (i) of FLSA, would violate any Federal wage-hour laws or regulations.

It is our opinion that the service charge distribution system would not violate any law or regulations administered by the Wage and Hour Division.

We trust that the above is responsive to your inquiry.

Sincerely,

William M. Otter
Administrator