



# Tax Researcher

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## REMINDER: THE FEDERAL MINIMUM WAGE INCREASES AGAIN

Effective 7/24/09, the last of the scheduled increases to the federal minimum wage takes effect. The legislation that was passed in 2007 provided for the following increases:

Effective Date	Min. Wage		Minimum Cash Wage	Maximum Hourly Tip Credit
	From	To		
7/24/07	\$5.15	\$5.85	\$2.13	\$3.72
7/24/08	\$5.85	\$6.55	\$2.13	\$4.42
7/24/09	\$6.55	\$7.25	\$2.13	\$5.12

With this latest increase, it's a good time to review two features of minimum wage law:

## “TIP CREDIT” IS NOT A TAX TERM – IT RELATES TO WAGE AND HOUR RULES

The notion of “tip credit” applies only to tipped employees. As defined by Federal law and in most states, any employee who “customarily and regularly” receives more than \$30 per month in tips is a “tipped employee.” And, what is a “tip”? It is a voluntary payment received by an employee from a customer, the amount of which is determined by the customer. The amount of the tip must not be dictated by employer policy or subject to negotiation with the employer. Therefore, for example, the 15% gratuity a hotel may require for service at a banquet is not a “tip.”

If a worker qualifies as a “tipped employee,” the employer may credit toward the required minimum wage rate some of the tips received by the worker and reported to the employer. By allowing a portion of tips received to qualify as wages for purposes of minimum wage requirements, the employer lawfully can pay at a lower cash wage rate. However, the tip credit per hour normally is limited to a certain maximum dollar amount (the “maximum tip credit”). This limit is \$4.42 per hour (\$5.12 effective 7/24/09) under Federal law, but varies from state to state.

When Congress amended the Fair Labor Standards Act to increase the Federal minimum wage rate on October 1, 1996, emphasis was moved away from the term “tip credit” and replaced with the “minimum cash wage for tipped employees.” Instead of attending to the maximum wage amount an employer can hold back from the tipped employee, the focus became a limit on how small an hourly “cash” wage the employee can lawfully receive. At all times, the applicable minimum wage rate must equal the sum of the maximum tip credit and minimum cash wage.

It is important to recognize that five states do not have their own minimum wage laws, although many of their employers must follow the Federal rules on tip credit and “minimum cash wage for tipped employees.” These states are Alabama, Louisiana, Mississippi, South Carolina and Tennessee.

In addition, another seven states do not allow the use of tip credit under their respective minimum wage laws. For the latter group of states, the “minimum cash wage for tipped employees” will always be the same as the state's regular minimum wage rate. The jurisdictions with no tip credit option are: Alaska, California, Minnesota, Montana, Nevada, Oregon, and Washington State.

Finally, Georgia and Virginia have no state laws regulating maximum tip credit. New Jersey does not have a maximum tip credit rate, but “recommends” a cash wage rate of at least \$2.13 per hour, for tipped employees.

## **IN STATES WHERE FEDERAL AND STATE MINIMUM WAGE RATES DO NOT AGREE, WHAT IS THE CORRECT CHOICE?**

The Federal minimum wage rate is set forth in the Fair Labor Standards Act (FLSA) which establishes various workplace standards, including a minimum wage rate for employees not exempt from its coverage. Generally, FLSA covers employers with annual sales of \$500,000 or more AND employees of firms if they are individually engaged in interstate commerce or in the production of goods for interstate commerce. (Such employees include those who work in communications or transportation; regularly use the mails, telephones; handle, ship, or receive goods moving in interstate commerce; regularly cross state lines in the course of employment.) Also covered are the employees of hospitals, residential institutions, schools and public agencies.

FLSA excludes from coverage the workers in certain types of jobs, such as executive, administrative and professional employees.

Normally, if an employer has annual sales of less than \$500,000, or doesn't engage in interstate commerce, the FLSA's minimum wage rules do not apply. The only minimum wage rate applicable would be that of the state where the work is performed, if that state has a minimum wage requirement.

Currently six states (Arkansas, Georgia, Kansas, Minnesota, Wisconsin and Wyoming) have a minimum wage rate lower than the Federal rate. (Note: Wisconsin will equal the federal rate of \$7.25 effective 7/24/09 and Kansas will equal it effective 1/1/10.) In addition, five states (Alabama, Louisiana, Mississippi, South Carolina and Tennessee) do not have a state minimum wage rate. So, if FLSA does not apply, employers in those five states are unregulated and may pay any hourly wage rate which gets employees to work for them. All other states have a state minimum wage rate equal to, or greater than, the current Federal rate of \$6.55 per hour (\$7.25 effective 7/24/09).

By way of contrast, suppose a Vermont company has annual sales of \$2 million. This company is subject to both the Federal rate of \$6.55 per hour (\$7.25 effective 7/24/09) and whatever minimum wage rate Vermont has legislated — \$8.06 per hour, effective 1/1/2009. Importantly, because the Vermont rate is more favorable to employees than the Federal rate, the Vermont minimum rate must be applied. Obviously, the outcome would be the same if the Vermont company had annual sales of only \$250,000, exempting it from FLSA coverage in the first place.

### **There May Be A Different Result With Tipped Employees**

Where an employer is subject to both the FLSA and the law of the state where the work is performed, the minimum cash wage rate most favorable to tipped employees must be used.

For example, a large Michigan restaurant with annual sales of \$1 million should pay the Michigan minimum cash wage rate of \$2.65 per hour, to its tipped employees — not the Federal minimum cash wage rate of \$2.13 per hour. This restaurant employer is subject to both the FLSA (because its annual sales are \$500,000 or more) and to Michigan minimum wage laws (because the work is performed there). The choice is made by selecting the minimum cash wage rate most favorable to the tipped employee.

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