

Gratuities – A Crash Course

***Understanding the relevant BC ESA provisions,
CRA Rules, and Tribunal and Court rulings***

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1. *Fundamentals*

Whose money is this anyway?

- Definition of “wages”
- Definition of “gratuities”
- Unlawful withholding and deductions

2. *Tip Pools*

Who gets to play in the pool?

- Lawful imposition of tip pools
- Lawful tip pool participants
- Case law
- Best practices

3. *Services and Surcharges*

Where is that money going?

- ESA rules
- What does the customer see?
- Best practices

4. *To tax or not to tax?*

Who is in control here?

- Direct vs. Controlled Tips
- *Ristorante a Mano*
- Making sense of it all
- Best practices & potential solutions

1. *Fundamentals*

Who's money is this anyway?

- Definition of “wages”
- Definition of “gratuities”
- Unlawful withholding and deductions

Employment Standards Act Definitions

- “Wages” – gratuities are expressly *excluded* from definition of wages
- “Gratuity” – is defined as:

Cash Tips

a payment voluntarily made to or left for an employee by a customer of the employee’s employer in circumstances in which a reasonable person would be likely to infer that the customer intended or assumed that the payment would be kept by the employee or shared by the employee with other employees

Electronic Tips

a payment voluntarily made to an employer by a customer in circumstances in which a reasonable person would be likely to infer that the customer intended or assumed that the payment would be redistributed to an employee or employees

Service / Surcharges

a payment of a service charge or similar charge imposed by an employer on a customer in circumstances in which a reasonable person would be likely to infer that the customer intended or assumed that the payment would be redistributed to an employee or employees

Unlawful Deductions under the Act

- Section 21
 - (1) except as permitted or required by this Act ... an employer must not, directly or indirectly, withhold, deduct or require payment of all or part of an employee's wages for any purpose
 - (2) an employer must not require an employee to pay any of the employer's business costs
 - (3) money required to be paid contrary to subsection (2) is deemed to be wages, whether or not the money is paid out of an employee's **gratuities**, and this Act applies to the recovery of those wages

Unlawful Deductions under the Act

- Business Costs
 - breakage & spillage
 - spoilage
 - dine and dash
 - cash float
 - special clothing
 - determinable fuel costs for personal vehicle used for deliveries
 - recovering an advance on wages or overpayment
 - subsidizing higher hourly rates of pay
 - credit/debit card processing fees (*see *ESA* definition of gratuity)

Unlawful Deductions under the Act

- ESA Definition of Gratuities ... *continued*

but does not include ...

(f) charges as may be prescribed relating to the method of payment used, or a prescribed portion of those charges;

- However ... “*as may be prescribed*” is important, as *nothing* has been prescribed yet.
- Bottom line ... employers in BC *cannot* deduct credit card fees from gratuities.

Unlawful Withholding under the Act

- Section 30.3
 - (1) An employer must not
 - (a) withhold gratuities from an employee,
 - (b) make a deduction from an employee's gratuities, or
 - (c) require an employee to return or give the employee's gratuities to the employer.
- Exceptions:
 - Authorized by law (e.g. garnishment or family maintenance order)
 - Tip Pooling (pursuant to section 30.4 of the Act)

2. *Tip Pools*

Who gets to play in the pool?

- Lawful imposition of tip pools
- Lawful tip pool participants
- Case law
- Best practices

Imposition of Tip Pools under the Act

- Section 30.4(1)

Despite section 30.3 (1), an employer may withhold gratuities from an employee, make a deduction from an employee's gratuities or require the employee to return or give the employee's gratuities to the employer *if **the employer** collects and redistributes gratuities among some or all of the employer's employees.*

- Effectively authorizes employer to *require* employees to pool tips
- But who is permitted to set the tip pool formula ... ?

Imposition of Tip Pools under the Act

- Employment Standards Guidelines:

Employers can require employees to pool their tips, and to share them with those employees who work in positions that otherwise have no access to tips, but who a reasonable person would assume would share in the tips.

Example:

An employer requires all employees who receive tips to put 15% of tips received into a pool. The pool is disbursed to all employees who do not receive tips at the end of each shift according to a formula agreed to by the employees. This activity does not contravene the Act.

- Is the employer permitted to set the formula ... ?
 - Yes ... but *should* the employer set the formula?

Imposition of Tip Pools

- What about tax, CPP and *EI*?
- Depends ... CRA says:
 - Controlled tips (paid by the employer) includes:

tips that are allocated to employees using a tip-sharing formula determined by the employer
 - Direct Tips (paid by the customer) includes:

tips are pooled or shared among employees using a tip-sharing formula determined by employees, rather than the employer

Lawful Tip Pool Participants – the Act

- Section 30.4 (3) & (5)

A director or shareholder of a corporate employer is not allowed to share tips unless they perform to a substantial degree the same work performed by (a) some or all of the employees who share in the redistribution or (b) employees of other employers in the same industry who commonly receive or share in gratuities.

- Section 30.4 (4)

An individual employer (a proprietor or a partner in a business) is not allowed to share tips unless they regularly perform to a substantial degree the same work performed by (a) some or all of the employees who share in the redistribution or (b) employees of other employers in the same industry who commonly receive or share in gratuities.

Lawful Tip Pool Participants – Case Law

- So, what about managers or administrative staff (i.e., not “owners”)?
- *Retail Action Network (RAN) v. Anna Gerrard*
2021 BCEST 5:
 - 50 ... there is nothing in the *ESA* prohibiting a tip pool that includes, for example, managers and administrative staff. ...
- But is inclusion of managers/admin staff a good idea?

Lawful Tip Pools – Best Practices

- Restrict to those doing the work – i.e., “*those who a reasonable person would assume would share in the tips*”
- Generally better to exclude managers & administrative staff
- Suggest and guide, but do not dictate
 - Consider establishing a tip committee
- Keep record of process, rules and formula

3. *Service and Surcharges*

Where is that money going?

- ESA rules
- What does the customer see?
- Best practices

Surcharges – Prior to May 2019

- Unlawful deductions to cover business costs always prohibited and deductions from gratuities have always rendered them recoverable as wages
- However, the term “gratuity” was not a defined term prior to May 2019
- Thus, “Surcharges” or “Services Charges” typically fell under the radar
- Example:

ADDITIONAL CHARGES AND FEES

All Food and Beverage functions are subject to a mandatory **18%** surcharge, plus applicable taxes.

Surcharges – After to May 2019

- “Gratuity” – defined under the *Act* in May 2019:

a payment of a **service charge or similar charge** imposed by an employer on a customer **in circumstances in which a reasonable person would be likely to infer** that the customer intended or assumed that the payment would be redistributed to an employee or employees

Surcharges – A Customer’s View

- The Test:

Would a reasonable person be likely to infer that the customer intended or assumed that the payment would be redistributed to an employee or employees (i.e., as part of a tip pool)?

If so, the payment will be deemed a gratuity and deductions from that payment to cover business costs will be unlawful.

Surcharges – Best Practices

- Clarity is key
- If any portion of service charge or surcharge is to be kept by the employer, this must be made explicitly clear to the customer
- Example:

ADDITIONAL CHARGES AND FEES

All Food and Beverage functions are subject to a mandatory **18%** surcharge, plus applicable taxes, of which **12%** is a gratuity that is distributed to the our servers and, as appropriate, other supporting staff, and the remaining **6%** is an administration fee retained entirely by Ryan's Lodge (and not distributed as wages, tips or gratuities to any employee).

4. To tax or not to tax?

Who is in control here?

- Direct vs. Controlled tips
- *Ristorante a Mano*
- Making sense of it all?
- Potential solutions & Best practices

A Primer – *Let's Start at the End*

- There are, essentially two tests: one used by the CRA and one used by the Courts:
 - **CRA** – are tips controlled by the employer before paid to the employees?
 - **Courts** – are tips possessed by the employer before paid to employees?
- Meet the first test, and you'll never see the second test.
- However, it's *easy* to fail the first test!

Controlled Tips – as per CRA

- Tips that an employer **controls** or *possesses* and then pays to the employee – for example: :
 - employer's **mandatory percentage or service charge** on a bill
 - **tips that are allocated to employees using a tip-sharing formula determined by the employer**
 - tips that an employer **includes in his business income**, then expenses and redistributes to employees in the form of pay
 - tips that the **employees turn over to their employer** who then distributes them to the employees
 - cash tips that are **deposited into the employer's bank account** and become, or are even commingled with, the property of the employer and then paid out to the employees

Controlled Tips – as per CRA

- CRA's example:

You are part of the serving staff in a restaurant. You receive tips from the restaurant's customers. However, some of the support staff feel that they should receive a share of those tips. The restaurant owner agrees to put in place a tip pool to make sure the tips are distributed among all staff members.

Controlled Tips – as per CRA

- Rules:
 - Controlled tips are part of an employee's total remuneration.
 - Employer is considered to have paid these amounts to the employee.
 - This triggers obligation to deduct and remit **income tax**.
 - Also triggers obligation to **deduct and remit CPP contributions and EI premiums** – both employee and employer's share.

Direct Tips – as per CRA

- Tips that are paid directly by the customer to the employee, where the **Employer has no control** over the tip amount or its distribution and *the employer is merely a conduit* for the tip from the customer to the employee
 - customer leaves money on the table at the end of the meal
 - employees and not the employer decide how the tips are pooled or shared among employees
 - a customer includes an amount for a tip when paying the bill by credit or debit card and the employer returns the tip amount in cash to the employee at the end of the shift or, in exceptional circumstances, the next day (if there was not enough available cash on hand)

Direct Tips – as per CRA

- CRA's example:

You are part of the serving staff in a restaurant. The restaurant owner informs you that if a customer pays by credit or debit card and includes a voluntary tip, the restaurant will return the **full** tip amount back to you in cash at the end of each shift.

Direct Tips – as per CRA

- Rules:
 - Direct tips are *not* considered to be paid by the employer.
 - Therefore no obligation to deduct (*at source*) and remit income tax.
 - Also no CPP contributions or EI premiums.

Pretty Simple, Right?

- Most employers want a direct tip system
 - Cash tips – easy
 - Employee controlled tip pool – “easy”
 - Credit card tips – still pretty “easy” (if you can pay fast)
- As the CRA says:

“... the employer is merely a conduit for the tip from the customer to the employee.”

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- But then the Courts get in the way ...
- Facts:
 - *Ristorante a Mano (RAM)* set and imposed tip pool – that is, the employer *controlled tips*
 - But, treated as *direct tips*
 - No CPP or IE deductions/remittances (or tax)
 - CRA Assessment found deductions/remittances should have been made because = controlled tips
 - *RAM* appealed to Minister of National Revenue, then Tax Court and then Federal Court of Appeal

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- Federal Court of Appeal finds:
 - When money is paid by the employer in respect of employment, this triggers CPP and EI obligations.
 - The word “paid” deserves a “broad interpretation”.
 - The applicable test is:

“simply, whether it was the employer who ‘paid’ (liberally construed) the tips to the servers”.
 - The electronic tips were *not* paid to or otherwise in possession of the servers ... rather, they were paid to the employer, who then paid them to employees.

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- Federal Court of Appeal – Bottom Line:

[52] While both the appellant and the respondent invited this Court to address the proper treatment of tips more broadly to bring clarity to the issue, in my view that is neither desirable nor necessary. The test is clear. In each case, **the question to be asked is whether**, based on the relevant facts in the case, **the amount in question is *paid by the employer* to the employee in respect of their employment.**

- In other words, ***possession*** is key.

Making Sense of it All?

- Have the rules changed?
- The CRA does not appear to think so – website still says:

Direct tips:

A customer includes an amount for a tip when paying the bill by credit or debit card and the employer returns the tip amount in cash to the employee at the end of the shift or, *in exceptional circumstances*, the next day (if there was not enough available cash on hand)

Potential Solutions & Best practices

- Not an insurmountable challenge ... just takes careful planning
- Address both concerns
 - Control – to satisfy the CRA
 - Possession – to satisfy the Courts

Potential Solutions & Best practices

- Create & Maintain a *Direct* Tip System – satisfy CRA
 1. Establish a tip committee & governance rules
 2. Guide but do not direct (then try to stay out of it)
 3. Keep a record of the results & revisit annually
 4. Avoid percentage of revenue models
 5. No mandatory gratuities / surcharges, or keep them very separate
 6. Avoid promises or contractual commitments regarding tip pool participation
 7. Make sure payout is at the end of each shift – have enough cash on hand for this each day
 8. Make tip payout, in cash, to tip committee rather than individual

Potential Solutions & Best practices

- *Possession* – satisfy the Courts:
 1. Tips to a “merchant account” or “Tip Committee Trust” for distribution to individuals
 2. Uber-style ... separate charges for tips to separate account
 3. Consider third-party solutions

Specific Questions

What's on your mind?

Q&A