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" o ns t e Tips

Many Canadians in the hospitality or service industry, and those with control over the ubiquitous tip jar, will want to know how the law treats tips and gratuities. In particular, do tips added to the bill or extra cash left behind belong to the employer or to the employee? Is an employee required by law to report tips to the employer?

In theory, there are arguments on both sides of the "whose tips?" question. On one hand, customers have a legal and contractual relationship with the business entity only, and employees are mere agents performing services and receiving payments for the employer. Under the control principle, the business hires, trains, and accepts risks for the employee. Customers only have a legal obligation to pay the employer. Tips may be considered as rewards to the business. If employees please customers, why should the employer not reap the benefits, including gratuities, for successful business service?

On the other hand, we know that customers are often personal in their tipping. They prefer tips to go to the employee. Tips might be individual employee "gifts," since they are given voluntarily by customers to the frontline service staff. Since customers are not required to leave tips and they determine the amounts, employers are distanced from this gratuity.

There is little legislation or common law to clarify ownership. Tips and gratuities "intended for an employee" in Prince Edward Island are the property of the employee. If they are taken by the employer, they must be returned within 60 days. Likewise, Quebec law states: "Any gratuity or tip paid directly or indirectly by a patron to an employee who provided the service belongs to the employee of right and must not be mingled with the wages that are otherwise due to the employee."

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Ideally, one would obtain the intention of each tipper at the time they tip, but that is not feasible. The intention of the tipper, if manifested, will always be paramount. Often tips are left at the point of sale without further communication. No intention is expressed, and the tip seems offered to the business like any other feedback. If the tipper says to the employee something like "here, take this and buy yourself something nice," it is a personal gift, even though it was given and received in the context of employment. Words to the effect that, "you've given us great service, so please keep the change" suggest that the tipper was giving the money directly to the tippee and not to the employer.

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Provincial legislation across Canada is clear that customers' tips cannot count as part of employees' wages. Employers must ensure that they pay at least minimum wage to employees. The Alberta *Employment Standards Code* is typical (or "tip-ical?"). It defines "wages" as "salary, pay … commission or remuneration for work, however calculated, but does not include … tips or other gratuities." This falls short of deciding the ownership issue, although it recognizes employee receipt of tips.

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Collective Agreements, employment manuals, and contracts may contain gratuities policies binding on employees. These provisions may stipulate that tips are pooled and distributed according to a formula, on the basis that more than one staffer makes the service complete. The tip issue may be addressed in the employment contract, oral or written. In *Wiskerke v. Theroux* (2001 ABPC 213), a taxi driver was awarded tips as part of his compensation. His employment contract allowed him to collect tips as compensation.

Canada Re enue - enc CR © Treatment

At an administrative level, the federal income tax department has a policy on workplace tips: those earned and collected by employees must be reported as income. However, whether tip income forms part of an employee's pensionable (CPP) and insurable (EI) earnings depends on whether they are considered to have been paid by the employer (controlled tips) or whether they are considered to have been paid by the client (direct tips).

According to CRA Interpretation Bulletin CPP-1, controlled tips are considered to have been paid by the employer to the employee. Examples of controlled tips include a mandatory service charge or a percentage added to a client's bill, distribution through the employer's tip-sharing formula, and tips that an employer collects and later pays out to employees as wages. Controlled tips are part of the employee's total remuneration upon which CPP contributions and EI premiums

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are deducted at source. If the employer handles the tips before redistributing them, they are taxed as employer wages (*Lake City Casinos Ltd. v. Canada* (2007 FCA 100)).

Direct tips are paid directly by the client to the employee without employer control. They include money left on the table at the end of the meal, a direct payment to a bellhop or porter, and tips pooled and shared among employees themselves. These direct tips do not attract CPP or EI contributions.

Provincial legislation prohibits employers from making payroll deductions unless they are legally authorized or agreed to. Therefore, an employer must follow the CRA rules with respect to pensionable and insurable earnings and may not be able to deduct the amount of tips from wages unless the employee consents. It cannot bring employees below minimum wage in any event.

It is important to remember that this CRA Interpretation Bulletin is only an administrative statement of policy, not a legally-binding document. While the "controlled" versus "direct" categories are interesting distinctions, this Bulletin only deals with a very minor issue: whether there must be pensionable and insurable source-deductions on those tips. It does not deal with the broader question of who is entitled to the tips in the absence of an agreement or policy.

Reasonable Expectations and Trade Custom

The hospitality and food service industries have the most minimum wage earners at 26.5%. These employers pay minimum wage because they expect tips to supplement this. In *Riverspot Restaurants Ltd. v. National Automobile* [2003 CanLII 62568 (B.C. L.R.B.)], it was agreed that while tips are not technically "wages," in the hospitality industry tips are regarded as employees' regular earnings, not as "gifts" or "additions."

Likewise, in a Manitoba case, *Nychka v. Red Lobster* (2008 MBQB 47), tips were viewed as regular income. When Dawn Nychka was dismissed, she claimed that she expected tips as part of her compensation, and her opportunity to earn tips was lost. Tips were so expected that both sides could accurately estimate tips based on gross sales each night. The Court awarded Nychka compensation for the tips she could have earned during her employment.

Conclusion

There is no obvious answer to the question of who – employer or employee – can legally collect tips given by customers. Provincial legislation only says that employers cannot count tips as part of their obligation to pay minimum wage. The *Income Tax Act* includes tips under the definition of "income" so they must be declared on income tax returns. They are taxed like wages. The Canada Revenue Agency further distinguishes "controlled" from direct" tips in determining whether one pays CPP and EI contributions at source.

This uncertainty has not led to disputes about whether tips are employee income or employer profit. Workplaces have policies on how tips are to be handled and distributed. Most employees start with a clear understanding about who gets the tips. Employers know that tips are an employee performance incentive; they take advantage of this by paying lower fixed wages. This gives rise to an implied understanding, recognized by courts as a custom of the hospitality trade, that tips contribute to total employment compensation. Notwithstanding this, it is wise to include this issue in the employment contract. The contract should specifically outline who the tips and gratuities belong to and how they will be handled.

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