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SUBJECT: **GRATUITIES/TIPS FOR RESTAURANT EMPLOYEES**

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We bring to your attention an important development regarding the processing of gratuities/tips as income for restaurant employers and as credits on account of salary for employees.

Pursuant to an appeal by Mr. Omri Case to the National Insurance Institute (Bituach Leumi) before the National Labor Court (the "**Judgment**"), as of January 1<sup>st</sup>, 2019, gratuities received by restaurant employees will now be considered part of the business' income and be reflected in the employee's salary, regardless of whether it was registered in the employer's books. If the gratuities are collected by the employer, the employer may now only use that money as part of the employee's wages (to ensure that they are paid at least minimum wage). The Judgment overturned the former practice as detailed below.

The Judgment considered the following regarding the receipt of tips in restaurants:

1. whether gratuities are included in the calculation of the employee's salary for the purpose of ensuring that the employee is at least receiving minimum wage;
2. whether gratuities should be included in the employee's salary when calculating the employee's social benefits;
3. whether the gratuities are included in the employee's salary when calculating the employee's rights vis-à-vis Bituach Leumi, such as unemployment payment; and
4. whether the employer has any right to the gratuities (e.g. rather than the employer exclusively).

The practice in restaurants before this Judgment, was **not** to recognize tips as income of the employer/business since the payments did not pass through the restaurant's register and, in parallel, were generally not recognized as salary from the employer, even though the gratuities were considered reportable income of the employee for tax purposes. This distinction was based on the interpretation of Section 10 of the Annual Vacation Law, 5711-1951 that defines "salary" as "all proceeds, cash or in kind, paid to the employee **by the employer** [...] with respect to the employee's **normal working hours**." Former case law was based on the strict reading of the law, that since tips were neither paid by the employer directly nor on behalf of the employee's normal,



agreed upon responsibilities vis-à-vis the employer, the employer did not recognize the tips as income and were not required to attribute the receipt by the employee as payment of salary.

The approach from before the Judgment, had both advantages and disadvantages for the employer and the employee. Employee salaries payable by the employers were at least minimum wage, including tips up to the sum of minimum wage, but tips received beyond minimum wage were not registered by the restaurant and were therefore not reported by the employers. This created a situation where gratuities were only partially recognized in the calculation for the purposes of social benefits, such as pension, severance, unemployment pay, etc. and employees were liable to report the other portion to the tax authorities.

According to the Judgment, gratuities must be recognized **in full** as restaurant (i.e. - employer) income which is then paid to the employee directly from the employer on account of at least minimum wage. This precedent is partly based on the Court's reassessment of the "voluntary test" that had been used in past rulings. While gratuities were once a voluntary act of the customer based on the service received by the restaurant employee, the Court recognized that it has become traditionally obligatory and not directly connected to the particular server, but rather to the restaurant experience as a whole. This new perspective also outweighs the Court's former test of whether the gratuities physically and formally passed through the restaurant/employer's cash register. Additionally, the Court used to examine the means of payment of tips as a further indication of their ownership. Even though often the gratuities are paid in cash by customers directly to their server and separate from the bill, they are sometimes included, and even paid for together with the bill, and not as separate cash passing from the hands of the customer to the server. Therefore, the Judgement recognized that as part of the gratuities norm, this "means of payment" test was also no longer relevant.

In summary, today gratuities are recognized as employer income, paid over to the employee as salary, which is in turn is reflected both in the calculation of social benefits and payments to/from Bituach Leumi. As to the issue of whether the restaurant/employer has any rights to the gratuities that are now considered as "passing through its register," the Court has restricted the employer's right to use the gratuities to serve only as payment of employees' salaries, and are not to be used as payment for various employee social benefits and compulsory payments. The Court further limited its ruling to only apply to restaurants and not to other businesses.

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***This memorandum is not to be considered as a legal opinion.  
For legal advice, we suggest that you contact legal counsel directly.***

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