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Israel

'Sad' Israel Court Case Says Tips Belong to Owners, Not Waiters



By Matthew Kalman

Israel's restaurateurs may appeal a court ruling saying tips belong to the employer instead of the serving staff.

The employer would transfer the tips to staff as part of their salary according to the March 26 National Labor Court ruling. Tax would be deducted at source and value-added tax would be levied on the total. The change will take effect Jan. 1.

The ruling would lower wages, deter young people from the trade, increase costs and create a class of employees being treated as self-employed without the accompanying benefits, restaurant owners said. The ruling comes after calls to regulate the practice in law, and fits into the government's efforts to ensure proper tax is being collected.

The five-judge panel said the ruling was necessary after legislators failed to clear up a legal tangle stemming from a 2013 high court ruling that said tips are the private income of serving staff, whose official salary is generally the statutory minimum of 28.49 shekels (\$8.11) an hour or 5,300 shekels a month.

The issue is relevant to as many as 200,000 restaurant workers "and thousands of restaurants and cafes throughout the country," the ruling said. But tax practitioners and industry groups say the decision hurts workers.

The Case

The court was considering two cases brought by former employees: one regarding whether money received as a cash tip should be taken into account when determining unemployment benefits, and the other regarding whether minimum wage was paid.

Because tipping hasn't been regulated, and has instead been determined by case law, restaurant employees' actual income is far more than the amount on which national insurance is paid, the judges said. That affected pension and unemployment benefits, as seen in one of the cases.

"Tip money in the restaurant industry should be considered as the restaurant's income, and each waiter's tip revenue should be considered as work income from his employer," the ruling said. "This is so even if the tip was paid directly to the waiter; even if it did not pass through the cash register; even if it was paid by means of payment separate from that used to pay for the meal; and even if it is not recorded in the restaurant books or in the service log."

The current arrangement is "a practical device enabling tax evasion on a large scale, estimated at 1 to 2 billion shekels a year" on undeclared gratuity income, the ruling said.

Considering Appeal

The ruling is "incomplete and does not provide a holistic solution to the issue of gratuities," Shai Berman, director of the Israel Restaurants Association—the only lobby for the industry—said March 29. It "contradicts previous court rulings, including those of the high court."

"If we don't manage to solve the problems through negotiations with the tax authority, I presume we will appeal to the high court," he said.

While he welcomed the regulation of social benefits, deeming tips to be business payments means the VAT collected on them will come out of salaries—and the employer won't be able to use the money for another purpose.

"They are being treated as though they are self-employed but they cannot reclaim the VAT on their expenses. There is no precedent for this in Israeli work relations, that someone who is a salaried employee is suddenly also considered self-employed," he said.

'A Disaster'

Snapshot

- Restaurants consider appeal
- Employers use tips to pay salaries, giving tax advantage but reducing social benefits

"The ruling is bad for everybody. It's a disaster," said Avraham "Tico" Franco, a Tel Aviv CPA specializing in restaurants. The local practice, endorsed by the high court in 2013, of paying waiters' salaries from tip money is known as the "Tico method" based on his invention.

"All the waiters' salaries were set at the minimum wage plus statutory travel and overtime. The cost to the employer came to about 35 shekels an hour. The money would come from the tips and the owner made up the difference if the tips weren't enough. If there was more, all the tips belonged to the waiting staff, but tax would be calculated based on the minimum," Franco said March 28.

The ruling leaves the tax issues "very open," he said.

The ruling will make it much harder for restaurant staff to make a living, and it could hurt the industry as "intelligent, high-end waiters" seek other jobs, said Nir Zook, a celebrity television chef and author who runs several restaurants in Tel Aviv.

"It's a very sad decision," Zook said. "Over the years, the country looked the other way when it came to waiters' benefits. Most waiters are students or in between jobs. It gave them the possibility to work a few hours, make quite a lot of money and get higher education."

What's Next

The fate of the ruling depends on the attitude of the tax authority, said Harel Perlmutter, a tax partner at Barnea, Jaffa, Lande and Co. law firm in Tel Aviv.

"Tips were treated as a gift—no-one was reporting or paying taxes on that," Perlmutter said March 27. "You were supposed to declare, but for a student working for a few hours after school in the evening, I don't see them opening a file in the tax authority and filing a report. I think it's not fair to ask waiters to open files and declare. All of their income will be spent on paying for accountants."

To contact the reporter on this story: Matthew Kalman in Jerusalem at correspondents@bloomberglaw.com

To contact the editor responsible for this story: Penny Sukhraj at psukhraj@bloombergtax.com

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