



# TaxNewsFlash

## United States

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### **Ninth Circuit: Employees' class action challenging tax withholding based on cash tips**

The U.S. Court of Appeals for the Ninth Circuit today reversed a federal district court's judgment in a class action brought by employees that challenged their employer's practice of withholding state and federal taxes from their paychecks based on cash tips received, and remanded with instructions to remand to a state court because all of the claims were jurisdictionally barred by the federal-state comity doctrine or the Tax Injunction Act.

The Ninth Circuit concluded that under the Tax Injunction Act and the Anti-Injunction Act, the federal district court lacked subject matter jurisdiction over the claims for declaratory and injunctive relief with respect to the employer's withholding of state and federal taxes. Also, the federal-state comity doctrine barred the federal district court from awarding statutory damages on the state-tax component of the employees' claims, from which the federal tax component could not be severed.

The case is: *Fredrickson v. Starbucks Corp.*, No. 13-36067 (9<sup>th</sup> Cir. November 3, 2016). Read the Ninth Circuit's [opinion](#) [PDF 95 KB]

#### **Summary**

This class action was brought against the employer by three employees who had worked at shops in Oregon. The employees challenged the employer's practice of withholding state and federal taxes from their paychecks based on the cash tips they received.

Employees pooled tips left by customers, and divided the tips up at the end of each week. They did not typically report to the employer how much they received in tips. Rather, the employer, for tax withholding purposes, simply imputed \$0.50 per hour in estimated tip income to each employee and withheld state and local taxes from his/her paycheck based on that amount.

The employees filed a class action against the employer in Oregon state court, asserting that there were five state-law causes of action, each predicated on the alleged violation of an Oregon wage-and-hour statute. The employees were not seeking actual damages—they had been able to recover any taxes wrongfully withheld by filing their annual tax returns and obtaining refunds for any over-withholding—but were seeking statutory damages (that differed depending on the statutes invoked). For instance, one Oregon statute allowed an employee not fully paid wages when due to recover up to 30 days of wages as a penalty.

The employer removed the case to federal district court, and shortly thereafter, moved to dismiss on the grounds that all of the claims were either pre-empted by federal law or barred under Oregon law. The employees opposed this motion, and requested that the case be remanded to state court. The federal district court denied the employees' motion, and granted the employer's motion and entered judgment dismissing the case with prejudice.

Today, the Ninth Circuit reversed and remanded.

The Ninth Circuit found that the district court lacked the authority to grant declaratory and injunctive relief with respect to either the state-tax component or the federal-tax component of the employees' claims under the Tax Injunction Act. Also, the appeals court found that the district court was foreclosed from awarding statutory damages under the federal-state comity doctrine, thus requiring that the entire case be remanded to the state court.

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