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Senate Bill 160

Labor and Employment - Payment of Minimum Wage - Tipped Employees

Position: OPPOSE

The Restaurant Association of Maryland strongly opposes Senate Bill 160 because of the negative consequences it would have on tipped employee earnings, restaurant operators, and customers.

Contrary to the false narrative used by advocates supporting legislation to eliminate the tip credit, there is no "subminimum wage" for restaurant tipped employees under state and local law. Tipped employees must earn at least the full applicable minimum wage per hour in base wages combined with tips. State and local minimum wage law allows employers to apply a tip credit to the minimum wage requirement for tipped employees. A minimum base wage is specified for the tip credit.

How the Tip Credit Works

The tip credit was established under the federal Fair Labor Standards Act in 1966 and is also allowed under most state minimum wage laws (43 states allow it).

Maryland's minimum wage law allows employers to pay tipped employees a base wage of at least $3.63 per hour (the base wage for tipped employees in Montgomery County is $4.00 per hour). The tip credit is the difference between the minimum base wage and the full applicable minimum wage. Under state and local minimum wage law, employers are required to make up any deficiencies if a tipped employee does not earn enough in base wages plus tips to make at least the full minimum wage per hour for the workweek. Therefore, restaurant tipped employees are guaranteed by law to earn at least the minimum wage, and most earn significantly more with tips included.

Why the Tip Credit is Important to Full-service Restaurants

The full-service restaurant industry is very labor-intensive and operates on razor-thin profit margins (typically 3-5% pre-tax margin). Food and labor costs are the two most significant line items for a full-service restaurant, each accounting for approximately 33 cents of every dollar in sales. All other expenses, including occupancy costs, generally represent about 29% of sales. The tip credit is critical to the full-service restaurant business model and has helped to facilitate the growth of full-service restaurants in communities where they can be affordable to the customers they serve.

Advocates for eliminating the tip credit often say that the restaurant industry continues to grow in the 7 non-tip credit states. Restaurants opening in those states know that the tip credit will not be part of their business models. Therefore, they decide to open in communities/locations that will support their menu prices and/or service charges. Maryland restaurant owners, however, have made financial commitments and secured mortgages or long-term leases based on a business model that utilizes the tip credit. Eliminating the tip credit would be devastating to these restaurants.

Outcome of Previous State/Local Tip Credit Elimination Bills

Maryland servers, bartenders, restaurant operators, and policymakers have made it abundantly clear that they support maintaining the tip credit.

State and local policymakers in Maryland have consistently preserved the tip credit. In 2014, 2015, 2017, 2019 and 2023, the Maryland General Assembly considered legislation that would have phased out the tip credit statewide, but it failed to pass because of strong opposition from tipped employees and restaurant operators. Servers and bartenders have repeatedly urged lawmakers to reject such proposals because they earn significantly more money under the current tipping system.

Locally, a Prince George's County Council Committee decided (on 10/12/2023) not to move forward with legislation that would have phased out the tip credit there after hearing strong opposition from local servers and restaurant operators. The Montgomery County Council also heard strong opposition from local servers and restaurants during a 10/17/2023 public hearing on similar legislation. The Montgomery County legislation did not have enough Council support to pass and was withdrawn on 1/16/2024. In 2021, the Howard County Council voted to preserve the tip credit in their local minimum wage law.

Note: A Montgomery County Council Office of Legislative Oversight Economic Impact Statement on the tip credit elimination legislation anticipated that enactment of the bill would have a net negative impact on economic conditions in the County due to reasons that many tipped employees and restaurant operators expressed in their concerns about the proposal.

On January 16, 2024, the same day the Montgomery County tip credit legislation was withdrawn, the Office of Legislative Oversight released a report of Preliminary Findings on the Economic Impact of Washington D.C.'s Initiative 82 (phasing out the tip credit). Among other enlightening information, pages 22-28 in Appendix 2 of the report includes open-ended survey responses from D.C. restaurant operators about the impact of phasing out the tip credit there, and "advice or suggestions" they would give to Montgomery Councilmembers who were considering enacting such a law.

How Much Full-Service Restaurant Tipped Employees Actually Earn

Tipped employees are among the highest earners in full-service restaurants (earning a median of $27/hour including tips, according to National Restaurant Association research). Servers at some restaurants can earn $40 or more per hour including tips.

In September-October 2023, the Restaurant Association of Maryland commissioned a survey of restaurant tipped employees in Montgomery and Prince George's Counties. The survey was conducted by CorCom, Inc. (Pittsburgh, PA). According to key findings from 257 respondents, many (37%) tipped employees said they are earning $20.00-$29.99 per hour, while others are earning $30.00-$39.99 per hour (28%), $15.00-$19.99 per hour (24%), or $40.00 per hour or more (11%).

Tip Credit Elimination Impact on Servers, Restaurants and Customers

Restaurant server earnings would significantly decrease if the tip credit was eliminated because most restaurants would be forced to impose service charges on customer checks to cover the substantially higher labor costs. Customers are unlikely to tip on top of service charges. And there would be no incentive for servers to provide the best possible customer service if they were no longer rewarded with tips.

Menu price increases alone cannot cover the additional labor cost (which would exceed the current profit of most full-service restaurants) because such a large increase in menu prices would result in fewer customers.

If the tip credit was eliminated, some restaurants that could offer counter service to dine-in customers would likely eliminate server positions altogether.

Initial Impact of Phasing Out the Tip Credit in District of Columbia (D.C.)

Restaurants in the District of Columbia (D.C.) are starting to increase menu prices and impose service charges following passage of a 2022 ballot initiative that phases out the tip credit there, and customer feedback has been negative. Many frequent D.C. diners have changed their dining habits to eat out less or dine outside the city more often.

According to a National Restaurant Association survey of 944 frequent D.C. diners, 43% have been eating out less and 32% have been seeking dining options outside the city more often.

Results from a recent Restaurant Association of Metropolitan Washington survey of their restaurant members found that more than one-third of restaurants are experiencing a drop in sales and traffic. Summer sales fell for more than one-third (35%) of restaurants compared to 2022, dropping an average of 31%. Summer customer traffic fell for 44% of restaurants compared to 2022, dropping an average of 28%.

According to a January 29, 2024 Restaurant Business online article about the likely effects of ending the tip credit, the initial impact of phasing out the tip credit in D.C., along with soaring street crime and downtown office employees continuing to work from home, has resulted in D.C. full-service restaurants cutting their payrolls by 4.4%, or 1,300 jobs, according to federal jobs data.

Note: D.C. is currently experiencing the initial phases of eliminating the tip credit. The impact is expected to get worse as the tip credit elimination progresses there. Service charges, menu price increases and reduced staff/working hours are expected to become more prevalent.

Clarification regarding *tips* vs. *service charges*.

Under federal law and IRS rules, service charges (sometimes called automatic gratuities) added to customer checks are part of the business's gross receipts and are not the same as tips. Although restaurants may choose to distribute all or part of such service charges to employees as regular wages (not tips), the law does not require it.

Eliminating the tip credit quadruples server labor costs. This will force many restaurants to impose service charges and use the revenue to cover these higher labor costs. Many D.C. restaurants are starting to impose service charges for this reason.

Bill Advocates' False Claim that 84% of Restaurants Violate Wage Laws Regarding Tip Credit

Supporters of legislation to eliminate the tip credit claim that an Obama administration report found that 84% of restaurants violate wage laws for tipped workers. This claim is false.

During our exhaustive research, we were unable to find any such 2014 report by the Obama administration. The only related language we could find was in a 2014 report by the Economic Policy Institute (a Washington, D.C.-based think tank) that supports eliminating the tip credit. This report language included the following excerpts regarding a 2010–2012 compliance investigation of nearly 9,000 full-service restaurants by the U.S. Department of Labor's Wage and Hour Division (WHD):

> *"... 83.8 percent of investigated restaurants had some type of violation."*
>
> *"Violations included 1,170 tip credit infractions that resulted in nearly $5.5 million in back wages.[17]"*
>
> *Report Endnotes*: "17. Email correspondence with U.S. Department of Labor program analysts from the Wage and Hour Division"

Apparently, the basis for the related claim was WHD email correspondence that the authors of the Economic Policy Institute's report used and cited – not a report by the Obama administration. Moreover, this statistic has been used incorrectly by bill advocates.

According to the referenced email correspondence with WHD analysts, 84 percent of investigated restaurants had "some type of violation." And "violations included 1,170 tip credit infractions." WHD violations can include many types of labor infractions. Bill advocates inaccurately claim that the 84 percent violations were regarding wage laws for tipped workers.

We reviewed WHD online violation data for the 2010–2012 compliance investigation period and found a total of 44 Maryland full-service restaurants with various types of labor violations. Of these, 10 full-service restaurants had violations related to minimum wage (which could include tip credit violations).

In Conclusion

Legislation to eliminate the tip credit is being pushed by a well-funded, Massachusetts-based activist group as part of their nationwide agenda. Maryland's state and local policymakers should reject that group's efforts to pursue their agenda at the expense of local restaurants and tipped employees who support maintaining the tip credit.

The tip credit maximizes the earnings potential of restaurant tipped employees, is critical to the full-service restaurant business model in Maryland, and should be preserved for businesses that choose to utilize it.

For these reasons, we oppose SB 160 and request an unfavorable report.