

Department of Legislative Services
Maryland General Assembly
2025 Session

FISCAL AND POLICY NOTE
First Reader

Senate Bill 823 (Senator McCray)
Finance and Budget and Taxation

No Tax on Tips Act

This bill phases in an increase in the State minimum wage to \$20.00 per hour by July 1, 2028. The bill phases out the tip credit for tipped employees so that, beginning July 1, 2028, an employer must directly pay a tipped employee at least the State minimum wage. An individual may claim an income subtraction modification and, for tax years 2027 and 2028, an employer may claim an income tax credit, as specified, based on tips. Additionally, a food service facility may not charge a service fee unless it is prominently disclosed to the customer, as specified. **Enactment of the bill is contingent on adoption by the voters of a constitutional amendment (Senate Bill 809/House Bill 1458 of 2025), which establishes the right to be paid the State minimum wage without regard to tips.**

Fiscal Summary

State Effect: No effect in FY 2026. General fund revenues decrease, potentially significantly, beginning in FY 2027 due to the subtraction modification and, in FY 2028 and 2029, also due to the tax credit. To the extent credits are claimed against the corporate income tax, Higher Education Investment Fund (HEIF) revenues and Transportation Trust Fund (TTF) revenues and expenditures also decrease in FY 2028 and 2029. State expenditures (all funds) increase potentially significantly beginning in FY 2027 from increasing the State minimum wage rate. Expanded application of existing penalty provisions is not expected to meaningfully affect general fund revenues.

Local Effect: Local government expenditures increase, potentially significantly in some jurisdictions, beginning in FY 2027 to pay higher wages to employees. Local income tax revenues decrease by an indeterminate but potentially significant amount annually beginning in FY 2027. Local highway user revenues may decrease in FY 2028 and 2029 to the extent credits are claimed against the corporate income tax.

Small Business Effect: Meaningful.

Analysis

Bill Summary:

State Minimum Wage

The bill specifies that, unless the federal minimum wage is set at a higher rate, the State minimum wage is:

- \$17.00 per hour beginning January 1, 2027;
- \$18.50 per hour beginning January 1, 2028; and
- \$20.00 per hour beginning July 1, 2028.

Food Service Facilities Service Fees

A “service fee” is a fee added by a food service facility to a customer’s total charge that is separate from (1) the facility’s menu price for food, drinks, or merchandise sold and (2) any sales tax the facility is required to collect.

A food service facility may not charge a service fee unless the facility prominently discloses to the customer on the menu, or in a location that is visible to the customer before placing an order, the amount and purpose of the service fee and whether the service fee is paid directly to employees in addition to their wages.

A violation of this is an unfair, abusive, or deceptive trade practice under the Maryland Consumer Protection Act (MCPA), subject to MCPA’s civil and criminal penalty provisions.

Tip Credit Phase Out

The tip credit that an employer may include as part of the wage of a tipped employee may not exceed the State minimum wage, less:

- \$12.00 for the 12-month period beginning January 1, 2027; and
- \$13.50 for the six-month period beginning January 1, 2028.

Beginning July 1, 2028, an employer may not include a tip credit as part of the wage of an employee subject to the Maryland Wage and Hour Law and must pay the employee at least the State minimum wage. Even so, the bill may not be construed as prohibiting the payment of tips to employees.

State Income Subtraction Modification

The bill allows a subtraction modification against the personal income tax for qualified tips received by an individual during the taxable year. Qualified tips are tips received by an individual during the course of employment in an occupation or industry in which an individual is customarily compensated through a combination of wages and tips that are paid to the individual by an unrelated party who does not have an ownership stake in the business providing the employment.

State Income Tax Credit

For tax years 2027 and 2028, a person may claim an income tax credit in an amount equal to 50% of the difference between the State minimum wage paid to an employee of the person and the allowable tip credit amount. The credit may not exceed the State income tax imposed for that taxable year or \$10,000, and unused credits may not be carried over to another taxable year.

Current Law: The Maryland Wage and Hour Law is the State complement to the federal Fair Labor Standards Act (FLSA), which specifies minimum wage and overtime requirements for employers and employees in the State. State law specifies that an employee must be paid the greater of the federal minimum wage (which is currently \$7.25 per hour) or \$15.00 per hour.

For additional related information, see the **Appendix – Maryland Wage and Hour Law**.

Tipped Employees

Generally, the employer of a tipped employee is allowed a tip credit that can be applied against the direct wages paid by the employer. The employee can be paid tipping wages so long as the wages plus the tips received equal at least the minimum wage, the employee retains all tips, and the employee customarily receives more than \$30.00 per month in tips. The tip credit is equal to the State minimum wage, less \$3.63. Thus, the wage paid by employers to tipped employees is \$3.63, as long as their wages plus tips equal the minimum wage.

The commissioner must adopt regulations, in consultation with payroll service providers and restaurant industry trade group representatives, to require restaurant employers that include a tip credit as part of the wage of an employee to provide tipped employees with a written or electronic wage statement for each pay period that shows the effective hourly tip rate as derived from employer-paid cash wages plus all reported tips for tip credit hours worked each workweek of the pay period.

Local Minimum Wage and Tip Credit Laws

Montgomery and Howard counties have local minimum wage laws. Howard County requires most employees to be paid the Howard County minimum wage rate of \$16.00 per hour by fiscal 2027. Montgomery County has different minimum wage rates depending on the employer's size. As of July 1, 2024, the Montgomery County minimum wage rates are \$15.00 for small employers (10 or less employees), \$15.50 for mid-sized employers (11 to 50 employees), and \$17.15 for large employers (51 or more employees), and are set to increase annually with inflation and to catch up with the large employer rate. Employees younger than 19 years of age and working less than 20 hours per week are exempt from the Montgomery County minimum wage rates. Montgomery County employers must pay tipped employees at least \$4.00 per hour.

Federal Fair Labor Standards Act

An employer must pay a tipped worker at least \$2.13 per hour under FLSA. When the state law differs from the federal FLSA, an employer must comply with the standard most protective to employees.

Food Service Facility

A "food service facility" is defined as a place where food or drink is prepared for sale or service on the premises or elsewhere or any operation where food is serviced to or provided for the public, with or without charge.

Maryland Consumer Protection Act

An unfair, abusive, or deceptive trade practice under MCPA includes, among other acts, any false, falsely disparaging, or misleading oral or written statement, visual description, or other representation of any kind which has the capacity, tendency, or effect of deceiving or misleading consumers. The prohibition against engaging in any unfair, abusive, or deceptive trade practice encompasses the offer for or actual sale, lease, rental, loan, or bailment of any consumer goods, consumer realty, or consumer services; the extension of consumer credit; the collection of consumer debt; or the offer for or actual purchase of consumer goods or consumer realty from a consumer by a merchant whose business includes paying off consumer debt in connection with the purchase of any consumer goods or consumer realty from a consumer.

The Consumer Protection Division is responsible for enforcing MCPA and investigating the complaints of aggrieved consumers. The division may attempt to conciliate the matter, issue a cease and desist order, or file a civil action in court. A merchant who violates MCPA is subject to a fine of up to \$10,000 for each violation and up to \$25,000 for each repetition

of the same violation. In addition to any civil penalties that may be imposed, any person who violates MCPA is guilty of a misdemeanor and, on conviction, is subject to a fine of up to \$1,000 and/or imprisonment for up to one year.

Taxation of Tips

Tips, including cash tips that are not reported to an employer, are taxable as income under the federal and State income tax and are generally considered wages for federal payroll tax purposes. Tips are also considered earned income for purposes of the federal and Maryland earned income tax credits.

State Revenues: Assuming voters approve the constitutional amendment in November 2026, general fund revenues decrease by an indeterminate but potentially significant amount annually beginning in fiscal 2027 due to subtraction modifications claimed against the personal income tax. Due to data limitations, the precise effect on State revenues cannot be reliably estimated at this time. For context, according to national W-2 statistics published by the Internal Revenue Service, tips reported on tax year 2018 W-2s totaled \$38.3 billion. To the extent that customers tip employees less as the tip credit is completely phased out by fiscal 2029, the decline in general fund revenues lessens; however, it is unknown to what extent customers will reduce their tipping practices.

Additionally, general fund revenues decrease by an indeterminate but potentially significant amount annually in fiscal 2028 and 2029 due to credits claimed against the State income tax for employers who claim the tip credit. Due to data limitations, the precise effect on State revenues cannot be reliably estimated at this time. To the extent credits are claimed against the corporate income tax, HEIF and TTF revenues also decrease in fiscal 2028 and 2029.

State Expenditures: Expenditure effects for the minimum wage increase and the income tax credit and the operational effect for administration are addressed separately in this section and assume voters approve the constitutional amendment in November 2026.

Minimum Wage Increase

State expenditures (all funds) increase potentially significantly beginning January 1, 2027, as a result of increasing the State minimum wage rate to \$17.00 per hour. State expenditures (all funds) increase further once the State minimum wage rate increases to \$18.50 per hour beginning January 1, 2028, and to \$20.00 per hour beginning in fiscal 2029. To the extent that the State contracts with service providers who employ low-wage or minimum wage workers, State expenditures further increase beginning midway through fiscal 2027, although any such effect is likely mitigated by the State's living wage requirements.

The actual impact of increasing the State minimum wage varies across State agencies. For example, the University of Maryland, College Park Campus notes that its employees have a starting wage of \$18.22 per hour and do not rely on tips to supplement their earnings, so it does not expect the bill to have a significant impact as major adjustments to current employee compensation levels are not anticipated. Meanwhile, Towson University expects higher education expenditures to increase annually beginning in fiscal 2027, so that by fiscal 2029, higher education expenditures increase by \$14.8 million from paying mostly hourly student workers increased State minimum wages. The University of Baltimore also anticipates increased higher education expenditures of \$765,000 in fiscal 2029 to pay student employees and other part-time workers a State minimum wage rate of \$20.00 per hour. Additionally, student workers who are paid through the federal work study program may run through their awards faster, resulting in fewer work hours under the federal work study program.

Income Tax Credit

To the extent credits are claimed against the corporate income tax, TTF expenditures for capital transportation grants to local governments (local highway user revenues) decrease in fiscal 2028 and 2029.

Administration

The Comptroller's Office can implement the tax provisions with existing budgeted resources. Likewise, the Office of the Attorney General, Consumer Protection Division, the Maryland Department of Labor, and the Judiciary can likely handle the bill's requirements with existing resources.

Local Revenues: Assuming voters approve the constitutional amendment in November 2026, local income tax revenues decrease by an indeterminate but potentially significant amount annually beginning in fiscal 2027 due to subtraction modifications claimed against the personal income tax. Due to data limitations, the precise effect on local revenues cannot be reliably estimated at this time. The Maryland Municipal League notes that municipalities with a high concentration of service workers, like Ocean City, could see a noticeable decline in revenues as a result of the bill.

Local highway user revenues decrease in fiscal 2028 and 2029 to the extent credits are claimed against the corporate income tax.

Local Expenditures: Generally, local government expenditures may increase significantly beginning halfway through fiscal 2027 to pay employees (typically part-time or contractual employees) the minimum wage rates specified in the bill. This may also increase the costs of certain contracts local governments enter into for services.

Montgomery and Howard counties have local minimum wage rates, so the effect may be less in those counties.

Small Business Effect: Small businesses in the State that employ minimum wage or low-wage workers may experience significant increases in their labor costs due to the bill beginning January 1, 2027. Montgomery and Howard counties have local minimum wage rates, so the effect on small businesses may be less in those counties.

Assuming the bill is enacted in November 2026, small businesses with tipped employees who use the tip credit benefit for a brief amount of time through December 31, 2026, from only having to pay tipped employees \$2.13 per hour under the federal FLSA as long as these employees earn at least the minimum wage.

Small businesses with tipped employees who use the tip credit must begin phasing out its use beginning January 1, 2027. By July 1, 2028, employers must pay tipped employees the full minimum wage rate without using a tip credit, thereby likely significantly increasing labor costs for employers that currently use a tip credit. However, a small business may claim a nonrefundable income tax credit in tax years 2027 and 2028 of up to \$10,000 for 50% of the difference between the State minimum wage paid to an employee of the person and the allowable tip credit amount.

Additionally, small businesses that are food service facilities must disclose to customers if they charge a service fee.

Additional Comments: The bill deletes the \$3.63 amount that is subtracted from the tip credit immediately once the bill takes effect after the November 2026 election (if approved by voters), but the tip credit of the minimum wage less \$12.00 does not take effect until January 1, 2027. Thus, from the effective date of the bill through December 31, 2026, the tip credit is the full minimum wage amount, so the federal FLSA provisions take effect as they are more protective to employees.

As Senate Bill 809 has been withdrawn by its sponsor, this bill is essentially only contingent on enactment of House Bill 1458 and subsequent approval of the proposed constitutional amendment by the voters at the 2026 general election.

Additional Information

Recent Prior Introductions: Similar legislation has not been introduced within the last three years.

Designated Cross File: HB 1400 (Delegate Boafó, *et al.*) - Economic Matters and Ways and Means.

Information Source(s): Maryland Municipal League; Office of the Attorney General (Consumer Protection Division); Comptroller's Office; Department of Budget and Management; Judiciary (Administrative Office of the Courts); Maryland Department of Labor; University System of Maryland; Department of Legislative Services

Fiscal Note History: First Reader - March 2, 2025
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Appendix – Maryland Wage and Hour Law

The Maryland Wage and Hour Law is the State complement to the federal Fair Labor Standards Act, which specifies minimum wage and overtime requirements for employers and employees in the State. State law specifies that an employee must be paid the greater of the federal minimum wage (which is currently \$7.25 per hour) or \$15.00 per hour. However, an employer may pay 85% of the State minimum wage rate to employees younger than age 18.

The Maryland Wage and Hour Law and minimum wage requirements do not apply to certain categories of employees, including those defined as administrative, executive, or professional; certain seasonal employees; part-time employees younger than age 16; salesmen and those who work on commission; an employer's immediate family; drive-in theater employees; employees training in a special education program in a public school; employees of an establishment that sells food and drink for on-premises consumption and has an annual gross income of \$400,000 or less; employees employed by an employer who is engaged in canning, freezing, packing, or first processing of perishable or seasonal fresh fruits, vegetables, poultry, or seafood; certain farm workers; specified minor league baseball players; and covered employees under the Secure Maryland Wage Act.

Generally, the employer of a tipped employee is allowed a tip credit that can be applied against the direct wages paid by the employer. The employee can be paid tipping wages so long as the wages plus the tips received equal at least the minimum wage, the employee retains all tips, and the employee customarily receives more than \$30.00 a month in tips. The tip credit is equal to the State minimum wage, less \$3.63. Thus, the wage paid by employers to tipped employees is \$3.63 as long as their wages plus tips equal the minimum wage.

Under Maryland's Wage and Hour Law, an employer is required to pay an overtime wage of at least 1.5 times the usual hourly wage for each hour over 40 hours that an employee works during one work week. This requirement does not apply to an employer that is subject to federal rail laws; a nonprofit concert promoter, legitimate theater, music festival, music pavilion, or theatrical show; or specified amusement or recreational establishments. It also does not apply to an employee for whom the U.S. Secretary of Transportation sets qualifications and maximum hours of service under federal law; a mechanic, parts person, or salesperson, under certain conditions; a driver employed by a taxicab operator; or specified air carrier employees under certain conditions. Also, specific exemptions apply for farm work, bowling establishments, and infirmaries.

If an employer pays less than the wages required, the employee may bring an action against the employer to recover (1) the difference between the wage paid to the employee and the wage required; (2) an additional amount equal to the difference as liquidated damages; and (3) legal fees. The court must award these differences in wages, damages, and counsel fees if the court determines that an employee is entitled to recovery. However, if an employer shows to the satisfaction of the court that the employer acted in good faith and reasonably believed that the wages paid to the employee were not less than the required wages, then the court must award liquidated damages of an amount less than the difference in wages or no liquidated damages.

A person who pays or agrees to pay less than the required wages is guilty of a misdemeanor and on conviction is subject to a fine of up to \$1,000.