Restaurant Association of Maryland

Senate Bill 823
No Tax on Tips Act

March 5, 2025

Position: **OPPOSE**

Madame Chair and Members of the Senate Finance Committee:

The Restaurant Association of Maryland strongly opposes Senate Bill 823.

As introduced, this legislation would significantly reduce the earnings of tipped employees and drastically increase labor costs for employers. And the potential benefit of no tax on tips would not be realized because the bill's phase-out of the tip credit would effectively replace tipped income with regular wages, which would be subject to Maryland income tax.

Regarding the disclosure of service fees (a.k.a. service charges), it's important to note the difference between service charges and tips. Under federal law and IRS rules, service charges added to customer checks are part of the business's gross receipts and are not the same as tips. Restaurants may choose to distribute all or part of such service charges to employees as regular wages (not tips). The disclosure requirement in this bill seems to acknowledge that many restaurants will be forced to impose service charges to help cover the higher labor costs associated with phasing out the tip credit.

With respect to the proposed increase to Maryland's minimum wage, mandates that increase the cost of labor affect the restaurant industry disproportionately. Our industry is extremely labor-intensive and requires significantly more labor per $1 million in sales than most other industries. Maryland's $15 minimum wage took effect in January 2024, and many of our businesses are still struggling to absorb this increase, in addition to inflation and soaring food costs. Restaurant industry labor costs have increased 31% since 2019. The minimum wage hike proposed by this legislation would exacerbate the operational challenges for our industry.

Eliminating the tip credit, as also proposed by this legislation, would quadruple labor costs for full-service restaurants. Tipped employee 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 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. Restaurant operators may also be forced to raise menu prices and eliminate jobs.

(*more*)

Contrary to what the bill advocates claim, there is no such thing as a “subminimum wage” for restaurant tipped employees. Maryland’s minimum wage law allows employers to pay tipped employees a base wage of at least $3.63 per hour. Employers are required by law 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 (currently $15/hour under Maryland minimum wage law). Tipped employees are among the highest earners in full-service restaurants, earning much more than minimum wage with tips included.

According to federal government employment data, the District of Columbia’s (D.C.) full-service restaurant sector has lost about 2,000 (6%) jobs since D.C. began phasing out the tip credit in May of 2023 after voters approved a 2022 ballot initiative. And it is expected to get worse as the tip credit there will be fully phased out by 2027. To further assess the situation, a D.C. City Council committee recently heard six hours of testimony (on 1/15/25) from City servers and bartenders about the negative impacts of phasing out the tip credit.

Previous Maryland proposals to eliminate the tip credit statewide or locally in Baltimore City, Prince George’s and Montgomery Counties have failed to pass because of strong opposition from tipped employees and restaurant operators.

These proposals are being pushed by an out-of-state activist group as part of their nationwide agenda. Maryland elected officials 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 so-called “No Tax on Tips” provision of this legislation is a misnomer because the proposed elimination of the tip credit would effectively replace tipping with service charges to cover the higher base wages for tipped employees. And as previously mentioned, most customers will not tip on top of service charges. Therefore, there would be few, if any, tips that would have otherwise been subject to State income tax. We supported legislation that focuses solely on excluding tips from State income tax. However, we do not support this legislation.

And finally, the proposed $10,000 tax credit for employers who opt to pay full minimum wage to tipped employees (before the tip credit is fully phased out) is insignificant compared to the labor cost difference.

For these reasons, we respectfully request an unfavorable report.

Sincerely,

Melvin R. Thompson
Senior Vice President
Government Affairs and Public Policy