HMRA
OCEAN CITY, MARYLAND
HOTEL · MOTEL · RESTAURANT · ASSOCIATION · INC.

March 1, 2025

Senate Bill 823 No Tax on Tips Act
Position: OPPOSE

Mr. Chairman and Members of the Economic Committee:

On behalf of the 450 Ocean City Hotel-Motel-Restaurant Association Members, I am writing to strongly oppose Senate Bill 823. This legislation would significantly reduce the earnings of tipped employees while sharply raising labor costs for employers. Any potential benefit of exempting tips from taxation would not be realized, as 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.

When it comes to the disclosure of service fees (or service charges), it's important to differentiate between service charges and tips. According to federal law and IRS guidelines, service charges added to customer checks are considered part of a business's gross receipts and are not categorized as tips. Restaurants may choose to distribute all or part of these service charges to employees as regular wages, not tips. The disclosure requirement in this bill appears to acknowledge that many restaurants will likely be forced to introduce service charges to help offset the increased labor costs resulting from the phase-out of the tip credit.

Regarding the proposed increase to Maryland's minimum wage, mandates that raise labor costs have a disproportionate impact on the restaurant industry. Our sector is highly labor-intensive and requires more labor per $1 million in sales than most other industries. Maryland's $15 minimum wage, which took effect in January 2024, is still a challenge for many businesses to absorb, especially with inflation and rising food costs. Since 2019, labor costs in the restaurant industry have increased by 31%. The additional minimum wage increase proposed in this legislation would further strain the industry's operations.

The proposed elimination of the tip credit would also have a severe impact, potentially quadrupling labor costs for full-service restaurants. If the tip credit were eliminated, tipped employee earnings would drop substantially, as most restaurants would likely be forced to add service charges to customer checks to offset the increased labor costs. Customers are unlikely to tip in addition to service charges, and without tips as an incentive, servers may lose motivation to provide excellent customer service. As a result, restaurant operators could be forced to raise menu prices or cut jobs to stay afloat.

Contrary to claims made by supporters of the bill, there is no such thing as a "subminimum wage" for restaurant tipped employees. MD's minimum wage law permits employers to pay tipped employees a base wage of at least $3.63 per hour. <u>However, employers are legally required to make up any difference if a tipped employee's combined base wage and tips do not total at least the full minimum wage for the workweek, which is currently $15 per hour under Maryland law</u>. Tipped employees are among the highest earners in full-service restaurants, often making significantly more than the minimum wage when tips are 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 proposals in Maryland to eliminate the tip credit, whether statewide or locally in Baltimore City, Prince George's County, and Montgomery County, have failed due to strong opposition from tipped employees and restaurant operators.

These proposals are being pushed by an out-of-state activist group as part of their broader national agenda. Maryland's elected officials should reject these efforts, as they would undermine local restaurants and the tipped employees who support maintaining the tip credit.

The so-called "No Tax on Tips" provision in this legislation is misleading because the proposed elimination of the tip credit would effectively replace tipping with service charges to offset the higher base wages for tipped employees. As mentioned earlier, most customers are unlikely to tip in addition to service charges, which means there would be few, if any, tips subject to State income tax. While we support legislation that focuses solely on excluding tips from State income tax, we do not support this bill.

Lastly, the proposed $10,000 tax credit for employers who choose to pay full minimum wage to tipped employees (before the tip credit is fully phased out) is minimal in comparison to the significant increase in labor costs.

For these reasons, we respectfully request an UNfavorable report.

Sincerely,

Susan L. Jones

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Executive Director

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