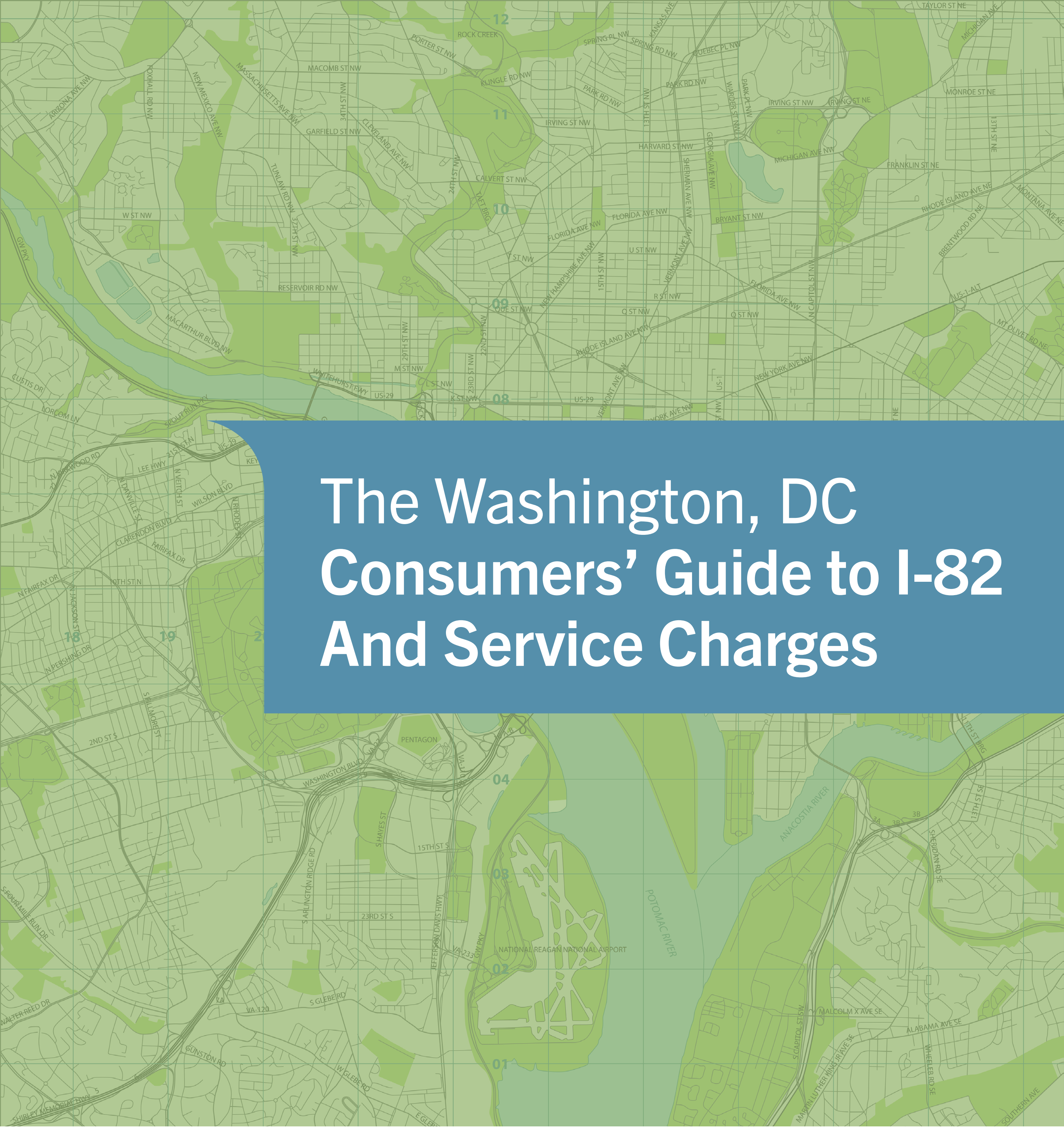

The Washington, DC **Consumers' Guide to I-82 And Service Charges**

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INTRODUCTION

With the passage of Initiative 82, Washington D.C. has made a historic move away from a business model built on the legacy of slavery, that has allowed a workforce that is overwhelmingly women and disproportionately women of color to continue to receive a subminimum wage 150 years since Emancipation.[1]

This guide outlines the potential for Initiative 82 to help create a better Washington, DC restaurant industry that can occur if employers, workers and consumers collaborate to ensure that service charges are implemented fairly and employers follow the law.

Key Points

1 | Following the passage of I-82 in Washington, DC, many DC restaurants switched from tips to service charges, at the urging of the Restaurant Association of Metropolitan Washington.

2 | Service charges are different from tips in that they are automatic gratuities that are the property of restaurant ownership. Service charges can be beneficial to workers in reducing the implicit racial bias of tipping, but only if they are actually passed on to workers — like tips, on top of wages, not to cover base wages — rather than being withheld by employers.

3 | The DC Attorney General has warned that most DC restaurants are not complying with DC consumer law that requires them to disclose exactly how service charges are being used and then use it as described. In fact, One Fair Wage found that only 9 percent of nearly 150 restaurants sampled were disclosing how they were using service charges as required by law.

4 | In 7 other states that have passed One Fair Wage — which has now been passed in DC with Initiative 82 — most restaurants have not converted to service charges, gratuities are passed on to workers, and wages, tips, small business growth rates, consumer spending and other metrics of business success are higher than they are in the 43 states that still allow a subminimum wage for tipped workers.

5 | The District of Columbia should be supporting and providing incentives to restaurants that seek to switch to service charges, as they can reduce implicit bias, but only those restaurants that fully and honestly disclose that they are passing the service charge funds on to workers — like tips, on top of wages, not to cover base wages — should receive these supports.

1 BACKGROUND ON SUBMINIMUM WAGES NATIONALLY AND IN WASHINGTON, DC

The History of the Subminimum Wage for Tipped Workers

The subminimum wage for tipped workers is a direct legacy of slavery that was used mainly to suppress the incomes of Black workers. After Emancipation, the restaurant industry sought to hire newly freed Black people without paying them, forcing them to live on tips.[2] This concept was made law, excluding a workforce of mostly Black women from the full minimum wage, even when other workers received the federal minimum wage as part of the New Deal in 1938.[3]

In the 43 states where it persists, the subminimum wage forces a population of tipped workers that is overwhelmingly women and disproportionately women of color to rely on customer tips for the majority of their income, making them more vulnerable than other workers to the race and gender inequities of tipping.[4]

Seven states have always done this differently — by paying a full minimum wage with tips on top, and have been better off for it.[5] These states have consistently performed better on all economic and industry metrics — better employee retention, better small business growth rates, dramatically lower rates of reported sexual harassment and steady or even higher rates of tipping.[6]

The Pandemic & Tipped Workers

Even before the COVID-19 pandemic, the subminimum wage for tipped workers created major challenges and inequities for restaurant and service workers. During the pandemic, the subminimum wage became unlivable. In thousands of surveys, workers reported that sexual harassment, already at the highest levels in the restaurant industry of any industry in the US, increased dramatically through the pandemic.[7] At the same time, workers reported that overall pay, as a result of declining tips, decreased dramatically through the pandemic.[8] Wage gaps increased between Black and white workers, as a consequence both occupational segregation and direct discrimination.[9] All of these factors led to workers leaving in record numbers. The restaurant industry is still not at the level of employment that it was prior to the pandemic, and currently faces the worst staffing crisis in its history.[10]

Initiative 82

Thanks to the tireless efforts of workers, advocates and volunteers, Washington D.C. will now move from being a jurisdiction that allows a subminimum wage to joining 7 states that have long required restaurants to pay a full minimum wage with tips on top. Following the victory achieved with 75 percent voter approval, the Washington Post reported that Initiative 82 was a huge victory for workers that set a precedent for winning worker wage increases and power through the ballot box.[11] Over 15,000 tipped workers in D.C. today who are more than 75 percent people of color, and are paid less than one-third the minimum wage — $5.35 an hour — will benefit from this measure.[12] I-82 passed with one of the highest margins of any measure in DC history as a result of workers and other voters understanding that these workers need a full minimum wage with tips on top.

2 SERVICE CHARGES: BENEFITS AND CHALLENGES

Service Charge vs. Tips

In response to the passage of Initiative 82, the Restaurant Association of Metropolitan Washington (RAMW) held a series of meetings to advise restaurants on how best to implement the law.[13]

A service charge is an automatic gratuity that requests that the consumer pay a set amount of gratuity rather than being able to decide how much they would like to leave as a gratuity. Beyond being a set amount, service charges are also different from tips in that employers control how they may be used, unlike tips, and as a result, they are subject to employer taxation.

More broadly, a service charge is any fee or charge set by the establishment.[14] Since a service charge is not a tip, it is subject to taxation by the Internal Revenue Service. This is because a tip is set by the customer, not the establishment, and is considered a gift directly to the employee and not direct revenue to the establishment.[15]

Tips can only be suggested to customers, not imposed. Legally they are the full property of employees, and not employers.[16] In subminimum wage jurisdictions, employers must ensure that tips bring workers up to full minimum wage. However, the U.S. Department of Labor found that 4 out of every 5 full-service restaurants the department investigated between 2009 and 2015 were violating wage and hour laws with regard to the subminimum wage for tipped workers. The most common violation being the failure to adequately compensate tipped workers.[17]

TABLE 1 Service Charges v. Tips in Washington, DC

	SERVICE CHARGE	TIP
Set By	**Set by the restaurant -** does not allow for implicit bias	**Set by the customer -** allows for implicit bias
Ownership	**Property of employers -** may or may not be passed on to workers	**Property of workers -** must be passed on entirely to workers[18]
Tax Status	**Subject to employer payroll taxes**	**Not subject to employer payroll taxes**
Conditions of Use	**Employer must disclose use of service charge** to consumer, and use the funds as described	**Workers may use tips at their discretion**

Service charges, on the other hand, are not necessarily the property of workers. Employers may use the service charges as they choose, but Washington, DC consumer law requires employers to clearly and prominently disclose how service charges are being used, and the fees must be used exclusively for the defined purpose.[19]

Given the differences between tips and service charges, consumers cannot assume a service charge is going to workers exclusively unless an employer clearly discloses on the menu that they are passing the service charge on entirely to workers and then actually does so.

Benefits of Service Charges

If passed on entirely to workers, service charges can be a critical tool to increase racial equity in the restaurant industry because they eliminate the customer implicit bias in tipping that leads to wage fluctuation and a wage gap between workers of color and white workers.

Implicit biases — the automatic association of stereotypes and attitudes toward particular groups — are prevalent even in places like Washington D.C. where the majority of people may reject explicit racism.[20] Research has shown that people who are consciously egalitarian are particularly likely to engage in “in-group preference” where they treat their own or the dominant group better without holding negative views about other groups.[21] When this involves race, as it often does, it translates into rating white people more positively than people of other races for otherwise identical behavior. This is precisely how tipping can result in differential wages based upon race.

Forcing restaurant workers’ to receive their income directly from customer tips has led to a consistent wage gap between workers of color and white workers, and in particular between Black women and white male workers, when working in the same jobs.[22] White servers and bartenders across all restaurant types earn more tips than most other racial groups, as per an Eater analysis of U.S. Census and Bureau of Labor Statistics data.[23] It has also led to a consistent wage gap between workers, largely due to customer implicit bias in tipping; research has shown that Black women are consistently tipped less than White men even providing the same service in the same role.[24]

While we know that Black women are paid only 58 cents for every dollar paid to white men across the economy, and the wage gap persists regardless of industry, this gap is worse in the restaurant industry as a result of the reliance on tipping. Tipping is even more susceptible to implicit biases than other pay decisions because the adjustments made to tips — increasing or decreasing them — tends to be spontaneous.[25] These differences can be extremely meaningful to people’s lives. Black women in the restaurant industry generally earn \$2.57 an hour less than their white male counterparts, which can also be understood as \$5,345 of income lost every year. Among ‘front-of-house’ (dining room) occupations that are more subject to the vagaries of tips, this race-gender gap increases to \$6.19 an hour, or \$12,875 annually.[26]

Service charges eliminate implicit bias in tipping by requiring consumers to pay a standard

If service charges are treated as gratuities and passed on entirely to workers, they would eliminate the implicit bias in tipping that leads to wage fluctuation and wage gaps.

amount of gratuity regardless of the race and gender of the server. These biases are extraordinarily difficult to reduce — so policy changes are critical.[27] If service charges are treated as gratuities and passed on entirely to workers, they would eliminate the implicit bias in tipping that leads to wage fluctuation and wage gaps.

Challenges With Service Charges: Employer Control and Lack of Transparency

Given the fact that service charges are the property of the employer, consumers cannot be certain that workers are receiving all of the service charge. Customers have raised concerns about DC restaurants adding fees, unsure if the establishments are taking portions of service charges to cover their costs rather than passing them on as gratuities.[28] However, DC has strong consumer protections that should allow consumers to know how service charges are being spent. District of Columbia consumer law requires restaurants to state they have a service charge and how that service charge is used; in addition, service charges must be spent in the manner the establishment claims they will be. As a result of consumer advocacy, Washington, DC customers and workers have far stronger protections with regard to service charges than other parts of the country.[29]

On March 7, 2023, the Attorney General for the District of Columbia described the laws regarding service charges in a consumer alert,[30] and stated that in order to comply with these laws, restaurants should:

- Clearly and prominently disclose fees at the beginning of the ordering process. This must include the type and amount of fee. For example: Servers could tell you about a fee verbally, or it could be disclosed in bold print on the menu.
- Accurately describe the reason for the fee, either by naming the fee clearly (like: "worker health insurance fee") or explaining how it is used.
- Use any fees exclusively for the purposes disclosed. For example, "service fees" must go fully and directly to service workers, unless other uses are prominently disclosed.

The Attorney General for the District of Columbia also laid out what is illegal. Restaurants may violate the District's consumer laws if they:

- Bury fee information in fine print on a menu.
- Fail to disclose the amount or percentage of a fee until the bill is given to the diner at the end of a meal.
- Use fees collected from diners for purposes contrary to the purposes disclosed.
- Use ambiguous or misleading language that fails to fully convey to a diner how a fee will be used (for example, charging an ambiguous "restaurant recovery" fee without explaining what the fee will assist in recovering).

The Office of the Attorney General (OAG) is the primary enforcer of the District's consumer protection laws. The OAG has warned the City Council that most restaurants are violating this law.

3 WIDESPREAD NON-COMPLIANCE WITH DC CONSUMER PROTECTION LAWS

With the confusion spread by the National Restaurant Association and the lack of transparency by restaurant owners, District residents have started to band together online to navigate the issue. One group of residents on the Reddit forum 'r/washingtondc' compiled a list of over 150 restaurants in the District of Columbia that customers had reported added a service charge of some form.[31]

One Fair Wage examined the websites of 142 of these establishments. OFW found that 52 percent of these establishments indicated that they would add on a fee to the patron's bills.[32] Of those that posted fee information on their website, One Fair Wage identified 31 establishments (41 percent) that put some form of an explanation around the fee, while the remainder provided no details. However, of those 31 establishments, only 13 disclosed exactly how the money would be used and distributed. **In other words, of the 142 establishments, only 9 percent fully disclosed that they had a service charge and detailed how the proceeds of that service charge would be used on their website.**

4 HIGHER WORKER WAGES BENEFIT RESTAURANT WORKERS AND RESTAURANTS IN THE LONG RUN

With the passage of I-82, DC's restaurant industry can be more equitable for all, especially if service charges are used fairly and legally and can thus address implicit bias in tipping. Research shows that the 7 states that have transitioned to a full minimum wage with tips on top (CA, OR, WA, NV, MN, MT, AK) have experienced reduced employee turnover, higher consumer spending, and greater resilience to market fluctuations. Despite recent media coverage claiming that the passage of I-82 and the transition of many restaurants to service charges will be harmful to the industry, in fact evidence shows just the opposite.[33]

In One Fair Wage States, Workers' Wages and Tips Are Higher

Seattle, Washington and Washington, D.C. have similar cost of living, but in Seattle all workers are paid the minimum wage of $15.75 — including tipped workers — and tipped restaurant workers earn 23 percent more than their DC counterparts.[34] Recent research has shown that Seattle ranks among cities with the highest tipping averages, with data showing that 38 percent of diners in Seattle tip more than 20 percent to their servers.[35]

Generally, tipping is the same or higher in the 7 states with One Fair Wage compared to Washington, DC;[36] this is a reflection of the fact that most restaurants in the 7 states that have passed One Fair Wage law have not transitioned to service charges; those restaurants that have transitioned to service charges pass on a majority of the income from the service charge to workers.

Since the implementation of I-82 has yet to occur, food service workers are more likely to live in poverty in the DC metro area, where the subminimum wage still persists, compared with workers in the LA, Seattle, or San Francisco metro areas, where there is no subminimum wage.[37]

No Impact on Employment Levels

Per a study by the Cornell Institute for Hospitality Labor and Employment Relations, a relatively modest mandated increase in employees' regular and tipped minimum wages in the past twenty years has not had large or reliable effects on the number of restaurant establishments or restaurant industry employment levels, although those increases have raised restaurant industry wages overall.[38] Even when restaurants have raised prices in response to wage increases, those price increases do not appear to have decreased demand or profitability enough to significantly or reliably decrease either the number of restaurant establishments or the number of their employees.[39]

No Decrease in Demand

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Reduction in Employee Turnover

The restaurant industry has had one of the highest turnover rates in the country—a widely recognized challenge for restaurant owners.[41] In 2019, the turnover rate for the accommodations and food services industry was 78.6 percent.[42] According to Black Box Intelligence, a marketing and human resources firm, turnover causes employers to lose nearly $2,000 per hourly employee.[43] High turnover costs are largely due to the constant recruiting, interviewing, and training of replacement workers.

The recruitment pipeline is costly and includes the labor time invested by managers and new-hire training. High turnover costs are also associated with the loss of experienced employees. Compared to experienced staff, new hires tend to be less productive, provide lower-quality service, and altogether require more attention from other staff for training and development needs.[44]

A majority of the costs associated with turnover can be addressed by paying workers well. A 2014 study by researchers at Cornell University demonstrated that employers can cut their employee turnover almost in half by increasing wages and providing better benefits.[45] The study also found that workers in 'high road' restaurants have higher morale, investment, and productivity, and were thus able to provide better service.[46] Underpaid workers are much less likely to be engaged at work and thus less productive, as they tend to view their job as a means of survival until they find a better option. Recent surveys have confirmed that one of the main reasons employees leave their jobs is to pursue higher compensation.[47] When restaurant workers are taken care of, they stay longer, are more productive, and provide better quality service.[48]

Increased Consumer Spending — Businesses Thrive with One Fair Wage

There is comprehensive evidence that most small businesses can absorb increased labor costs without losing revenue or reducing their workforce.[49] Employers in the seven states (California, Oregon, Washington, Nevada, Montana, Minnesota, Alaska) that pay a full minimum wage for tipped workers with tips on top have fared well and even better in terms of sales, employment, and establishment growth. Restaurant sales growth is higher in states that require employers to pay the full minimum wage to tipped workers. According to 2017-2018 estimates by the National Restaurant Association, restaurant sales in states that implement One Fair Wage (a full minimum wage with tips on top) grew by 17 percent, compared to 15.6 percent in subminimum wage states. California, a One Fair Wage state, had the highest restaurant sales, topping over $97 billion — reflecting an annual restaurant sales increase of 18 percent.[50] As recently as April 2021, Denny's CFO revealed that its chain's restaurants in California outperformed all other states in terms of sales and guest traffic, despite the state's minimum wage increase.[51]

Restaurant employment and restaurant establishment growth rates are also equal or higher in states that pay the full minimum wage to all workers. From 2011 to 2016, full-service restaurant employment (FSRE), where tipping is concentrated, grew by 20.4 percent in One Fair Wage states, compared to 16.37 percent in subminimum wage states during the same time period.[52] From 2011 to 2016, full-service restaurants in One Fair Wage states grew by 9.44 percent, compared to 8.8 percent in states that pay the subminimum wage.[53]

Increased Resilience to Market Fluctuations

Even amidst the COVID-19 pandemic, businesses in subminimum wage states have closed at higher rates than those in states that mandate a full minimum wage. The seven states that do not have a subminimum wage for tipped workers have had, on average, almost exactly the same rate of decline in open hospitality businesses, as states with a subminimum wage. According to data published by Opportunity Insights, the mean rate of decline in open businesses between January 2020 and January 2021 for the seven states that require a full minimum wage for tipped workers is 49.9 percent, and the mean rate of decline in open hospitality businesses for the other 43 states that allow a subminimum wage for tipped workers is 49.4 percent.[54] Some of these seven states have had the greatest COVID restrictions of almost any state, but still have not experienced a greater decline in open hospitality business rates than other states.[55]

Despite contentious political arguments to the contrary, economic research shows that businesses and workers alike benefit from a higher minimum wage. The increase in low-wage workers' income generates increased spending in the local economy. The workers who would receive this wage increase are more likely to spend it, compared to higher-earning households.[56] A study by the Federal Reserve Bank of Chicago found that a $1 raise for a minimum wage worker translates to an additional $700 in consumer spending by their household over the course of a year.[57] This increased demand will provide some relief to the struggling restaurant industry.

CONCLUSION

Washington, DC policymakers and consumers should support restaurants in using any model that respects worker gratuities, whether they are service charges or tips, as the property of workers, and provides transparent and accurate information to consumers. This includes supporting restaurants in transitioning to service charges, which eliminate the implicit bias in tipping, IF they actually pass on the service charges to workers — like tips, on top of wages, not to cover base wages — and transparently display the use of service charges to consumers.

DC policymakers should not provide incentives or support to restaurants that transition to using service charges but do not pass them on as gratuities to workers and do not transparently display what the service charges are being used for.

Any restaurants using service charges but not displaying how the service charges are being used should be reported to the District of Columbia's Office of Consumer Protection or the One Fair Wage hotline.

District of Columbia Consumer Complaint
https://oag.dc.gov/consumer-protection/submit-consumer-complaint

One Fair Wage Hotline
(786) 233-9344.

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