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The Development of Tip Elimination and Its Effects on the Industry

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The Development of Tip Elimination and Its Effects on the Industry

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Overview of Topics

- Brief history
- Current Status of Tipping
- Forces against the elimination of tip credit
- Forces for the elimination of tip credit
- Future Implications



History of Tipping in the US

- Origin is debated
- To Insure Promptness
- Dutch? Latin?
- Civil War? Roman times?
- Near the time of prohibition (1920-1933)
- Restaurant sales were down
- Employees were encouraged to except tip from customers
- Increased over time and formalized in 1960's



Tipping and the IRS

- 1965: employers must withhold FICA tax on tips from employees' pay
- 1982: employees must report at least 8% of gross sales as tips
- 1993: FICA tip credit enacted - employers allowed a tax credit
- 1993: introduction of Tip Rate Determination/Education Program (TRDEP)
 - encourages employees to report the correct amount of tip income to their employer.
- 2002: Supreme Court rules the IRS can determine the amount of tips it thinks employees should have reported based on restaurant data and can assess the employer share of FICA tax on suspected unreported tips
- 2013: IRS clarifies distinction between tips, service charges and treatment of each



Department of the Treasury
Internal Revenue Service

Tips v. Service Charges

- Tips
 - Voluntarily given from customer
 - Go directly to service worker
 - Directly from Customer
 - From Tip Pools, Splitting...
- Service Charges
 - Involuntarily given from customer
 - Considered business revenue
 - Examples
 - Hotel Service Charge
 - Banquet Event Fees



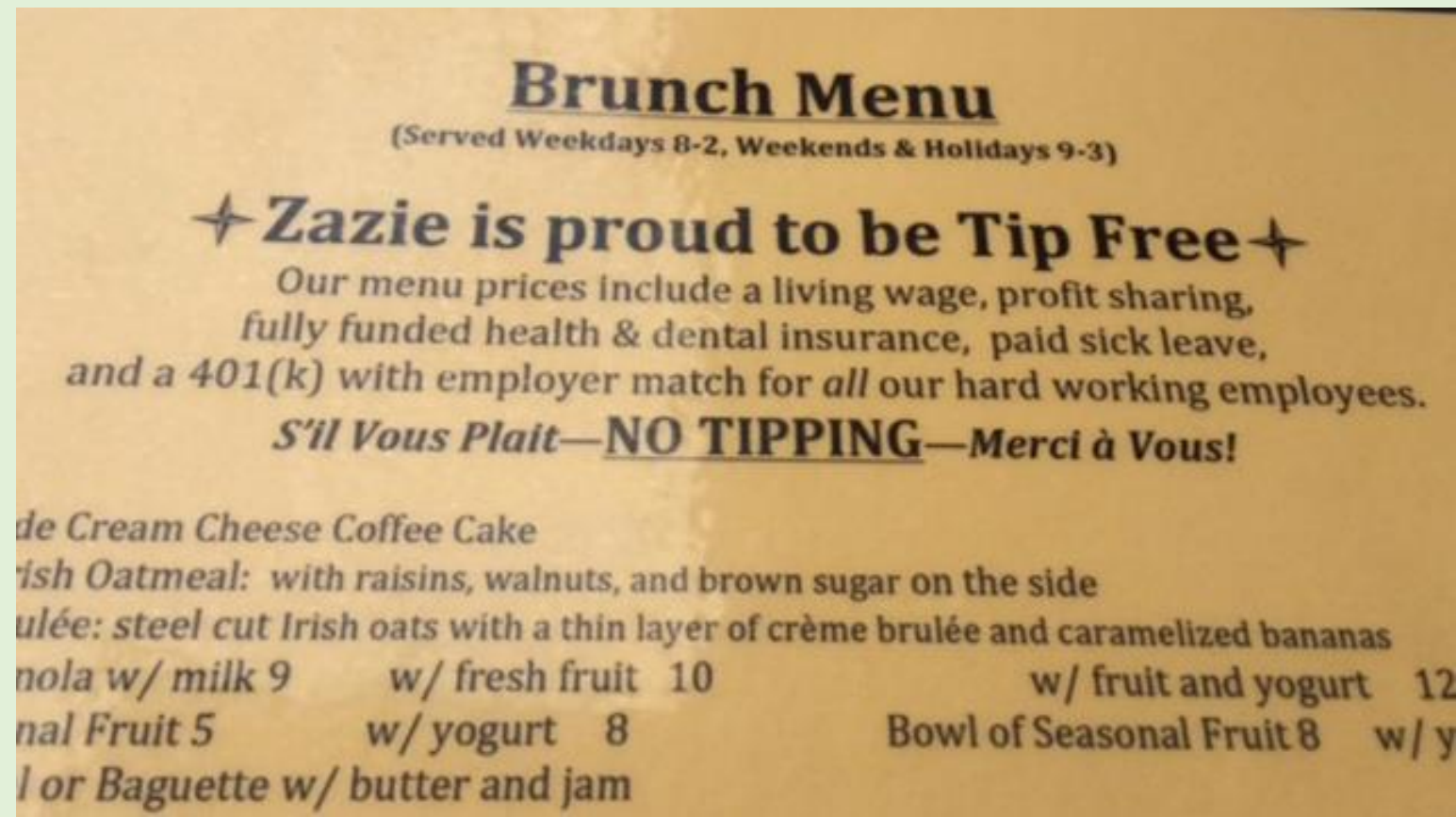
Current Status of Tipping

- Federal Tip allocated wage has been \$2.13 since 1991.
- Federal minimum wage is 7.25
- Federal Tip credit is \$5.12
- Average reported tipped wage ~11-12/hr
- Business Model of 80+ years
- Tips constitute the bulk of pay
- There are forces for and against subminimum wage.

| | |
|--------------------|----------|
| Tip allocated wage | \$2.13 |
| Tip credit | + \$5.12 |
| ===== | |
| Minimum wage | \$7.25 |

Forces for the Elimination of Tipping

- State laws
- Popular Restaurateurs
- Raise Wage Act
- Poverty Thresholds
- Special Interest Groups
- Research



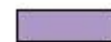
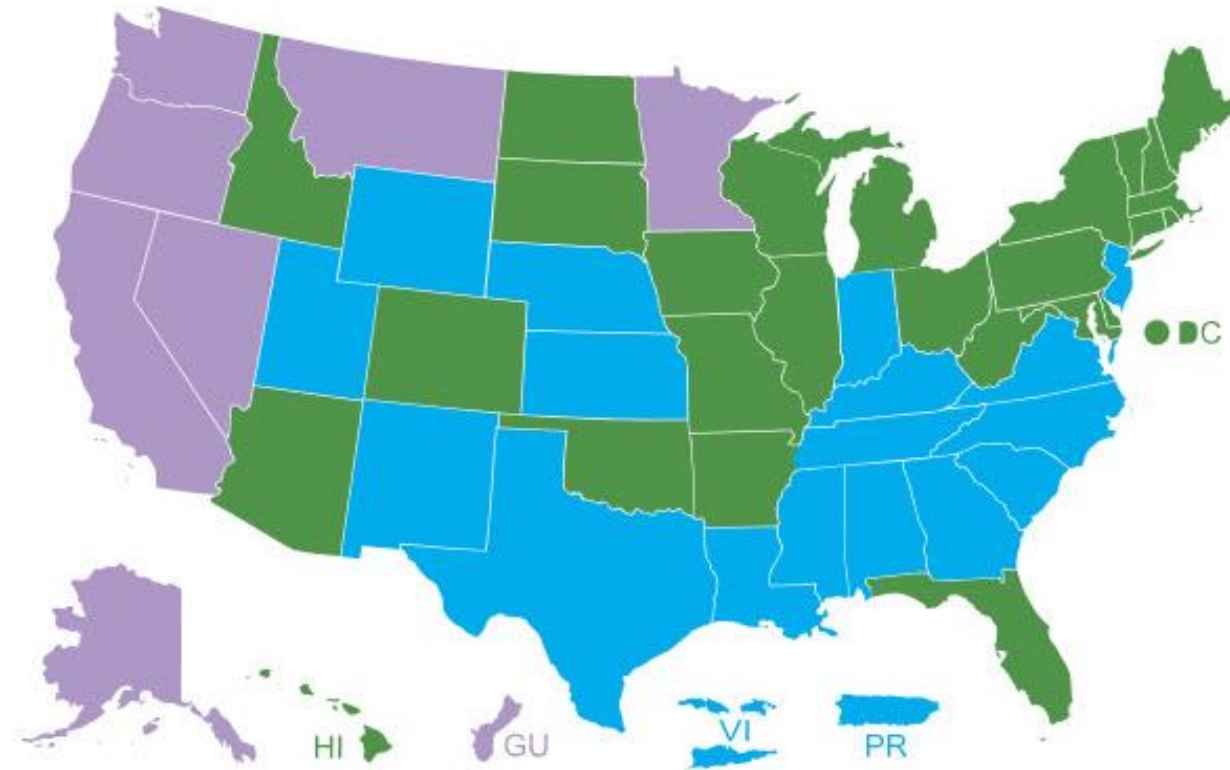
The Elimination of Tip credit by State

7 states have no tip credit
26 2.13 > 5.12 tip credit
17 have full tip credit

Wage and Hour Division (WHD)

Minimum Wages for Tipped Employees

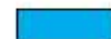
January 1, 2016



State requires employers to pay tipped employees full state minimum wage



State requires employers to pay workers above federal tipped minimum wage



State requires employers to pay workers as low as federal tipped minimum wage (\$2.13/hr.)

Research: Tips Discriminate

- Tipping Creates an Environment where:
 - Better Service
 - White males
 - Less Service
 - Young, old, people of color, women, religions, foreigners

Tippers are typically male and 70% servers are female.

Non-White Servers make less \$ than white servers.

Bottom line.....

Tips cause discrimination among both customers and employees



Danny Meyer and the Media

- High profile operators
 - Thomas Keller
 - Danny Meyers
 - Joe's Crabshack*
 - 20+ others in NYC

Case Study Example

- NY minimum wage rising
- Tip Credit eroding
- Shortage of kitchen workers
 - Needs to pay more to attract them. \$11.25 to \$15.25
- Money for this increase has to come from somewhere.
 - Prices could be increased
 - Lower profit margins accepted
 - Equilibrium achieved
- Scenario doesn't apply to most



Raise Wage Act

- **S.1150 — 114th Congress (2015-2016) Murray**
- Wants to raise to Fed. Min. Wage from \$7.25 to \$12.00/hour by 2020




Poverty Thresholds in the US

| United States Department of Health and Human Services(HHS) figures for Federal Poverty Level in 2015 | | | |
|--|-------------------------------|----------|----------|
| Persons in Family Unit | 48 Contiguous States and D.C. | Alaska | Hawaii |
| 1 | \$11,770 | \$14,720 | \$13,550 |
| 2 | \$15,930 | \$19,920 | \$18,330 |
| 3 | \$20,090 | \$25,120 | \$23,110 |
| 4 | \$24,250 | \$30,320 | \$27,890 |
| 5 | \$28,410 | \$35,520 | \$32,670 |
| 6 | \$32,570 | \$40,720 | \$37,450 |
| 7 | \$36,730 | \$45,920 | \$42,230 |
| 8 | \$40,890 | \$51,120 | \$47,010 |
| Each additional person adds | \$4,160 | \$5,200 | \$4,780 |

Note: if a single individual works 40 hours @ \$7.25 = \$15,080

Special Interest Groups


- Began after 9/11 to help Windows of the World employees
- Erika Medeiros of ROC
- “tips aren’t guaranteed”
- Many are below the poverty line.
- \$7.25

**ROCUNITED**
RESTAURANT OPPORTUNITIES CENTERS UNITED

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Download Diner's Guide App

ABOUT OUR WORK TAKE ACTION ONE FAIR WAGE LIVING OFF TIPS MEDIA RESEARCH LOCALS

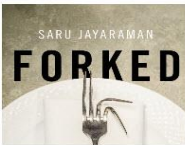
**I AM A RESTAURANT OWNER**


Our mission: To improve wages and working conditions for the nation's 10 million restaurant workers.
Our Story»

ACTION ALERTS

Get One Fair Wage Campaign Updates!

LATEST NEWS

**Announcing Our New Book: Forked!**
What happens when an author goes undercover at a popular "family-friendly" restaurant? We find out in a new video released today announcing *Forked: A New Standard For American Dining*, the forthcoming book from Saru Jayaraman, the best-selling author of *Behind The Kitchen Door* and co-founder of Restaurant Opportunities... [Read More](#)

**Why It's Difficult to Stomach Olive Garden's Slogan "We're All Family Here."**
I live off tips and a sub-minimum wage of \$2.83 an hour. As a mother to two young sons, I am barely scraping by. There have been plenty of nights where after a long day of serving unlimited breadsticks and Italian dishes to a stream of customers, I struggled to put food on my own table. I've been a server at Olive Garden for two years... [Read More](#)



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Report Finds San Francisco Massively Underpays Minority Restaurant Workers
<https://t.co/LPHS8AFOCI> about 8 hours ago
ReplyRetweetFavorite

RT @marianmyotte: The Dem party platform calls for ending sub-min wage, uses @rocunited #1FairWage language <https://t.co/oU3mNEMmc>
<https://t.co/03:58:35> AM July 13, 2016
ReplyRetweetFavorite

RT @EqualRightsAdv: New @rocunited study finds Bay Area restaurants have the largest race #wagegap at \$6.12.
<https://t.co/1y2wzdxsC> 03:58:19 AM July 13, 2016
ReplyRetweetFavorite

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Research Findings: Tips v. Service Quality

- *Tip amount has little to do with service quality.*
 - Theory
 - gratuity is motivation to do their best
 - Reality
 - Size of a tip has less to do with the quality of service provided
 - Mostly attributed to the size of the bill.
 - Customers
 - reluctant to leave anything less than the normal 20% gratuity
 - fear of social disapproval
 - gratuity unlikely to fluctuate is unlikely to motivate.
- M. Lynn, Cornell



Research Findings: Tips Diminish Teamwork to TEA

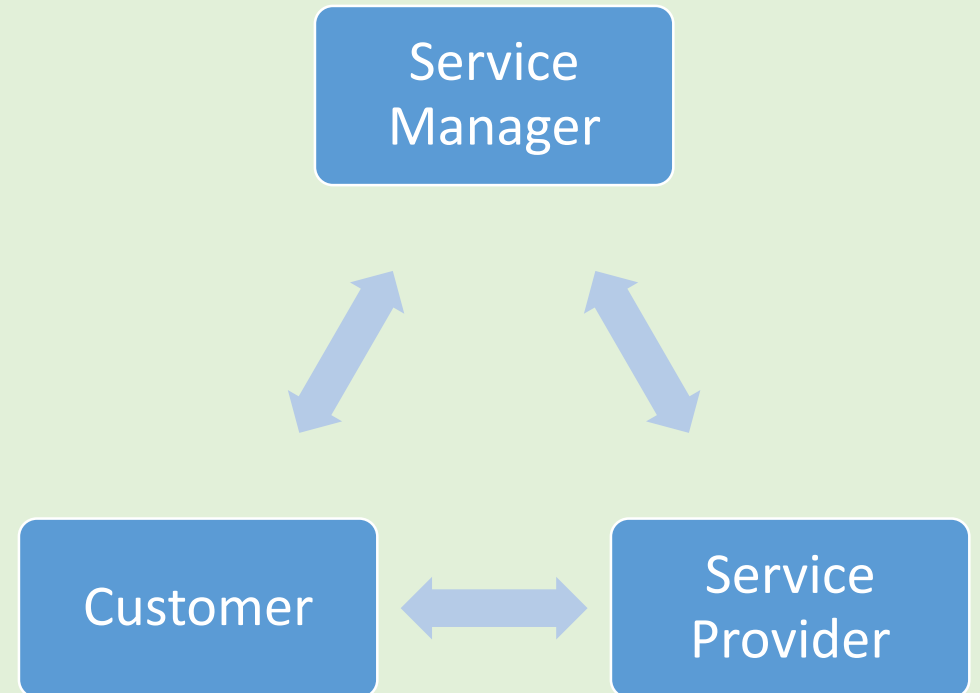
- Provides no incentive for working as part of a team.
- Focused on their customers and theirs alone
 - “That’s not my section”
 - “I’ll get your server”
- Pooling tips among servers can help alleviate this circumstance
 - most servers dislike
 - fear of sharing with team members that work less



M MORE?

Theory: Tips Make it Difficult to Manage

- Danny Meyer
 - Direct transaction between
 - the customer and service provider
 - leaves no place for the manager.
 - Eliminating tips
 - puts the manager between these two parties
 - allows them to manage service through pay increases, bonuses and promotions.
 - Meyer is confident that his managers will be better at this than his customers.



Tipping is North American (Europe)

- The rest of the world as a case study
 - What can we learn from them?
- Initial Points
 - They have never had it.
 - Cultural Differences.
 - Different service expectations.
 - More government intervention.
 - Serving is a respectful career choice.



Forces Against the Elimination of Tipping

- Elimination of tipping is not working
 - Customers perceptions
 - Felt they lost control
 - Didn't like mandated tip
 - Service Providers
 - Delivered less service
 - Earned less money
 - Managers
 - Dealt with lower CSS



Research: Customer Opinions

- Changing the familiar business model
- Consumer attitudes have been extensively researched
- Customers
 - unwilling to tip less than the norm or not at all
 - feel a sense of transactional power where tipping is involved
 - feel powerless without tipping
 - Resent being mandated to pay



Raising Menu Prices

- Example: Meyer has stated that he will be raising the prices on his menu by more than 20%.
- sticker shock for many customers.
- acceptable in NYC
- What if none of your competitors do the same?
 - Will customers understand what you are doing?
- The French Laundry
 - a service charge is acceptable.
 - unwelcomed most everywhere else.



Comparison of Tipped/Hourly @ 40 hours



- Scenario 1 – Erika
- Coffee Shop
- \$2.13/hour \$9.87 tips
- 40 hours
- 15% taxes = \$72
- \$13.20 paycheck
- Poor Sally
- Dependent on tips



- Scenario 2 – Ron
- Home Depot
- \$12/hour
- 40 hours
- 15% taxes = \$72
- \$408 paycheck
- Rich Ron
- HD pays him well!

What they don't mention...



- Scenario 1 – Erika
- Coffee Shop
- \$2.13/hour
- \$9.87/hour in tips which is the national “reported” average
- Take-home is the same.
- If it falls below \$246.50 the café will compensate. (still above poverty level)
- She would have received an additional \$88 (~\$14.20/hr) for enough taxes to be deducted for a \$0 paycheck.



- Scenario 2 – Ron
- Home Depot
- \$12/hour
- Take home is the same
- Guaranteed pay, but no opportunity for an extra \$88/week.

Research

Who benefits from a higher minimum wage?

WHAT PEOPLE THINK

Teenager

Works part time
after school

Lives with parents

Earning extra
spending money



THE REALITY

Average age:
36 years old

89% are not teens,
they're 20 or older

37% are
40 or older

56% are
women

28% have children

57% work
full time

On average, they earn
more than half of their
family's total income



Statistics describe civilian workers, ages 16+, that would be affected by an increase in the federal minimum wage to \$12.00 by 2020. The median age of affected workers is 32 years old.

ECONOMIC POLICY INSTITUTE

go.epi.org/raisethewage

Research: Service Worker Perspectives

- *Survey of tipped service workers*
- *Servers are motivated by money*
 - Serving and bartending are difficult jobs.
 - physically demanding
 - hours are long
 - workweek is unconventional
 - public can be difficult
 - primary motivation for doing these jobs is \$\$\$\$ (yes, passion too)
- *Servers are risk takers*
 - Preferred uncertainty of tips over a steady wage
 - Many mentioned the actual amount of money they can make on a busy Friday.
 - When asked about a dead Tuesday, they again mentioned “Making Bank” on Friday.



Research: Service Worker Perspective

- *Servers are entrepreneurial*
- Indicated that they worked hard to
 - provide great service
 - upsell for their financial benefit
- Preferred working alone
- Expected to benefit from their effort.
- Didn't expect the house or their co-workers to take what they had earned.
- *Servers are Transitory*
 - servers consider themselves as something else.
 - students paying their way through school
 - out of work accountants, teachers looking to supplement
 - make money and move on
 - less interested in promotion, 401K's



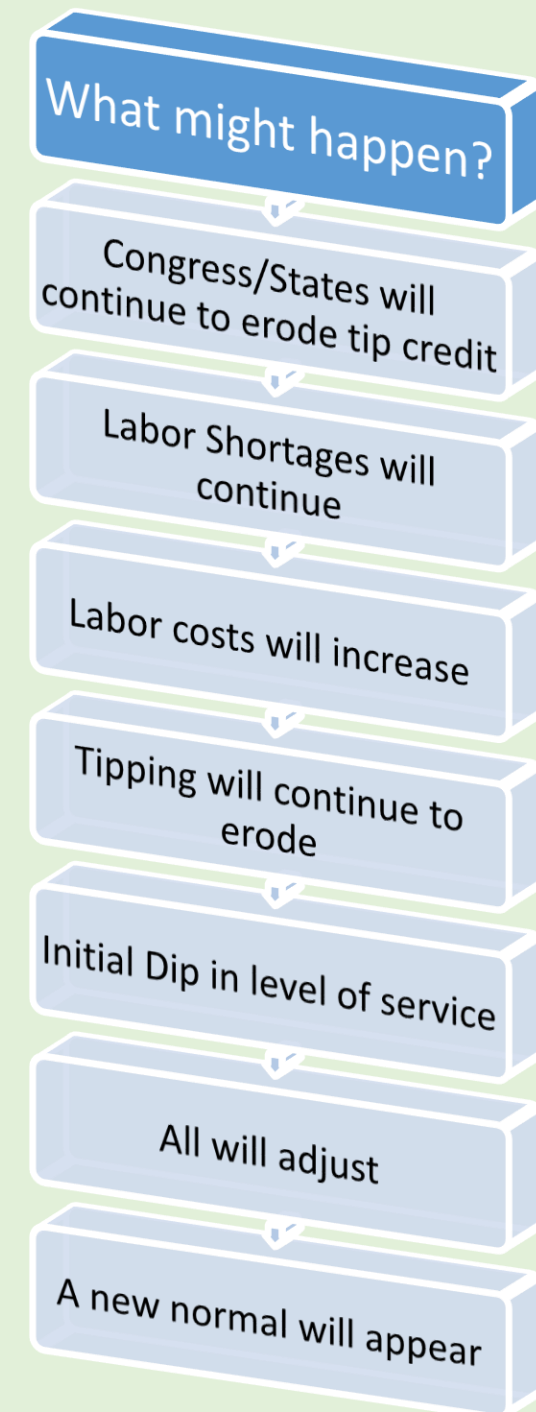
Entities to Consider

- Special Interest Groups
 - Will aggressively
 - Will people believe bad statistics?
- Industry Change Agents
 - Will they continue?
 - Tipping Point? (Malcolm Gladwell)
- National Restaurant Association
 - Continues to aggressively lobby against
- Workers
 - don't like it
 - but can they adjust?
- Owners
 - are mostly against it
 - but they are a highly adaptable group
- Customers
 - don't like the change
 - but do they matter?
 - norms have changed throughout history



Future Predictions

Insert picture of back
to the future



Questions/Comments?

Thank you for attending
I appreciate that you are here.