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Tax on Tips

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Carol, a 38-year-old single parent to an 18-year-old child, works full time as a restaurant server. Her employer pays her \$2.13 per hour, which is legal according to federal law and the laws of Indiana, Kansas, Kentucky, Louisiana, Mississippi, North Carolina, Texas, Utah, Virginia, and Wyoming. She also earns tips, which bring her wages up to \$7.25 per hour. Her tips might have brought her wages above the \$7.25 federal minimum wage, but when Carol makes more than \$5.12 in hourly tips, her employer takes the excess and distributes it among Carol's coworkers. Recently, Democrats and Republicans promised to adopt a "no tax on tips" policy, exempting tips from the federal income tax. On July 4, 2025, President Trump enacted the first-ever tips-received deduction, which is effective through 2028.

Unfortunately, the tips-received deduction will not help Carol and threatens to increase her reliance on tip income. Since her \$15,080 annual earnings are lower than her standard deduction, Carol does not owe federal income taxes. Thus, for Carol—and the 37% of restaurant employees who are not paid enough to owe federal income taxes—the tips-received deduction produces no tax savings. Proposals that would exclude tips from income would be even worse, threatening Carol's Earned Income Tax Credits and future Social Security benefits, which are calculated based on her earnings. In 2024, for example, her earnings of \$15,080 made her eligible for an Earned Income Tax Credit of \$4,213. If tips were excluded from her income, that credit would drop to \$1,505. Assuming that Carol retires in 30 years, Social Security will pay her \$3,259 monthly if tips remain included in her wages but only \$950 monthly if tips are excluded.

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This Article rejects “no tax on tips” slogans and is the first to offer an alternative to help lower-wage tipped workers like Carol. It proposes revising the multi-billion-dollar Section 45B tax credit to encourage restaurant employers to directly pay all workers the \$7.25 federal minimum wage and to allow workers to retain all their tips. Further, it seeks to use any money saved from revising the credit to fund expansion of the Earned Income Tax Credit, particularly for workers who do not have children or whose children are aging out of tax benefits.

INTRODUCTION.....	3
I. TIPPING AND ITS TAX TREATMENT.....	6
II. HOW THE EXCLUSION OF TIPS FROM EMPLOYEES’ FEDERAL TAXES FAILS TO HELP, AND CAN HARM, TIPPED WORKERS.....	14
A. More Than a Third of Tipped Workers Pay No Federal Income Taxes, Even Though Tips Are Included in Gross Income	14
B. The Neediest Tipped Workers Will Receive Less Generous Tax Credits If Tips Are Excluded from Federal Income Taxes.....	15
C. Tipped Workers Will Receive Less Generous Social Security and Medicare Benefits If Tips Are Excluded from Federal Payroll Taxes.....	18
D. Tip Tax Relief Could Harm Tipped Workers	25
E. The Tips-Received Deduction Undermines Horizontal Equity Between Tipped Workers and Nontipped Workers.....	31
F. While the Instinct to Improve Tipped Work Is Well-Founded, Tip Tax Relief Can Harm Workers	32
III. TURNING THE HORIZONTAL-EQUITY FRAME ON THE EMPLOYERS OF TIPPED WORKERS.....	33
A. Employers of Tipped Workers Need Not Directly Pay the Minimum Wage	35
B. Employers of Tipped Workers Can Require Their Workers to Cross-Subsidize Each Other.....	38
IV. AMENDING THE SECTION 45B CREDIT FOR EMPLOYERS OF TIPPED WORKERS OFFERS A BETTER WAY TO HELP TIPPED WORKERS	47
A. Section 45B Is Inequitable and Dishonest	48
B. A Proposal to Make Section 45B More Equitable and Honest.....	54
C. Advantages of Amending Section 45B.....	59
1. Improving Horizontal Equity Between Employers and Jobs.....	59
2. Mitigating Racism.....	61
3. Mitigating Sexual Harassment and Sexism.....	65

Tax on Tips

4. Facilitating Stable and Predictable Incomes.....	69
5. Reducing Opportunities for Tip Theft.....	70
D. Counterarguments Against Amending Section 45B Are	
Insufficient.....	71
1. Legal Requirements Limit Decentralized Business	
Judgment.....	71
2. Restaurants Will Close and Displace Workers.....	74
3. Service Will Suffer.....	76
CONCLUSION.....	79

INTRODUCTION

“No tax on tips.” In the last months of the 2024 presidential election, Donald Trump¹ and Kamala Harris² both made campaign promises to exempt tip income from federal income taxes. Politically, it was a savvy move.³ Nevada, with six electoral votes, appeared up for grabs, and is

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1. Donald J. Trump, Address at Political Rally at Sunset Park in Las Vegas (June 9, 2024) (transcript available at *Speech: Donald Trump Holds a Political Rally at Sunset Park in Las Vegas - June 9, 2024*, ROLL CALL, <https://rollcall.com/factbase/trump/transcript/donald-trump-speech-political-rally-las-vegas-june-9-2024/> [https://perma.cc/8ZLX-BW6Z]) (“[W]hen I get to office, we are going to not charge taxes on tips I think it’s never been brought up before, and I also think it’s very appropriate.”).
 2. Kamala Harris, Remarks at a Campaign Event in Las Vegas, NV (Aug. 10, 2024) (transcript available at *Speech: Kamala Harris and Tim Walz Speak at Campaign Rally in Las Vegas - August 10, 2024*, ROLL CALL, <https://rollcall.com/factbase/harris/transcript/kamala-harris-speech-campaign-rally-las-vegas-august-10-2024> [https://perma.cc/W9W3-ADGY]) (“[W]hen I am president, we will continue our fight for working families of America—including to raise the minimum wage—and eliminate taxes on tips for service and hospitality workers.”).
 3. Joseph J. Thorndike, *No Tax On Tips: A Good Policy?*, FORBES (Nov. 5, 2024, 12:55 PM), <https://www.forbes.com/sites/taxnotes/2024/11/05/no-tax-on-tips-a-good-policy/> [https://perma.cc/5CE2-YPS7] (describing the proposal as “vote buying at its most obvious. The plan is designed to win the votes of people working in the hospitality industry, and especially the ones who live and work in Nevada. . . . Those two, they don’t agree on much, but they do both understand that Nevada is a swing state and in a close election year, Nevada’s six electoral votes, they could make the difference between winning and losing.”).

populated by “the highest concentration of tipped workers in the country.”⁴ Broadly, Donald Trump was advancing a populist message while Kamala Harris aimed to prove that Democrats protect working families.⁵

With the election complete, the first-ever tips-received deduction signed into law and effective from 2025 through 2028, and “no tax on tips” proposals politically popular,⁶ this Article considers whether exempting tips from tax helps tipped workers. Part I describes tipping and its tax treatment. Part II reveals that the recently adopted tips-received deduction threatens to harm the lowest-paid tipped workers, saving them no federal income taxes, discouraging their employers from paying them fixed hourly wages, and depleting their opportunities for alternative employment. If future tip tax relief is structured as an exclusion from income, it could also make workers’ Earned Income Tax Credit (“EITC”) benefits stingier and

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4. Kevin Freking & Josh Boak, *Trump Is Proposing to Make Tips Tax-Free. What Would That Mean for Workers?*, ASSOCIATED PRESS (June 21, 2024, 12:13 AM), <https://apnews.com/article/trump-tips-taxes-nevada-0fc5fa0fb7bdcf963757c748c01bfbe9> [<https://perma.cc/9B9J-QDH5>].
 5. *See, e.g.*, Hannah Grabenstein, *Killing Taxes on Tips Sounds Good, but Experts Say It Doesn’t Solve the Real Problem*, PBS NEWS (Sep. 4, 2024, 5:13 PM), <https://www.pbs.org/newshour/economy/trump-and-harris-say-theyll-kill-taxes-on-tips-how-would-that-work> [<https://perma.cc/7JZC-X8RH>] (“Trump raised the idea to end taxing tips at a June campaign rally in Las Vegas, home to the Culinary Workers’ Union. ‘When I get to office we are going to not charge taxes on tips, people making tips,’ Trump said, adding, ‘You do a great job, you take care of people, and I think it’s going to be something that really is deserved.’ Harris was also in Las Vegas when she announced she supported a similar proposal in August. ‘When I am president, we will continue our fight for working families of America, including to raise the minimum wage and eliminate taxes on tips for service and hospitality workers,’ Harris said.”).
 6. *Proposed Policy to End Federal Income Tax on Tips Has Bipartisan Support*, IPSOS (Aug. 22, 2024), <https://www.ipsos.com/en-us/proposed-policy-end-federal-income-tax-tips-has-bipartisan-support> [<https://perma.cc/2XCD-EGD2>] (“A new Ipsos poll finds that a majority of Americans support ending federal income tax on tip income, even across party lines. The plan, which has been proposed by both Republican presidential nominee Donald Trump and Democratic presidential nominee Kamala Harris, is supported by roughly three in four Republicans (73%), Democrats (75%), and independents (73%). However, Americans are more mixed on the potential outcomes of the policy: 54% say they think workers receiving tipped wages would be more financially secure, while 43% say employers would figure out how to pay workers less.”).

provide them with lower Social Security wage bases and thus lower Social Security benefits post-retirement.

Instead of extending the tips-received deduction or exempting tip income from federal income or payroll taxes, this Article proposes that lawmakers should reform tax law to prioritize (1) protecting the tipped workers' EITCs and Social Security benefits, and (2) making workers less reliant on tip income. The current desire to help tipped workers would make this tax reform more feasible. Rather than increasing the differential treatment of tipped workers relative to nontipped workers, this Article is the first to argue—in Part III—that tax law should aim for greater horizontal equity⁷ between *employers* of tipped and nontipped workers.

A further innovation of this Article is to propose—in Part IV—that lawmakers should revise the multi-billion-dollar Section 45B credit to allow employers of tipped restaurant workers to take the credit only if they directly pay their workers the full \$7.25 federal minimum wage and do not require their workers to pool tips. Thus, the Section 45B credit would be targeted at employers who treat tips as solely owned by the direct tip recipient. Revenue gained by the proposed revision to the Section 45B credit should be redirected to make the EITC more generous, particularly for workers who do not have children or who, like Carol, have children who are aging out of the definition of a qualifying child. This proposal would, as Section IV.C explains, improve labor mobility and opportunities for nontipped employment, mitigate the racism that tipping perpetuates, mitigate the sexual harassment and sexism that tipping fosters, provide more stable and predictable incomes for workers, and reduce opportunities for tip theft. Finally, Section IV.D acknowledges that while employers who take advantage of the 45B credit while also paying subminimum wages or imposing tip pools will face transitional harm due to this proposal, that harm will likely be offset by recent growth in restaurant profits, by the slashing of the corporate tax rate in the Tax Cuts and Jobs Act (the “TCJA”), by expansions of Sections 199A and 168(k), and by other employer-friendly perks in the One Big Beautiful Bill (the “OB BB”).

7. Ira K. Lindsay, *Tax Fairness by Convention: A Defense of Horizontal Equity*, 19 FLA. TAX REV. 79, 80-81 (2016) (“Horizontal equity is the principle that taxpayers who are positioned identically relative to the tax base should pay equal tax.”). When this Article aims for horizontal equity between employers, it aims to impose similar tax burdens on employers who pay similar wages and receive similar profits.

I. TIPPING AND ITS TAX TREATMENT

Thirty-eight-billion dollars of tips were reported on 6 million federal income tax returns in 2018 alone, the most recent year for which the Internal Revenue Service (the “IRS”) has released data.⁸ Tips are common in many industries—from restaurants to hotels to nail salons.⁹ However, they are by far most common in restaurants.¹⁰ More than 14 million American workers¹¹—10% of the U.S. workforce¹²—currently work in the restaurant industry. Restaurant workers earned \$472.4 billion in compensation in 2022.¹³ Restaurant industry sales represent 6% of the U.S. GDP.¹⁴ For many Americans, restaurants provided our first experience of what it means to work, earn compensation, and owe taxes. One in 3 adults in America had our first job in a restaurant.¹⁵

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8. BRENDAN McDERMOTT, CONG. RSCH. SERV., IF12728, TAXATION OF TIP INCOME 1 (2025), https://www.congress.gov/crs_external_products/IF/PDF/IF12728/IF12728.3.pdf [<https://perma.cc/D3QU-CKHF>].
 9. See, e.g., Michael Lynn, George M. Zinkhan & Judy Harris, *Consumer Tipping: A Cross-Country Study*, 20 J. CONSUMER RSCH. 478, 482 (1993) (estimating that over 30 service jobs including tipping).
 10. See Yoram Margalioth, *The Social Norm of Tipping, Its Correlation with Inequality, and Differences in Tax Treatment Across Countries*, 11 THEORETICAL INQUIRIES L. 561, 561–62 (2010) (“[T]ips paid to waiters in restaurants . . . are the most significant in terms of percentage of total remuneration and salience.”); George C. Banks, Haley M. Woznyj, Sven Kepes, John H. Batchelor & Michael A. McDaniel, *A Meta-Analytic Review of Tipping Compensation Practices: An Agency Theory Perspective*, 71 PERS. PSYCH. 457, 457–58 (2018) (estimating that in the restaurant industry alone, tips are close to \$50 billion annually following a 400% increase over the last 3 decades).
 11. See *Economic Contributions of the Restaurant & Foodservice Industry*, NAT’L REST. ASS’N 4 (Summer 2024), https://www.restaurant.org/getmedia/206bb262-fc48-4f00-b91b-3402ea6d97f1/usa_econ_impact_study_fs-3.pdf [<https://perma.cc/4PER-VYSW>] (“The industry had 14,168,238 employees . . . in 2022.”).
 12. *Id.* at 2.
 13. *Id.* at 4.
 14. See *id.* at 2 (“Eating and drinking places will directly contribute \$1.4T in output (or sales) to the U.S. economy in 2024 dollars, based on estimates of publicly available 2022 data. That’s roughly equivalent to 6% of real GDP.”).
 15. Sara Rush Wirth, *How Restaurants Have Taught America to Work*, REST. BUS. ONLINE (Feb. 19, 2019), <https://www.restaurantbusinessonline.com/special->

Tax on Tips

Even prior to the COVID-19 pandemic, tipping was an important source of compensation and economic activity. While their informal and variable nature makes it difficult to measure tips precisely, researchers estimate that before the pandemic, tips in the U.S. food industry were somewhere between \$30 billion¹⁶ and \$47 billion annually.¹⁷ Tips are “a major source of income for millions of workers.”¹⁸

The COVID-19 pandemic brought significant increases to the prevalence and magnitude of tips.¹⁹ Businesses increased their use of

reports/how-restaurants-have-taught-america-work
[<https://perma.cc/P6L7-QRPH>].

16. Heidi Shierholz & David Cooper, *Workers Will Lose More Than \$700 Million Annually Under Proposed DOL Rule*, ECON. POL’Y INST.: WORKING ECON. BLOG (Nov. 30, 2019, 10:14 PM), <https://www.epi.org/blog/workers-will-lose-more-than-700-million-dollars-annually-under-proposed-dol-rule/> [<https://perma.cc/ZV5U-PSVZ>] (“[W]e find that tips in full-service restaurants are \$30.5 billion, which is roughly twice the amount of tips reported in food service in the [Current Population Survey].”).
17. Ofer H. Azar, *Business Strategy and the Social Norm of Tipping*, 32 J. ECON. PSYCH. 515, 525 (2011) (“Tipping is an important economic phenomenon, involving about \$47 billion a year in the US food industry alone, and trillions of dollars across different occupations and countries over the years.”); Emek Basker, Lucia Foster & Martha Stinson, *Tip of the Iceberg: Tip Reporting at U.S. Restaurants, 2005-2018* 1 (U.S. Census Bureau, Ctr. for Econ. Stud., Working Paper No. 24-68, 2024), <https://www2.census.gov/library/working-papers/2024/adrm/ces/CES-WP-24-68.pdf> [<https://perma.cc/6T7X-M77T>] (“Tipping is ubiquitous. Nearly half of jobs at U.S. full-service restaurants reported tip earnings to the Internal Revenue Service (IRS) over the period 2005–2018. Total *reported* tips averaged \$24.2 billion per year over this period.” (emphasis added)); *see infra* notes 42-47 and accompanying text (estimating historical trends in the under-reporting of tips).
18. Azar, *supra* note 17, at 515.
19. Basker, Foster & Stinson, *supra* note 17, at 9 (“[T]he Covid-19 pandemic had a profound impact on service industries in general and [full-service] restaurants in particular, and changed the way many patrons tip.”); *see also id.* at 42-43 (“Much has happened in the [full service] restaurant industry in the years since 2018. Automation, including the use of apps and dedicated devices to view menus, order, and pay, has changed the jobs of servers at many restaurants. Many of these apps and devices include prompts to tip, often at higher rates than patrons had previously applied, and in circumstances – such as ordering take-out – in which many patrons had not previously tipped at all. In addition, apps and devices have increased tipping

tablets to prompt customers with suggested tip amounts and applications like Square and Toast to prompt tips remotely.²⁰ Perhaps more importantly, customers felt “social appreciation for ‘frontline workers’” who brought us meals.²¹ One customer recalls:

[M]any of us were lucky enough to be able to work from home and to be relatively safe. And we felt a lot of gratitude for the people who weren’t able to do that, who were bringing us food and delivering groceries. And so, there was an explosion in tipping . . . even in places where we didn’t used to tip. If you go and pick up takeout at a restaurant, you probably always tip your delivery driver. But if you went to the restaurant and you picked it up, you didn’t tip there. But now in the pandemic moment, they add a tip screen saying, would you like to tip? And yeah, of course, I’d like to tip. These people are risking their lives out there to make my chicken tikka masala.²²

These changes in tipping norms appear poised for even further change. A 2023 Pew Research Center survey finds that “[a]round seven-in-ten U.S. adults (72%) say tipping is expected in more places today than it was five years ago, a finding that tracks with anecdotal reporting and has been

outside the [full service] restaurant industry, including in fast food restaurants.”).

20. Bree Hall, *The Tipping Point: Network Effects of Tipping Quick-Service Restaurant Cashiers*, 38 NOTRE DAME J.L. ETHICS & PUB. POL’Y ONLINE SUPPLEMENT 569, 581-82 (2024) (“This change in tipping practices is ‘driven in large part by changes in technology that have enabled business owners to more easily shift the costs of compensating workers directly to customers.’ Two of the largest players in this market include Toast and Square. ‘Toast and Square are payment processing platforms for small businesses, offering a range [of] tools, including restaurant point-of-sale (POS) systems, mobile payments, online ordering, integration with delivery systems and inventory management.’”).
21. “No Tax on Tips”: *Budgetary, Distributional, and Tax Avoidance Considerations*, THE BUDGET LAB 15 (Sep. 16, 2024) [hereinafter “No Tax on Tips” *Budget Lab Report*], <https://budgetlab.yale.edu/sites/default/files/2024-09/The%20Budget%20Lab%20No%20Tax%20on%20Tips%20Report%202024.pdf> [https://perma.cc/T8JF-LTFM].
22. THE DAILY: *Why Tipping is Everywhere*, at 6:37-7:19 (N.Y. Times, Aug. 29, 2024), <https://www.nytimes.com/2024/08/29/podcasts/the-daily/tipping-trump-harris.html?showTranscript=1> [https://perma.cc/S8QC-NBUB].

dubbed ‘tipflation.’”²³ However, while recent “changes imply that tipping as a form of compensation will continue to be an important part of earnings for many workers,”²⁴ 66% of Americans now express a negative view of tipping, and many feel that tipping is “out of control.”²⁵

Americans are searching for a way to mitigate tipflation while protecting tipped workers, which helps explain the emergence of “no tax on tips” proposals and the recent adoption of a tips-received deduction.²⁶ “What’s certain is that a change in the taxation of tips would affect millions. The U.S. Bureau of Labor Statistics estimates there are 2.24 million waiters and waitresses across the country, with tips making up a large percentage of their income.”²⁷ What is not certain is whether tip tax relief would either mitigate tipflation or help tipped workers. This Article aims to carefully evaluate the recently adopted tips-received deduction and alternative “no tax on tips” proposals and, given the risks that they will encourage an even greater reliance on tips and harm the lowest-income tipped workers, proposes an alternative. It proposes that a multi-billion-dollar income tax credit currently available to the *employers* of tipped restaurant workers

23. Drew DeSilver & Jordan Lippert, *Tipping Culture in America: Public Sees a Changed Landscape*, PEW RSCH. CTR. 12 (Nov. 9, 2023), https://www.pewresearch.org/wp-content/uploads/2023/11/SR_23.11.09_tipping-culture_report.pdf [<https://perma.cc/G8CQ-BLNZ>].

24. Basker, Foster & Stinson, *supra* note 17, at 42-43.

25. Jack Kelly, *Tipflation: Americans Think Tipping Culture Is ‘Out of Control’ And Workers Should Be Paid More*, FORBES (Aug. 1, 2023, 9:06 AM), <https://www.forbes.com/sites/jackkelly/2023/08/01/tipflation-americans-think-tipping-culture-is-out-of-control-and-employees-should-be-paid-more/> [<https://perma.cc/U8FP-6Q5N>] (“A recent survey by Bankrate found that roughly 66% of Americans have a negative view of tipping. Around 30% of respondents think that tipping culture is “out of control,” with more companies encouraging customers to tip at their counters than ever before. Patrons find the pre-entered tip screens aggravating (32%) and think businesses should pay their employees more rather than rely on gratuity (41%). . . . One of the reasons why tipping has become a major topic of conversation is because of ‘tipflation’—the rapid increase in restaurants, stores, shops, supermarkets, cafes, airports and many other establishments implementing digital payment checkout systems that prompt customers to select the gratuity rate—sometimes exceeding 30%. This creates an uncomfortable interaction with a sense of pressure being exerted.”).

26. *See infra* notes 112-120 and accompanying text.

27. Freking & Boak, *supra* note 4.

should be reformed to encourage employers to relieve their employees from relying on tips.

The tips that workers receive are included in their “gross incomes” and subject to federal income taxes, just like other forms of compensation.²⁸ Provided an employee receives more than \$20 per month,²⁹ cash tips³⁰ are also included in their³¹ “wages” and subject to Federal Insurance Contributions Act (“FICA”) taxes (otherwise known as payroll taxes). Employees pay FICA taxes of 7.65%³² on their tips and other wages. In addition,³³ employers pay 7.65% employer-side FICA taxes on their employees’ tips and other wages.³⁴

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28. I.R.C. § 61(a)(1) (2024). Tips are unusual in that I.R.C. § 6053 (2024) authorizes the IRS to tax imputed tips of at least 7% when the tips reported by a workplace are unrealistically low. “If total tips actually reported by all of the tipped employees in a restaurant did not equal or exceed seven percent, the deficiency would be allocated among the tipped workers and reported to the IRS.” Joel Newman, *Waiter, There’s an IRS Agent in My Soup*, 40 TAX NOTES 861, 864 (1988). However, “[S]ection 6053 is no longer significant because in 2018, only 81,000 of the 6.1 million employees (1.3 percent) reporting tipped income reported any allocable tips. The \$170 million in total allocable tips pales in comparison with \$38.3 billion in reported tips.” Martin A. Sullivan, *What Happens After You Leave a Tip on the Table?*, 184 TAX NOTES FED. 1211, 1218 (2024). Thus, this Article will not address the minor impact of I.R.C. § 6053.
 29. See I.R.C. § 3121(a)(12)(B) (2024) (excluding from wages “cash tips received by an employee in any calendar month in the course of his employment by an employer unless the amount of such cash tips is \$20 or more”).
 30. See I.R.C. § 3121(a)(12)(A) (excluding from wages “tips paid in any medium other than cash”).
 31. This Author embraces the singular use of they/them/theirs.
 32. *Understanding Employment Taxes*, IRS, <https://www.irs.gov/businesses/small-businesses-self-employed/understanding-employment-taxes> [<https://perma.cc/7VVV-MAPT>] (“Employers generally must withhold Social Security and Medicare taxes from employees’ wages and pay the employer share of these taxes. Social security and Medicare taxes have different rates and only the Social Security tax has a wage base limit.”); *Contribution and Benefit Base*, SOC. SEC., <https://www.ssa.gov/oact/cola/cbb.html> [<https://perma.cc/HS55-5ES4>] (noting that employers and employees *each* pay 6.2% of wages towards Social Security up to the wage base limit, which for 2025 is \$176,100 plus 1.45% towards Medicare.).
 33. While the combined FICA tax rate is 15.3% (including 6.2% + 1.45% employee-side tax plus 6.2% + 1.45% employer-side tax), it might be more accurate to view the combined FICA tax rate as 14.2%. See Daniel N. Shaviro,

Tax on Tips

The IRS distinguishes tips, which are excluded from federal *payroll* taxes to the extent that an employee receives noncash tips or receives tips less than \$20 per month, from service charges, which are entirely “wages” subject to payroll taxes. Tips fall within the discretion and control of the customer, while service charges fall within the discretion and control of the employer. Revenue Ruling 59-252 provides:

To constitute a “tip” [i]t must be presented by the customer free from compulsion; he must have the unrestricted right to determine the amount thereof; and such amount should not be the subject of negotiation or dictated by employer policy. Generally, ***the customer has the right to determine precisely who shall be the recipient of his generosity.*** The absence of any of these factors creates a serious doubt as to whether the payment is really a tip and indicates that it is in fact a service charge for the use of certain facilities.³⁵

Thus, when restaurants or hotels specify “additional amounts to be paid by the customer . . . for distribution to employees of the [restaurant or] hotel, then such amounts may not be treated as tips or gratuities but will be considered as service charges which constitute wages for purposes of” federal payroll taxes.³⁶ Revenue Ruling 2012-18 specifies that the employer’s characterization of a payment is not determinative: “[T]he absence of any of the”³⁷ factors listed above in Revenue Ruling 59-252

Effective Marginal Tax Rates on Low-Income Households, EMP. POL’YS INST. 10 (Feb. 1999), https://epionline.org/wp-content/uploads/2025/03/shaviro_02-1999.pdf [<https://perma.cc/QPX5-Q69S>] (noting that because the employer-side FICA tax is excluded from the wage base, the combined FICA rate is lower than it would be if it was imposed on a tax-inclusive wage base).

34. See I.R.C. § 3121(q) (“[T]ips received by an employee in the course of his employment shall be considered remuneration for such employment (and *deemed to have been paid by the employer* for purposes of subsections (a) [imposing a 6.2% payroll tax for Social Security] and (b) [imposing a 1.45% payroll tax for Medicare] of section 3111.” (emphasis added)). However, see *infra* notes 187-195 and associated text for a description of the Section 45B credit, which effectively reimburses employers for the employer-side FICA taxes that employers pay on their employees’ tips and other wages.
35. Rev. Rul. 59-252, 1959-2 C.B. 215 (emphasis added).
36. *Id.* at 216.
37. Rev. Rul. 2012-18, 2012-26 I.R.B. 1032.

“creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge.”³⁸ Likewise, “automatic gratuities” imposed by restaurants or hotels, like service charges, are fully included in the wages that are subject to payroll taxes.³⁹

While tax law has long subjected tips to federal income and payroll taxes,⁴⁰ tipped employees failed to report tips until recently. Thus, tipped employees have—for practical purposes—experienced a recent and significant increase in both federal income taxes and payroll taxes as their *reporting* of tips increased.⁴¹ Whereas tipped employees only reported an estimated 16% of their tips in 1981 (implying failure to report 84% of tips at that time for a tax gap of \$2.3 billion in 1981),⁴² increased tip tax

38. *Id.*

39. Memorandum from Shenita Hicks, Director, Examination, SB/SE Small Bus./Self-Employed Div., IRS, SBSE-04-0612-057, Interim Guidance on Tips vs. Service Charges (June 7, 2012), <https://www.irs.gov/pub/foia/ig/spder/sbse-04-0612-057.pdf> [<https://perma.cc/MF9V-WXE7>].

40. *See* *Bubble Room, Inc. v. United States*, 159 F.3d 553, 557 (Fed. Cir. 1998) (explaining that as of 1965, employers have been liable for FICA taxes on tips and employees’ Social Security benefits have been calculated with tips included; as of 1977, employers have been liable for FICA taxes on tips received by their employees up to the amount of the federal minimum wage; and as of 1987, employers have been liable for FICA taxes on tips received by their employees within the so-called “wages band” above \$20 per month and below the FICA contribution base (which for 2025, is \$176,100)). As to the 1987 expansion of employer liability for FICA taxes on tips, a Senate Committee on Finance report explained that the expansion aimed to increase horizontal equity between employers of tipped workers and employers of nontipped workers, a goal that was later undermined by the adoption of the Section 45B tax credit. *See id.* at 564 (“The bill which contained the 1987 version of § 3121(q) was accompanied by a Report of the Senate Committee on Finance . . . [which explained that] current law in effect provides a benefit to employers whose employees receive part of their compensation in the form of tips, as compared to other employees who receive all their compensation as salaries. It is believed that to apportion the costs of Social Security benefits more accurately, employers should be subject to tax on all tips which are credited for benefit purposes.”).

41. Notably, the Section 45B credit gave employers a dollar-for-dollar income tax credit for their concomitant increase in payroll taxes due to higher tip reporting.

42. Lawrence A. Zelenak, *Why Nix a Tip Tax Now?*, TAX NOTES (Oct. 8, 2024), <https://www.taxnotes.com/featured-analysis/why-nix-tip-tax-now/2024/10/07/7lsvb> [<https://perma.cc/LVU8-PGGB>]. Unreported tips

Tax on Tips

collection tools ended a history in which “tips had been [made] de facto tax exempt, or nearly so”⁴³ and caused tipped employees to report an estimated 48% of their tips in 2006.⁴⁴ While that increase in reporting still implies a failure to report 52% of tips in 2006 for a tax gap of \$23 billion,⁴⁵ Lawrence A. Zelenak demonstrates that diners’ declining use of cash further increased tip-reporting compliance.⁴⁶ He speculates that the recent “no tax on tips” movement was historically unnecessary because, until recently, tipped workers could avoid tax by underreporting their tipped income:

The obvious explanation for the absence of an organized movement to exempt tips before 1982 is that the de facto tax exemption of 84 percent of tip income was good enough. And for several decades after 1982, the surviving de facto exemption for about half of tipped income was still pretty good More recently, however, the ever-dwindling significance of cash as a method of payment for restaurant meals may have increased the tip compliance rate to somewhere in the neighborhood of 80 to 90 percent.⁴⁷

cause both a federal income tax gap and a federal payroll tax gap. *See, e.g., The Supreme Court 2001 Term—Leading Cases*, 116 HARV. L. REV. 200, 432 (2001) (“In 1982, the FICA tax gap due to unreported tip income was estimated at close to twenty billion dollars.”).

43. Zelenak, *supra* note 42.

44. *Id.*

45. *Id.*

46. *See id.* (citing data that only 19% of dine-in customers prefer to pay in “cash, compared with 36 percent preferring credit cards and 39 percent preferring debit cards” and that “of total U.S. restaurant purchases of \$77.2 billion in February 2022, only \$8.3 billion (less than 11 percent) were made with cash” to support the suggestions that “[i]f tax reporting of charged (credit and debit card) tips is close to 100 percent and if something like 80 percent or 90 percent of restaurant meals are charged, then tip reporting compliance for large food and beverage establishments must also be something like 80 percent or 90 percent.”).

47. *Id.*

Tip reporting—and with it, the de facto tax rate on tip income—is likely to continue rising as computer and mobile phone apps automatically record a greater share of total tips.⁴⁸

II. HOW THE EXCLUSION OF TIPS FROM EMPLOYEES' FEDERAL TAXES FAILS TO HELP, AND CAN HARM, TIPPED WORKERS

A. More Than a Third of Tipped Workers Pay No Federal Income Taxes, Even Though Tips Are Included in Gross Income

For tipped workers, the inclusion of tips in “gross income” for federal income tax purposes is a double-edged sword. To the extent that tipped workers pay federal income taxes, the inclusion of tips *might* cause a higher tax liability. However, the Budget Lab at Yale estimates that 37% of tipped workers have insufficient income to owe federal income tax “even before accounting for tax credits.”⁴⁹ Other tipped workers have just enough income to be taxed in the lowest federal income tax brackets, meaning that the exclusion of each dollar of tipped income saves them only 10 or 12 cents.⁵⁰ More troublingly, the exclusion of tips from gross income would

48. See MCDERMOTT, *supra* note 8 (noting that despite recent increases, “tip income has a lower [federal income tax] compliance rate than other wages and salaries and is harder to detect during an audit”); Basker, Foster & Stinson, *supra* note 17, at 42-43 (“[B]ecause the apps track tips automatically, administrative records of tips are likely to continue improving.”).

49. Ernie Tedeschi, *The “No Tax on Tips Act”: Background on Tipped Workers* (June 24, 2024), BUDGET LAB YALE, <https://budgetlab.yale.edu/news/240624/no-tax-tips-act-background-tipped-workers> [<https://perma.cc/2MYB-NXHF>] (“More than a third—37 percent—of tipped workers had incomes low enough that they faced no federal income tax in 2022, even before accounting for tax credits.”).

50. See *Occupational Employment and Wages, May 2023, 35-3031 Waiters and Waitresses*, U.S. BUREAU OF LAB. STAT., DEP’T OF LAB., (Apr. 3, 2024), <https://www.bls.gov/oes/2023/may/oes353031.htm> [<https://perma.cc/QS6K-QVUL>] (estimating that waiters and waitresses in the 10th percentile wage have an hourly wage of \$8.94, thus working 2,080 hours per year would cause an annual wage of \$18,600; those in the 25th percentile wage have an hourly wage of \$11.43 (\$23,770 annually if working 2,080 hours); those in the median percentile wage have an hourly wage of \$15.36 (\$31,940 annually if working 2,080 hours); those in the 75th percentile wage have an hourly wage of \$20.00 (\$41,600 annually if working 2,080 hours); and those in the 90th percentile wage have an hourly wage of

Tax on Tips

not just fail to help many low-income tipped workers, it would harm the most disadvantaged among them.

B. The Neediest Tipped Workers Will Receive Less Generous Tax Credits If Tips Are Excluded from Federal Income Taxes

The Earned Income Tax Credit is a refundable credit aimed at low-income earners that is responsible for lifting millions of Americans out of poverty.⁵¹ “[T]he credit is now one of the federal government’s largest antipoverty programs.”⁵² Unlike the recently adopted tips-received deduction, the EITC helps the lowest-income workers who pay little-to-no federal income tax. It is a refundable credit by which the lowest-income workers receive net payments *from* the government as opposed to making payments to the federal income tax system.

\$28.89 (\$60,100 hourly if working 2,080 hours)). In 2023, the annual mean wage for waiters and waitresses is \$20,730-\$29,160 in Montana, South Dakota, Minnesota, Oklahoma, Arkansas, Louisiana, Kentucky, Mississippi, Alabama, Georgia, and South Carolina. *Id.* Since a standard deduction of \$15,750 is the *minimum* deduction any taxpayer takes, in 2025, an unmarried individual would never pay more than 10% tax if her gross income was not more than \$27,675 (reflecting \$15,750 gross income sheltered by the standard deduction + \$11,925 taxable income taxed at 10%) and never more than 12% if her gross income was not more than \$64,225 (reflecting \$15,750 gross income sheltered by the standard deduction + \$48,475 taxable income taxed at 10% or 12%). *See* I.R.C. § 63(c)(7)(A)(i) (2024) (providing a \$23,625 standard deduction for head-of-household taxpayers); I.R.C. §§ 63(c)(7)(A)(ii), (2)(A) (providing a \$15,750 standard deduction for unmarried individual taxpayers and a \$31,500 standard deduction for married taxpayers filing jointly); Rev. Proc. 2024-40, 2024-45 I.R.B. 1100 § 2.01 tbl. 1 (imposing a 10% tax on taxable income up to \$23,850 and a 12% tax on excess taxable income up to \$96,950 for married taxpayers filing jointly); *id.* at tbl. 2 (imposing a 10% tax on taxable income up to \$17,000 and a 12% tax on excess taxable income up to \$64,850 for head-of-household-taxpayers); *id.* at tbl. 3 (imposing a 10% tax on taxable income up to \$11,925 and a 12% tax on excess taxable income up to \$48,475 for married taxpayers filing jointly).

51. *See* David Park, *The Earned Income Tax Credit: An Underutilized Tool to Fight Poverty*, NAT’L LEAGUE OF CITIES (Jan. 26, 2024), https://www.nlc.org/article/2024/01/26/the-earned-income-tax-credit-an-underutilized-tool-to-fight-poverty/#_edn1 [<https://perma.cc/M973-JN93>].
52. MARGOT L. CRANDALL-HOLLOCK, CONG. RSCH. SERV., R44825, THE EARNED INCOME TAX CREDIT (EITC): A BRIEF LEGISLATIVE HISTORY 1 (2018).

Passed in the 1970s, the EITC was initially named the “work bonus” plan because it aimed to encourage participation in the paid labor force.⁵³ Policymakers structured the benefit to ensure that “the more [a taxpayer] works the more [that taxpayer] gets.”⁵⁴ Legislative history indicates that these policymakers believed that the “EITC’s prime objective should be ‘to assist in encouraging people to obtain employment, reducing the unemployment rate, and reducing the welfare rolls.’”⁵⁵ The EITC’s antipoverty goal came second to incentivizing paid work:

Over time, policymakers began to turn to the EITC as a tool to achieve another goal: poverty reduction. . . . Unlike other policies targeted to low-income workers, like the minimum wage, the EITC was viewed by some as better targeted to the working poor with children. In addition, unlike creating a new means-tested benefit program, the EITC was administered by the IRS. This may have appealed to some policymakers who did not wish to create additional bureaucracy when administering poverty programs.⁵⁶

The work-incentivizing and antipoverty goals of the EITC continue to coexist in complicated ways.

For the lowest-income workers, the inclusion of tips in gross income⁵⁷ is beneficial because the EITC is “an amount equal to the credit percentage of so much of the taxpayer’s *earned income* for the taxable year as does not exceed the earned income amount.”⁵⁸ Thus, the lowest-income workers are in a “phase-in range,” where each additional dollar of earned income receives a matching credit at the credit percentage. For each dollar of tip income that is included in their earned income, they receive a larger credit. The “phase-in range” occurs all the way up to an “earned income amount,” which for 2025 is \$8,490 for claimants with no qualifying children, \$12,730 for claimants with 1 qualifying child, and \$17,880 for claimants

53. See *id.* at 2 (“Senator Long proposed a ‘work bonus’ plan that would supplement the wages of poor workers.”).

54. 118 CONG. REC. 33011 (1972) (statement of Sen. Russell Long, Chairman of the Senate Finance Committee).

55. CRANDALL-HOLLICK, *supra* note 52, at 4 (quoting S. REP. NO. 94-36, at 33 (1975)).

56. *Id.* at 5.

57. See I.R.C. § 32(c)(2)(A)(i) (2024) (currently including tips in “earned income” for purposes of the EITC).

58. I.R.C. § 32(a) (emphasis added).

Tax on Tips

with 2 or more qualifying children.⁵⁹ Unfortunately, EITC recipients were already harmed when the Tax Cuts and Jobs Act permanently adopted a measure of inflation adjusting that tends to result in lower estimates of inflation.⁶⁰ Thus, while the benefits offered by the EITC will become more generous due to inflation adjusting, they will do so at a slower rate than previous law provided.⁶¹

Excluding tips from the earned incomes of EITC recipients in the phase-in range would make their refundable credits stingier. This harm can be seen by returning to the example of Carol, a 38-year-old single parent to an 18-year-old child who earns \$15,080 annually,⁶² including \$4,430.40 in direct wages⁶³ and \$10,649.60 in tips. In 2024, Carol's earnings of \$15,080 made her eligible for an EITC of \$4,213.⁶⁴ If tips were excluded from Carol's income, then her EITC would be slashed to \$1,505.⁶⁵

For workers who earn incomes within the EITC's plateau, the inclusion of tips in gross income is likely to have little or no impact on the amount of

59. See I.R.C. § 32(b)(2)(A) (providing non-inflation-adjusted earned income amounts depending on the taxpayer's number of qualifying children); Rev. Proc. 2024-40, 2024-45 I.R.B. 1100 § 2.06(1) (adjusting the earned income amounts for tax year 2025 for inflation).

60. See Robert McClelland, *Adjusting the Individual Income Tax for Inflation*, TAX POL'Y CTR., URBAN INST. & BROOKINGS INST. 1 (Feb. 16, 2023) (explaining that prior to 2017, tax law computed inflation adjustments according to the Consumer Price Index, which some lawmakers believed overestimated inflation and enabled "excessive increases in tax deductions and credits" but that "[i]n 2017, the Tax Cuts and Jobs Act mandated the use of a so-called chained index that typically, but not always, indicates less inflation").

61. *Id.*

62. Annual earnings of \$15,080 reflect 2,080 hours for full-time work multiplied by \$7.25 hourly federal minimum wage.

63. Annual direct pay of \$4,430.40 reflects 2,080 hours for full-time work multiplied by \$2.13 hourly subminimum wage.

64. See *Use the EITC Assistant*, IRC, <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/use-the-eitc-assistant> [<https://perma.cc/B49D-S2PN>] (calculating EITC where taxpayer is a head of household between 25 and 64 years old with \$15,080 adjusted gross income ("AGI"), and the child is 18 years old or younger).

65. *Id.* (calculating EITC where taxpayer is a head of household between 25 and 64 years old with \$4,430.40 AGI, and the child is 18 years old or younger).

their credit.⁶⁶ For workers who earn incomes in the EITC's phaseout range, the inclusion of tips in gross income causes a quicker, costlier phaseout.⁶⁷ Finally, for taxpayers who are above the phaseout range even if tips are not included in their earned incomes, no EITC is available.

In sum, the current inclusion of tips in "gross income" for federal income tax purposes is associated with an inclusion of tips in "earned income" for EITC purposes, which helps the lowest-income tipped workers earn more generous refundable credits. In contrast, excluding or deducting tips from gross income threatens to harm those same workers.⁶⁸

C. Tipped Workers Will Receive Less Generous Social Security and Medicare Benefits If Tips Are Excluded from Federal Payroll Taxes

Similarly, for tipped workers, the inclusion of tips in "wages" for federal payroll tax purposes is also a double-edged sword. It causes them to pay 7.65% payroll taxes on higher wages, but it makes them eligible for more generous Social Security benefits during retirement and increases

66. CRANDALL-HOLICK, *supra* note 52, at 12 ("When earnings are between the 'earned income amount' and the 'phaseout threshold'—referred to as the 'plateau'—the credit amount remains constant at its maximum level."). For married taxpayers filing jointly in 2025, the plateau occurs from \$8,490 to \$17,730 for claimants with no qualifying children (who receive the maximum credit of \$649); from \$12,730 to \$30,470 for claimants with one qualifying child (who receive the maximum credit of \$4,328); and from \$17,880 to \$30,470 for claimants with 2 or more qualifying children (who receive maximum credits of \$7,152 if they have 2 qualifying children or \$8,046 if they have 3 or more qualifying children). Rev. Proc. 24-40, 2024-45 I.R.B. 1100 § 2.06(1) (adjusting the threshold phaseout amounts for tax year 2025 for inflation).

67. Rev. Proc. 24-40, 2024-45 I.R.B. 1100 § 2.06(1) (adjusting the 2025 EITC phaseout range for inflation such that for married taxpayers filing jointly in 2025, the phaseout range occurs from \$17,730 to \$26,214 for claimants with no qualifying children, from \$30,470 to \$57,554 for claimants with 1 qualifying child, from \$30,470 to \$64,430 for claimants with 2 qualifying children, and from \$30,470 to \$68,675 for claimants with 3 or more qualifying children).

68. Similar harms occur when calculating the refundable portion of the child tax credit. *See, e.g.,* McDERMOTT, *supra* note 8 ("Tips that are part of a taxpayer's gross income are considered earned income. Earned income is important for calculating the earned income tax credit (EITC) and the refundable portion of the child tax credit, known as the additional child tax credit (ACTC).").

the likelihood that they will be eligible for Social Security Disability Insurance (“SSDI”).

Social Security benefits are “earned” based on the recipient’s wage history.⁶⁹ The Social Security Administration calculates retirement benefits based on “the average of the highest 35 years of earnings, wage-indexed to the year before retirement.”⁷⁰ Excluding tips from earnings for payroll tax purposes would thus also remove them from a worker’s earnings history. Those lower reported earnings would generate lower Social Security benefits for tipped workers. Unfortunately, Social Security benefits are more important for tipped workers than nontipped workers. The replacement rate is higher for lower earners, meaning that Social Security benefits replace a larger percentage of the preretirement income of tipped workers, who tend to earn lower incomes,⁷¹ while replacing a smaller

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69. BARRY F. HUSTON, SARAH A. DONOVAN & ANTHONY A. CILLUFFO, CONG. RSCH. SERV., R47087, SOCIAL SECURITY BENEFIT FORMULA AND PAYROLL TAXES: POTENTIAL IMPACTS OF POLICY CHANGES ON SELECTED WORKER GROUPS 3 (2022) (“The first step of computing a Social Security benefit is determining a worker’s *average indexed monthly earnings* (AIME), a measure of a worker’s career-average covered earnings [T]he AIME computation process first updates past covered earnings by indexing them to near-current wage levels to account for the growth in overall economy-wide earnings For retired workers, the AIME equals the average of the highest 35 years of indexed earnings divided by 12.”). For an argument that “recommends unbundling the benefit side of social security from its longstanding payroll tax funding mechanism,” see Henry Ordower, *Unbundling Social Security from the Payroll Tax*, 27 FLA. TAX REV. 269 (2023).
70. OFF. OF THE CHIEF ACTUARY, SOC. SEC. ADMIN., ACTUARIAL NOTE 2024.9, REPLACEMENT RATES FOR HYPOTHETICAL RETIRED WORKERS 1 (2024), <https://www.ssa.gov/OACT/NOTES/ran9/an2024-9.pdf> [<https://perma.cc/PU2D-8VW6>].
71. Hall, *supra* note 20, at 573 (“‘The typical restaurant worker in the United States earns approximately \$15,000 per year, or one-third of what the average American worker earns.’ In particular, tipped restaurant workers ‘live in poverty at nearly three times the rate of the total employed [United States] population.’ Additionally, women’s wages are concentrated in the bottom of the restaurant industry with approximately two-thirds of women in this sector earning the subminimum wage. In 2016, roughly one-and-a-half million American employees had wages below the federal minimum. In the same year, two-thirds of workers earning minimum wage or below were employed in food preparation and serving related jobs.”) (quoting *Working Below the Line: How the Subminimum Wage for Tipped Restaurant Workers Violates International Human Rights Standards*, FOOD RSCH. CTR., INT’L HUM. RTS. L. CLINIC & REST. OPPORTUNITIES CTRS. UNITED 14 (2015), [19](https://www.law.</p></div><div data-bbox=)

percentage of the preretirement income of nontipped workers.⁷² For many participants, Social Security is an especially cost-effective way of saving for retirement⁷³ that avoids the risk of defined contribution plans—that retirement funding might run out.⁷⁴ This makes Social Security particularly

berkeley.edu/wp-content/uploads/2015/04/WorkingBelowTheLine_FULL-LR-2.01PM-151207.pdf [https://perma.cc/44MW-7XPK]).

72. HUSTON, DONOVAN & CILLUFFO, *supra* note 69, at 4 (“The replacement rate is higher for relatively low earners (e.g., 83% for very low earners) than for relatively high earners (i.e., 37% for high earners). The formula also results in *individual equity*: The more a worker earns (and pays in payroll tax), up to the taxable maximum, the higher the [primary insurance amount].”).
73. *Uncharted Waters: Paying Benefits from Individual Accounts in Federal Retirement Policy, Study Panel Final Report*, NAT’L ACAD. OF SOC. INS. 3 (Jan. 2005), www.nasi.org/wp-content/uploads/2010/07/Uncharted_Waters_Report.pdf [https://perma.cc/45W9-N4DD] (arguing that Social Security “emerges, in part, as a response to market failure in private insurance” and “build[s] on the notion that a competitive economy sometimes fails to provide for all individuals, exposing them to risks outside their control and not commonly insured by the private market. Some workers earn low wages over their entire work careers and cannot save adequately for retirement, while others face circumstances that significantly derail their ability to save. A prolonged period of involuntary unemployment, sickness, or incapacity can deplete whatever savings have been set aside for the future. Social insurance, through universal participation, pools risks broadly to provide a basic level of economic security to all.”); *see also id.* at 4 (“Social Security pays relatively more for a given level of earnings and contributions to: (a) low earners, whose monthly benefits replace a larger share of past earnings; (b) some widowed and divorced spouses, who receive benefits without paying additional contributions; (c) disabled workers and young families of deceased workers, who have disability and survivor protection against these risks; (d) larger families, because additional benefits are paid for children without requiring additional contributions; and (e) people who live a long time into advanced old age, who benefit from the guarantee of inflation-indexed benefits that last for life.”).
74. Jeffrey R. Brown & Mark J. Warshawsky, *Longevity-Insured Retirement Distributions from Pension Plans: Market and Regulatory Issues* 1 (Nat’l Bureau of Econ. Rsch., Working Paper No. 8064, 2001), https://www.nber.org/system/files/working_papers/w8064/w8064.pdf [https://perma.cc/6LKX-K4XB] (“While defined benefit (DB) and defined contribution (DC) plans differ along many margins, one of the most important differences is the method of distributing retirement income. Traditional DB plans typically paid benefits in the form of a life annuity and thus provided retirees with a form of insurance against outliving their

important for tipped workers, who tend to lack access to employer-subsidized, or even employer-sponsored, retirement plans.⁷⁵

If tips were excluded from wages for payroll tax purposes, tipped workers' lost benefits after retirement would likely also be significant. "Social Security remains the foundation of retirement income. It is the largest single source of income for older adults, providing the majority of income for half of retirees and at least 90 percent of income for 18 percent of retirees."⁷⁶ Social Security and Supplemental Security Income "accounted for almost 90% of total money income received by the aged population whose incomes were below the poverty thresholds in 2021."⁷⁷ By boosting the typically modest incomes of people aged 65 and older, Social Security is estimated to help "lift 16.5 million older adults [and 900,000 children] above the poverty line"⁷⁸ It increases household income for the 5.7 million children who live in families that receive Social Security benefits.⁷⁹ As the Center on Budget and Policy Priorities explains:

Social Security is especially important for women and people of color. Women tend to earn less than men, take more time out of the paid workforce, live longer, accumulate less savings, and receive smaller pensions. Social Security brings 9.4 million older women above the poverty line Black and Latino workers benefit substantially from Social Security because they have higher

resources. According to standard economic life-cycle theory, this longevity insurance is quite valuable to consumers, as it provides a higher sustainable level of consumption than is available in the absence of this insurance. Defined contribution plans, on the other hand, are much less likely to offer life annuities to retirees. Instead, most DC plans offer some form of lump-sum payment and/or 'phased withdrawal' options upon retirement. While these alternative distribution methods offer retirees a high degree of flexibility and liquidity, they fail to provide a formal mechanism by which individuals can insure against the risk of outliving their resources").

75. See *infra* note 127 and accompanying text (observing that restaurant jobs generally come without retirement savings benefits).

76. Kathleen Romig, *Social Security Lifts More People Above the Poverty Line Than Any Other Program*, CTR. ON BUDGET & POL'Y PRIORITIES 8 (Jan. 31, 2024), www.cbpp.org/sites/default/files/atoms/files/10-25-13ss.pdf [<https://perma.cc/U2WA-R3ZR>].

77. ZHE LI & JOSEPH DALAKER, CONG. RSCH. SERV., R45791, POVERTY AMONG THE POPULATION AGED 65 AND OLDER 2 (2022).

78. Romig, *supra* note 76, at 1-2.

79. *Id.* at 2.

disability rates and lower lifetime earnings than white workers, on average. . . . Without Social Security, the poverty rate among older Latino adults would be 43 percent, and the poverty rate among older Black adults would be 47.4 percent.⁸⁰

Because excluding tips from earnings for payroll tax purposes would reduce the Social Security benefits that keep millions of older Americans out of poverty and forfeit funding to the Social Security trust fund, it would trade near-term benefits for long-term harms. Returning to the example of Carol, whose \$15,080 annual income includes \$4,430.40 in direct pay plus \$10,649.60 in tips, Social Security retirement benefits would be \$3,259 per month if tips remained included in earnings and only \$950 per month if tips were excluded.⁸¹

Excluding tips from earnings for payroll tax purposes also threatens tipped workers' eligibility for Social Security Disability Insurance (SSDI) and Medicare. To qualify for SSDI, a worker must have a qualifying disability that "significantly limit[s their] ability to do basic work-related activities, such as lifting, standing, walking, sitting, or remembering – for at least 12 months"⁸² and "must have earned the required number of work credits within a certain period ending with the time [the worker's] disability begins."⁸³ For example, a "person with a qualifying disability at age 31 or older generally needs at least 20 credits in the 10 years immediately before their disability began."⁸⁴ Work credits also determine

80. *Id.*

81. See *Benefit Calculators*, SOC. SEC. ADMIN., <https://www.ssa.gov/OACT/quickcalc/index.html> [<https://perma.cc/D3S9-L95H>] (calculating a \$3,259 monthly retirement benefit for a worker born on June 15, 1987, who earned \$15,080 annually and retired in June 2055, and a \$950 monthly retirement benefit for a worker with the same birth and retirement dates who earned \$4,430 annually). Both calculations were as of May 2, 2025, and assumed future increases in prices and earnings.

82. *Disability Benefits: How Does Someone Become Eligible?*, SOC. SEC., <https://www.ssa.gov/benefits/disability/qualify.html#anchor3> [<https://perma.cc/8CB8-3DWX>].

83. *Id.*

84. SOC. SEC. ADMIN., No. 05-10072, *HOW YOU EARN CREDITS 3* (2025), <https://www.ssa.gov/pubs/EN-05-10072.pdf> [<https://perma.cc/9MEV-34M6>].

Tax on Tips

Medicare eligibility starting at age 65⁸⁵ and determine eligibility for Social Security survivor benefits for workers' families.⁸⁶

Work credits are based on the amount of a worker's earnings. The earnings necessary to receive a credit increase each year due to inflation adjusting. For 2025, a worker earns 1 credit for each \$1,810 of earnings, up to a 4-credit-per-year maximum.⁸⁷ Thus, if excluding tips from wages caused a tipped worker to receive less than \$7,240 earnings in 2025 (reflecting \$1,810 per credit multiplied by 4-credit-per-year maximum), that exclusion would make it more difficult to qualify for SSDI even if they had a long-term and debilitating disability. Unfortunately, the Social Security Administration estimates that "[f]or an insured worker who attains age 20 in 2022, the probability of becoming disabled between age 20 and normal retirement age is 25 percent."⁸⁸ Excluding tips from earnings could therefore significantly harm approximately 1 in 4 of tipped workers by making it more difficult for them to qualify for SSDI. For Carol, SSDI benefits would be \$922 per month if tips remained included in earnings and only \$270 per month if tips were excluded.⁸⁹

Before considering either the recently adopted tips-received deduction or alternative "no tax on tips" proposals, it is worth noting that while the exclusion of tips from payroll taxes would be necessary to provide tax relief to the more than one-third of tipped workers who do not earn

85. *Id.* at 5.

86. *See id.* at 1; *Benefit Calculators*, *supra* note 81 (calculating family maximum survivor benefits of \$1,410.70 per month for a worker born on June 15, 1987, who earned \$15,080 annually and died on February 12, 2025, and \$413.10 per month for a worker with the same birth and death dates who earned \$4,430.40 annually).

87. *See* SOC. SEC. ADMIN., *supra* note 84, at 1 ("In 2024, you receive 1 credit for each \$1,730 of earnings, up to the maximum of 4 credits per year."); SOC. SEC. ADMIN., FACT SHEET: 2025 SOCIAL SECURITY CHANGES, <https://www.ssa.gov/news/press/factsheets/colafacts2025.pdf> [<https://perma.cc/66LH-PKJ3>] (adjusting for inflation from \$1,730 in 2024 to \$1,810 in 2025).

88. OFF. OF THE CHIEF ACTUARY, SOC. SEC. ADMIN., ACTUARIAL NOTE 2022.6, DISABILITY AND DEATH PROBABILITY TABLES FOR INSURED WORKERS WHO ATTAIN AGE 20 IN 2022 1 (2022).

89. *See Benefit Calculators*, *supra* note 81 (calculating a \$922 monthly disability benefit for a worker born on June 15, 1987, who earned \$15,080 annually and became disabled on February 12, 2025, and calculating a \$270 monthly disability benefit for a worker with the same birth and disability dates, who earned \$4,430.40 annually).

enough to owe federal income taxes even before accounting for credits,⁹⁰ politically, it remains unlikely that tips will be excluded from payroll taxes.

Recent changes to tax law, including the July 4, 2025, One Big Beautiful Bill, have occurred through the budget reconciliation process.⁹¹ Through the reconciliation process, major tax law changes can be approved by a simple majority of senators.⁹² For example, the Senate approved the Tax Cuts and Jobs Act by a 51-48 margin⁹³ and the OBBB by a 51-50 margin.⁹⁴ However, tax law changes cannot be passed through the reconciliation process if they reduce funding to the Social Security Trust Fund.⁹⁵ Thus, while a simple majority of senators recently adopted OBBB's tips-received

90. See *supra* note 49 and accompanying text.

91. See Jasmine C. Lee & Sara Simon, *How Every Senator Voted on the Tax Bill*, N.Y. TIMES (Dec. 19, 2017), <https://www.nytimes.com/interactive/2017/12/19/us/politics/tax-bill-senate-live-vote.html> ("The bill was able to pass with a simple majority of votes because of a Senate mechanism known as budget reconciliation, which forced Republicans to keep the cost of the bill under \$1.5 trillion over 10 years."). But see Reuven S. Avi-Yonah & Doron Narotzki, *The Tariffs Are Coming! The Tariffs Are Coming!*, 185 TAX NOTES FED. 1991, 1998 (2024) (anticipating that the second Trump term might address taxes in a "partisan reconciliation bill and a bipartisan bill" that, for example, permanently expands the child tax credit).

92. Doug Sword, *Tax Bill Should Include Tips; SALT Solution Unclear, Scalise Says*, 185 TAX NOTES FED. 2256-57 (2024) ("Reconciliation has become the favored approach for partisan bills that affect taxes and revenues because a reconciliation bill needs only a simple majority to pass the Senate rather than the usual 60 votes Senate legislation requires to pass. The TCJA was passed in 2017 via a reconciliation bill without a single Democrat voting in favor, while the Inflation Reduction Act passed via the budget reconciliation process in 2022 without a single Republican voting in favor.").

93. Lee & Simon, *supra* note 91 (noting that all Republican senators, except John McCain, who was absent for health reasons, voted in favor of the TCJA).

94. Catie Edmondson, Carl Hulse, Michael Gold & Megan Mineiro, *After Narrow Senate Passage, Trump's Policy Bill Faces Resistance in House*, N.Y. TIMES (July 2, 2025), <https://www.nytimes.com/2025/07/01/us/politics/senate-trump-bill.html>.

95. See Sullivan, *supra* note 28, at 1213 ("Congress... could have simply exempted tips from payroll tax, but that would have reduced revenue paid into the politically sacred Social Security and Medicare trust funds. The more immediate concern was that exemption would have seriously jeopardized passage of the bill because, under the Senate's budget rules, a reconciliation bill cannot pass with 50 votes if it harms Social Security finances.").

Tax on Tips

deduction through 2028 and could, over future budget windows, exempt tips from the federal *income* tax, they cannot exempt tips from the federal *payroll* tax. Additionally, recent polling indicates that most Americans oppose cuts to Social Security.⁹⁶ Thus, even as tax relief for tipped workers is popular, it is unlikely to come in the form of a permanent income tax cut or even a temporary cut to federal payroll taxes.

D. Tip Tax Relief Could Harm Tipped Workers

On July 4, 2025, President Trump signed into law the One Big Beautiful Bill, which adopts a new federal income tax deduction for certain tips for tax years 2025 through 2028. The Senate relied on the tie-breaking vote of Vice President J.D. Vance to pass the Bill 51-50 over the opposition of Senate Republicans Susan Collins, Rand Paul, and Thom Tillis, and all Senate Democrats. By relying on the reconciliation process, the Senate passed the Bill by a simple majority, rather than the 60-vote supermajority typically required.⁹⁷

According to the One Big Beautiful Bill,⁹⁸ workers will still include tips in their gross incomes but will be eligible for an offsetting tips-received deduction of up to \$25,000⁹⁹ available to taxpayers from 2025 through 2028 regardless of whether they itemize or take the standard deduction.¹⁰⁰

96. Amanda Seitz & Hannah Fingerhut, *Most Oppose Social Security, Medicare Cuts: AP-NORC Poll*, ASSOCIATED PRESS (Apr. 7, 2023), <https://apnews.com/article/social-security-medicare-cuts-ap-poll-biden-9e7395e8efeab68063d741beac6ef24b> [<https://perma.cc/8KLE-358D>].

97. Jason Breslow & Elena Moore, *Senate GOP Passes Trump's Sweeping Policy Bill, Setting Up Decisive Vote in the House*, NPR (July 1, 2025, 2:54 PM ET), <https://www.npr.org/2025/07/01/nx-s1-5450367/senate-republicans-trump-tax-bill-medicare> [<https://perma.cc/EL8C-LA96>] (“The final vote was 51-50 with Vice President JD Vance breaking a tie. Three Republicans broke ranks and voted against the bill: Susan Collins of Maine, Thom Tillis of North Carolina and Kentucky’s Rand Paul. . . . To get the bill through, Republicans turned to a special budget tool known as reconciliation. By doing so, the party was able to sidestep a Democratic filibuster and pass the bill with a simple majority.”). The One Big Beautiful Bill Act, H.R.1, 119th Cong. (2025), became Public Law No. 119-21 on July 4, 2025.

98. One Big Beautiful Bill Act, Pub. L. No. 119-21, § 70201, 139 Stat. 72, 170 (2025). The OBBB adopts a new I.R.C. § 224 that parallels the No Tax on Tips Act, S. 4621, 118th Cong. (2024).

99. I.R.C. § 224(b)(1) (as added by One Big Beautiful Bill Act, Pub. L. No. 119-21, § 70201, 139 Stat. 72, 170 (2025)) (“[The deduction] shall not exceed

\$25,000.”). For sole proprietors, the tips-received deduction is also capped at net income from the trade or business that produced the tips, meaning that the tips-received deduction can reduce trade or business income to (but not below) zero. *See* I.R.C. § 224(c) (“In the case of qualified tips received by an individual during any taxable year in the course of a trade or business (other than the trade or business of performing services as an employee) of such individual, such qualified tips shall be taken into account under subsection (a) only to the extent that the gross income for the taxpayer from such trade or business for such taxable year (including such qualified tips) exceeds the sum of the deductions (other than the deduction allowed under this section) allocable to the trade or business in which such qualified tips are received by the individual for such taxable year.”). To avoid a double benefit according to which tips received are both fully deducted according to § 224 and deducted 20% according to § 199A of the TCJA, tips deducted under § 224 are excluded from the definition of qualified business income for purposes of § 199A. *See* One Big Beautiful Bill Act § 70201(d) (“Section 199A(c)(4) is amended by striking ‘and’ at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and inserting ‘, and’, and by adding at the end the following new subparagraph: ‘(D) any amount with respect to which a deduction is allowable to the taxpayer under section 224(a) for the taxable year.’”); *see also* I.R.C. § 199A(b)(2)(A) (2024) (providing an amount deductible that generally is “20 percent of the taxpayer’s qualified business income with respect to the qualified trade or business”).

100. The One Big Beautiful Bill Act § 70201(b) makes the deduction for tips received a below-the-line deduction available to nonitemizers as well as itemizers by subtracting it at I.R.C. § 63(b)(5) as part of the Internal Revenue Code’s § 63(b) definition of taxable income. The One Big Beautiful Bill Act § 70201(i) directs the Secretary of the Treasury to modify withholding rules such that taxpayers who are eligible for the tips-received deduction have less tax withheld throughout the year but risk facing higher year-end tax bills. The No Tax on Tips Act, S. 4621, 118th Cong. (2024) had similarly proposed to make the deduction for tips a below-the-line deduction available to nonitemizers and itemizers alike. While deductions are more commonly classified as above-the-line deductions, regular itemized deductions, or suspended miscellaneous itemized deductions, the § 224 tips-received deduction joins a growing number of below-the-line deductions available to nonitemizers as well as itemizers. *See, e.g.,* Samuel A. Donaldson, Donald B. Tobin & Rebecca N. Morrow, *Federal Income Tax: A Contemporary Approach* 217-18 (4th ed. 2024) (describing that deductions generally are of various types, including above-the-line deductions, regular itemized deductions, or miscellaneous itemized deductions, but that IRC § 63(d) references a list of deductions (at § 63(b)(1)-(7)) that are none of these types). Thus, its treatment is similar to the § 199A deduction for 20% of certain qualified business income of noncorporate businesses. *Qualified*

Tax on Tips

This deduction, which is newly codified as § 224 of the Internal Revenue Code, will shelter qualified tip income from federal income taxes, but for EITC purposes, “earned income” will still include tips. Likewise, for payroll tax (and Social Security benefits) purposes, “wages” will still include tips. Structuring the perk as a below-the-line tips-received deduction maintains current EITC and Social Security benefits for the lowest-income tipped workers. However, it results in no tax savings for the many tipped workers who owe no federal income tax. It may reduce tipped workers’ *nonrefundable* tax credits.¹⁰¹ Unfortunately, it also harmfully encourages greater reliance on tip income and less reliance on fixed wages while reducing federal revenues by an estimated \$40 billion.¹⁰²

In addition to tipped workers who owe no federal income tax, the new § 224 tips-received deduction provides no tax savings to tipped workers who file and pay their federal income taxes without reporting a Social Security number.¹⁰³ The deduction will also provide no tax savings to married-filing-separately taxpayers¹⁰⁴ who are above an income phaseout range (for unmarried individuals, the tips-received deduction begins to phase out at a modified adjusted gross income¹⁰⁵ of \$150,000 (\$300,000

Income Business Deduction, IRS, <https://www.irs.gov/newsroom/qualified-business-income-deduction> [<https://perma.cc/EQ5P-QSYJ>].

101. See MCDERMOTT, *supra* note 8, at 2 (observing that tax perks that reduce a taxpayer’s income tax liability can also cause a taxpayer to “lose some or all of their benefit from nonrefundable credits, which must be claimed against positive income tax liability.”).
102. *Id.* (“The Joint Committee on Taxation estimated that the tip provision of H.R. 1 would reduce federal revenues by \$40 billion from FY 2025 to FY 2034. Most revenue effect would be concentrated in FY 2026-FY 2029, when the deduction would be in effect.”).
103. I.R.C. § 224(e)(1) (“No deduction shall be allowed under [Section 224] unless the taxpayer includes on the return of tax . . . such individual’s social security number.”). The One Big Beautiful Bill Act § 70201(c) provides that omission of a correct Social Security number may be treated as a mathematical error.
104. I.R.C. § 224(f) (stating that the Section 224 deduction shall only be available for married taxpayers if they “file a joint return for the taxable year”).
105. Modified adjusted gross income is adjusted gross income increased if the taxpayer earned certain income abroad or in Puerto Rico, Guam, American Samoa, or the Northern Mariana Islands. See I.R.C. § 224(b)(2)(B) (“[T]he term ‘modified adjusted gross income’ means the adjusted gross income of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933.”); I.R.C. § 911 (2024) (excluding certain foreign income of taxpayers living abroad); I.R.C. § 931

for married filing jointly) and is fully phased out at \$400,000 (\$550,000 for married filing jointly)).¹⁰⁶ Additionally, the deduction will provide no tax savings to taxpayers who receive in-kind tips,¹⁰⁷ who work outside of an occupation that traditionally received tips prior to 2025,¹⁰⁸ who work in a

(2024) (excluding income from sources within Guam, American Samoa, or the Northern Mariana Islands); I.R.C. § 933 (2024) (excluding income from sources within Puerto Rico).

106. I.R.C. § 224(b)(2) (stating that the \$25,000 cap on the tips-received deduction “shall be reduced . . . by \$100 for each \$1,000 by which the taxpayers’ modified adjusted gross income exceeds \$150,000 (\$300,000 in the case of a joint return)”). Thus, an unmarried individual with modified adjusted gross income below the \$150,000 threshold is eligible to deduct tips up to the full \$25,000 cap. An unmarried individual with modified adjusted gross income above \$400,000 is not eligible to deduct any tips. (The taxpayer’s \$400,000 modified adjusted gross income exceeds the \$150,000 threshold by \$250,000. The \$1,000 interval goes into that excess 250 times. We reduce the \$25,000 cap on deductible tips by \$100 for each of the 250 \$1,000 intervals in that excess, meaning that we reduce the \$25,000 cap on tax credit by \$25,000 (\$100 multiplied by 250) to \$0.) An unmarried individual with modified adjusted gross income of \$270,000 is eligible to deduct tips up to \$13,000. (The taxpayer’s \$270,000 modified adjusted gross income exceeds the \$150,000 threshold by \$120,000. The \$1,000 interval goes into that excess 120 times. We reduce the \$25,000 cap on deductible tips by \$100 for each of the 120 \$1,000 intervals in that excess, meaning that we reduce the \$25,000 cap tax credit by \$12,000 (\$100 multiplied by 120) to \$13,000.)
107. I.R.C. § 224(d)(3) restricts deductible tips to cash tips “received from customers that are paid in cash or charged and, in the case of an employee, tips received under any tip-sharing arrangement.”
108. I.R.C. § 224(d)(1) restricts deductible tips to “cash tips received by an individual in an occupation which customarily and regularly received tips on or before December 31, 2024, as provided by the Secretary.” The One Big Beautiful Bill Act directs the Secretary of the Treasury to publish a list of such customarily tipped occupations by early October 2025. *See* One Big Beautiful Bill Act § 70201(h) (directing publication of the list “[n]ot later than 90 days after the date of the enactment [July 4, 2025]”). Section 224 also authorizes the Secretary of the Treasury to add “other requirements” to the definition of deductible “qualified tips” per I.R.C. § 224(d)(2)(C) and to “prescribe such regulations or other guidance as may be necessary to prevent reclassification of income as qualified tips, including regulations or other guidance to prevent abuse of the deduction allowed by this section.” I.R.C. § 224(g).

Tax on Tips

so-called “specified service trade or business,”¹⁰⁹ or who are compensated with fixed service charges.¹¹⁰ It may unknowingly be forfeited by tipped workers who are not aware of the new deduction.

Because the § 224 tips-received deduction expires on December 31, 2028,¹¹¹ it is worthwhile to consider the alternative structures for tip tax relief that lawmakers considered prior to adopting the tips-received deduction, and to demonstrate their potential harmful effects, should they be considered and adopted in the future. Many of these alternative structures for tip tax relief would have harmed the neediest workers by reducing their EITC credits and Social Security benefits.

The Tax-Free Tips Act of 2024 sought to classify tips as gifts and to exclude them from workers’ gross incomes.¹¹² Excluding tips from “gross income” for federal income tax purposes would also have excluded tips from “earned income” for EITC purposes, harming workers in the phase-in range.¹¹³ For purposes of federal payroll taxes, “wages” would also have excluded tips.¹¹⁴ Thus, tipped workers would have paid less payroll tax but received lower Social Security and disability benefits.¹¹⁵ The federal payroll tax changes proposed by the Tax-Free Tips Act of 2024 remain

109. I.R.C. § 224(d)(2)(B) and I.R.C. § 224(d)(2) (flush language) state that a gratuity is a deductible tip only if “the trade or business in the course of which the individual receives such [tip] amount is not a specified service trade or business (as defined in section 199A(d)(2)),” which modifies § 1202(e)(3)(A) to define specified service trade or business as “any trade or business involving the performance of services in the fields of health, law . . . accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees [or owners].” I.R.C. § 224(d)(2)(B); I.R.C. § 199A(d)(2) (2024); I.R.C. § 1202(e)(3)(A) (2024).

110. Per the new § 224(d)(2)(A), a gratuity is a deductible tip only if the “amount is paid voluntarily without any consequence in the event of nonpayment, is not the subject of negotiation, and is determined by the payor.” I.R.C. § 224(d)(2)(A).

111. The One Big Beautiful Bill Act § 70201(a) adopts a new § 224 that per § 224(h) expires on December 31, 2028. One Big Beautiful Bill Act § 70201(a); I.R.C. § 224(h).

112. *See* H.R. 8785, 118th Cong. (2d Sess. 2024).

113. *See supra* notes 64-68 and accompanying text.

114. H.R. 8785, 118th Cong. (2d Sess. 2024).

115. *See supra* notes 81, 89, and accompanying text.

unlikely to pass because changes to Social Security cannot be made through the reconciliation process and require a 60-vote supermajority.¹¹⁶

Finally, the Tip Tax Termination Act would have allowed tipped workers to exclude up to \$20,000 in tips from “income,” “earned income,” and “wages” through the end of 2028.¹¹⁷ Because it would have reduced “wages” and thus the payroll tax base, the Tip Tax Termination Act would have required payments from the federal general fund to payroll tax-financed trust funds to replace lost revenue to Social Security and Medicare programs.¹¹⁸ Unfortunately, transferring federal general funds to make the Social Security and Medicare systems whole (potentially to qualify as a budget reconciliation bill) is not the same as ensuring that tipped workers remain eligible for the same Social Security benefits they would have received had tips been included in their wage history. To the contrary, the exclusion of tips from “wages” would have reduced tipped workers’ monthly retirement and disability benefits¹¹⁹ and reduced the survivor benefits available for their families.¹²⁰

In sum, the tips-received deduction enacted by the One Big Beautiful Bill is preferable to the alternative structures for tip tax relief that lawmakers considered in that it maintains tipped workers’ Earned Income Tax Credits, Social Security benefits, and Medicare benefits. However, it provides no tax savings to many tipped workers, encourages greater reliance on tip income and less reliance on fixed wages, and reduces federal revenues by an estimated \$40 billion.

116. *See supra* note 95.

117. H.R. 7870, 118th Cong. (2d Sess. 2024).

118. *Id.* § 2(b)(1)(B) (“There are hereby appropriated to the Federal Old-Age and Survivors Insurance Trust Fund, the Federal Disability Insurance Trust Fund, and the Federal Hospital Insurance Trust Fund amounts equivalent to the reduction in revenues to each such Trust Fund, respectively, by reason of the amendment made by subparagraph (A) (determined without regard to this subparagraph). Amounts appropriated by the preceding sentence shall be transferred from the general fund at such times and in such manner as to replicate to the extent possible the transfers which would have occurred to such Trust Fund had this section not been enacted.”).

119. *See supra* notes 81, 89, and accompanying text.

120. *See supra* note 86.

E. The Tips-Received Deduction Undermines Horizontal Equity
Between Tipped Workers and Nontipped Workers

Although the lowest-income tipped workers could be harmed by the tips-received deduction or alternative forms of tip tax relief, higher-income tipped workers likely will benefit. Thus, the “no tax on tips” debate also prompts horizontal-equity questions such as: “Why should a service worker avoid tax on tips while a [grocery clerk] earning exactly the same income must pay tax on wages?”¹²¹ Horizontal-equity concerns weigh against either an exclusion of tips from income or a tips-received deduction.¹²² However, a restaurant worker and a grocery clerk are not the same, even when their wages are. A restaurant worker receives variable income, depending on the amount of tips received, while a grocery clerk receives predictable, hourly wages. To the extent that a restaurant worker depends on tips to achieve the same wages as a grocery clerk, the restaurant worker bears risk that the grocery clerk does not.¹²³ In economics, we generally demand compensation for bearing risk (a so-called risk premium). Yet, instead of giving a risk premium to the restaurant worker or seeking to reduce the uncompensated risk that worker must bear, federal law imposes on the restaurant worker a subminimum wage of \$2.13 whereas the grocery clerk is protected by the minimum wage of \$7.25.¹²⁴ While the tips-received deduction will create additional horizontal inequities between restaurant workers and grocery

121. See, e.g., Howard Gleckman, *Untipped: Why Trump’s Tax Cut Promise Would Hurt Many Service Workers*, TAX POLICY CTR.: URBAN INST. & BROOKINGS INST. (June 17, 2024), <https://taxpolicycenter.org/taxvox/untipped-why-trumps-tax-cut-promise-would-hurt-many-service-workers> [https://perma.cc/C4UQ-ABQD] (asking: “Why should a service worker avoid tax on tips while a warehouse employee earning exactly the same income must pay tax on wages?”). To facilitate a more similar comparison, this Article will compare restaurant workers to grocery clerks and will assume that the restaurant worker receives tips while the grocery clerk does not.

122. See MCDERMOTT, *supra* note 8, at 2 (“[H]orizontal equity [is the equitable] distribution of a burden or benefit among different types of workers with the same incomes. Excluding tip income from taxation would raise after-tax incomes for some tipped workers, but not for nontipped workers with similar incomes [which creates a horizontal inequity].”).

123. See *infra* notes 284-292 and accompanying text.

124. While the proposed reform in this Article does not give a “risk premium” to tipped workers, it seeks to reduce the uncompensated risk they must bear by seeking to decrease their reliance on tips.

clerks, this Article's proposal aims to mitigate current inequities by seeking to reduce the uncompensated risk that restaurant workers currently bear.

F. While the Instinct to Improve Tipped Work Is Well-Founded, Tip Tax Relief Can Harm Workers

There is significant political and popular support to improve employment rewards for tipped workers.¹²⁵ This support is justified. Over the last several decades, tipped workers have, for practical purposes, experienced increases in the effective income tax and payroll tax burdens on tips as cash tips have become less common and credit/debit card tips have become more common.¹²⁶ Current working conditions for tipped workers tend to be poor. "[T]he bulk (80 percent) of restaurant jobs are not good jobs in terms of labor market rewards: workers are paid minimum and subminimum wages, lack schedule control (making work/family balance and opportunities to gain additional income difficult), and often come without health care and retirement savings benefits."¹²⁷ Tipped workers bear more wage risk and volatility than their peers who are compensated with hourly wages. As the next Part will demonstrate, current labor laws expose tipped workers to exploitation by allowing their employers to take tip credits against minimum wage requirements and to appropriate their tips through employer-designed tip pools.

Unfortunately, the tips-received deduction and alternative forms of tip tax relief fail to help and could hurt the lowest-income tipped workers. The tips-received deduction fails to help the more than one-third of tipped workers who currently owe no federal income tax, even before accounting for credits. Excluding tips from gross income would also reduce the refundable earned income tax credits that tipped workers in the phase-in range currently receive. Excluding tips from wages for federal payroll tax purposes would deprive tipped workers of retirement, disability, and healthcare benefits that they currently earn through Social Security and Medicare.

Finally, the tips-received deduction will create new inequities between tipped and nontipped workers. It is likely to nudge the economy in favor of tip income, encourage grocery clerks to become restaurant employees,

125. *See supra* note 6.

126. *See supra* notes 41-48 and accompanying text.

127. MARY GATTA, WAITING ON RETIREMENT: AGING AND ECONOMIC INSECURITY IN LOW-WAGE WORK 14 (2019).

Tax on Tips

shift compensation from fixed wages to variable tips, and exacerbate the unfair advantages currently provided to employers of tipped workers. These behavioral effects are likely to be significant¹²⁸ and threaten to harm the workers they purport to help.

III. TURNING THE HORIZONTAL-EQUITY FRAME ON THE EMPLOYERS OF TIPPED WORKERS

When the horizontal-equity frame is turned to *employers* of tipped workers and *employers* of nontipped workers, it becomes clear that current labor and tax laws unfairly advantage the former over the latter. Employers already have too many incentives to make their employees rely on tips. The tips-received deduction will increase those incentives, while reforms to the Section 45B federal income tax credit could offset them while encouraging reliance on fixed wage income.

Labor law rewards employers who make their workers rely on tips. Consider, for example, the employer of a restaurant worker and the employer of a grocery clerk, who each earn \$20,000 annually. While both employers receive equally valuable services, only the grocery employer directly pays for those services. In contrast, the restaurant employer need only pay the \$2.13 subminimum wage multiplied by 2,080 hours per year for full-time work, for a total of \$4,430.40 annually. The restaurant employer can rely on customer tips to cover the remaining \$15,569.60 of the restaurant worker's \$20,000 total compensation.¹²⁹ As Section III.A below will explain, this inequity is created by the so-called "tip credit" against the minimum wage. While this Author supports efforts to eliminate the "tip credit" against the minimum wage, to raise the \$2.13 federal subminimum wage that employers must directly pay tipped workers, and to raise the \$7.25 federal minimum wage more generally,¹³⁰ the focus of

128. See *infra* notes 232-241 and accompanying text.

129. Basker, Foster & Stinson, *supra* note 17, at 8 ("For employers, tips represent a means of compensating their employees that has fewer tax obligations and less risk than formal wage compensation.").

130. Many states impose state minimum wages above the federally required \$7.25 per hour, impose state subminimum wages above the federally required \$2.13 per hour, prohibit employers from taking tip credits for state minimum wage requirements, and/or impose more stringent limitations on who can count as a tipped employee. For a recent table showing the requirements in each state, see *Minimum Wages for Tipped Employees*, U.S. DEP'T LAB. (Jan. 1, 2025), <https://www.dol.gov/agencies/whd/state/minimum-wage/tipped> [<https://perma.cc/L5WU-DNEG>]. Most Americans

this Article is on tax improvements to the inequities created by minimum wage tip credits. It proposes a tax incentive for employers to pay the full \$7.25 minimum wage.

Furthermore, even if the restaurant employer does not take a tip credit for minimum wage purposes, the restaurant employer need not directly pay for each of their workers' services. To the contrary, as Section III.B below will explain, the restaurant employer can design and impose a tip pool according to which tipped workers must cross-subsidize each other's wages and even subsidize the wages of employees who do not receive direct tips.¹³¹ This is possible because, while the law generally recognizes tips as the property of the recipient, it makes broad exceptions that allow restaurant employers to appropriate one worker's tips for the purpose of paying another worker. Federal law does not limit the amount or percentage of tips that employers can appropriate for purposes of imposing a tip pool.¹³² Because employer-imposed tip pools minimize the compensation that employers pay their collective workforces, this Article proposes a tax disincentive to these tip pools.

Finally, state and local tax law rewards employers who make their workers rely on tips by excluding the tip portion of a transaction from tax. For example, a grocery employer must collect state and local *sales* taxes on the full value of any sodas or sandwiches it sells to consumers,¹³³ whereas a restaurant employer needs only to collect state and local sales taxes on the pretip portion of that value. To illustrate, it might be helpful to think of a common method that customers use to calculate tips on their restaurant bills by "doubling the tax" shown on each bill. The combined state and local sales tax on restaurant meals in New York City, for example, is 8.875% and is imposed on the cost of the meal *before any tip*. Thus, many customers double that amount to easily calculate a tip of roughly 18%.¹³⁴ While the

support raising the minimum wage. *See, e.g., Hidden Common Ground Snapshot Survey: Economic Opportunity and Inequality*, PUB. AGENDA, USA TODAY & IPSOS 1 (Sep. 24, 2020), <https://publicagenda.org/wp-content/uploads/HCG-Economic-Opportunity-Inequality.pdf> [<https://perma.cc/L5WU-DNEG>] ("Most Americans (72%) support raising the minimum wage, including most Republicans (62%), Democrats (87%) and Independents (69%).").

131. *See infra* notes 165-176 and accompanying text.

132. *See infra* notes 155-160 and accompanying text.

133. *See infra* note 135.

134. Zack Guzman, *This Simple Tipping Trick Could Save You Over \$400 a Year*, CNBC MAKE IT (Apr. 9, 2019, 5:22 PM), <https://www.cnbc.com/>

Tax on Tips

total amount spent on the meal includes an 18% tip, the state and local sales tax was imposed before that tip. In contrast, when a customer purchases a sandwich from a grocery store in New York City, the 8.875% combined sales tax is imposed on the full cost—including any portion of the cost that compensates the grocery clerks who help sandwiches reach customers.¹³⁵ It is beyond the scope of this Article to propose changes to state and local sales taxes. However, their tip-exclusive nature is another example of the incentives that employers already have to make their employees rely on tips. This Article proposes a federal income tax reform to mitigate those incentives.

A. Employers of Tipped Workers Need Not Directly Pay the Minimum Wage

Employers have an incentive to make their employees rely on tips so that they can avoid paying the full federal minimum wage. Although employers cannot lawfully take workers' tips,¹³⁶ most employers appropriate the economic benefit of those tips by taking "tip credits" against their minimum wage obligations.¹³⁷ Instead of paying their

2018/02/12/tipping-trick-could-save-you-over-400-a-year.html
[<https://perma.cc/8J26-5D9C>].

135. *Quick Reference Guide for Taxable and Exempt Property and Services, Tax Bulletin ST-740*, N.Y. STATE DEP'T OF TAX'N & FIN. (Feb. 1, 2019), https://www.tax.ny.gov/pdf/tg_bulletins/sales/b19-740s.pdf [<https://perma.cc/5DBB-AAJM>] (listing candy, bottled water, soda, alcoholic beverages, sandwiches, and heated foods as subject to New York sales tax); *Food and Food Products Sold by Food Stores and Similar Establishments, Tax Bulletin ST-283*, N.Y. STATE DEP'T OF TAX'N & FIN. (Apr. 8, 2019), https://www.tax.ny.gov/pdf/tg_bulletins/sales/b19-283s.pdf [<https://perma.cc/LL6S-JPT8>]; Yoram Margalioth, *The Case Against Tipping*, 9 U. PA. J. LAB. & EMP. L. 117, 131-32 (2006) ("If the service component is charged separately, through a tip, it does not appear in the bill, and sales tax is evaded.").
136. 29 U.S.C. § 203(m)(2)(B) (2024) ("An employer may not keep tips received by its employees for any purposes, including allowing managers or supervisors to keep any portion of employees' tips, regardless of whether or not the employer takes a tip credit.").
137. It is worth noting that generally, income tax liability does *not* depend on whether a recipient possesses the income but on whether the recipient received economic benefit from or controlled the income. *See, e.g., Comm'r v. Glenshaw Glass*, 348 U.S. 426, 431 (1955) (holding that income requires an

workers the minimum wage, these employers pay a subminimum wage and use tips to make up the difference.

The Fair Labor Standards Act (the “FLSA”), enacted in 1938, requires employers to pay their employees sufficient compensation to maintain “the minimum standard of living necessary for health, efficiency, and general well-being of workers.”¹³⁸ It also requires that employees “engaged in commerce or in the production of goods for commerce”¹³⁹ be paid a federal minimum wage. Currently, that federal minimum wage is \$7.25 per hour.¹⁴⁰

However, courts have held that the FLSA does not require employers to directly pay their workers \$7.25 per hour. Instead, if an employee directly or indirectly receives \$5 per hour in tips, then the employer can satisfy minimum wage requirements by paying only \$2.25 per hour, bringing the employee’s hourly wage to \$7.25.¹⁴¹ The employer takes a “tip credit” for the amount of tips received and pays only the remainder in direct wages. The FLSA also imposes a “subminimum wage” of \$2.13 per hour that the

accession to wealth, clearly realized, and in the taxpayer’s control); *Lucas v. Earl*, 281 U.S. 111, 114-15 (1929) (holding that income depends on control); *Old Colony Trust v. Comm’r*, 279 U.S. 716, 729 (1929) (holding that income depends on economic benefit rather than possession).

138. 29 U.S.C. § 202 (2024).

139. *Id.* § 206(a).

140. *Id.* § 206(a)(1)(C) (imposing \$7.25 minimum wage). For the states that impose state minimum wages above the federally required \$7.25 per hour, see *supra* note 130.

141. *Id.* § 203(m)(2)(A) (“In determining the wage an employer is required to pay a tipped employee, the amount paid such employee by the employee’s employer shall be an amount equal to—

(i) the cash wage paid such employee which for purposes of such determination shall be not less than the cash wage required to be paid such an employee on August 20, 1996 [\$2.13]; and

(ii) an additional amount on account of the tips received by such employee which amount is equal to the difference between the wage specified in clause (i) [\$7.25] and the wage in effect under section 206(a)(1) of this title [\$2.13].

The additional amount on account of tips may not exceed the value of the tips actually received by an employee. The preceding 2 sentences shall not apply with respect to any tipped employee unless such employee has been informed by the employer of the provisions of this subsection, and all tips received by such employee have been retained by the employee, except that this subsection shall not be construed to prohibit the pooling of tips among employees who customarily and regularly receive tips.”).

Tax on Tips

employer must directly pay, regardless of the amount of tips received by an employee.¹⁴² Thus, the maximum that an employer may take as a tip credit against the \$7.25-per-hour minimum wage is \$5.12.¹⁴³ Accordingly, for minimum wage workers, the employer need only pay less than 30% of the minimum wage and can rely on customer tips to cover more than 70% of the minimum wage. Neither the minimum wage nor the subminimum wage is inflation adjusted.¹⁴⁴ There have been no increases to the \$7.25 federal minimum wage since 2009.¹⁴⁵ The \$2.13 subminimum wage has not budged since 1991.¹⁴⁶

In sum, although federal labor law holds that employers cannot lawfully take workers' tips, it allows employers to appropriate the economic benefit of the first \$5.12 in tips per employee per hour, even in the absence of a tip pool.

142. See 29 C.F.R. § 531.59 (2025) (requiring that employers directly pay \$2.13 hourly subminimum wage). For the states that impose state subminimum wages above the federally required \$2.13 per hour, see *supra* note 130.

143. \$7.25 (federal minimum wage) - \$2.13 (federal subminimum wage) = \$5.12 (maximum federal tip credit). See 29 C.F.R. § 531.59 (authorizing tip credits). For the states that prohibit tip credits and require employers to directly pay the full minimum wage, see *supra* note 130.

144. Sylvia A. Allegretto, *Two and a Half Decades: Still Waiting for Change*, WASHINGTON CTR. FOR EQUITABLE GROWTH (Oct. 31, 2016), <https://equitablegrowth.org/two-and-a-half-decades/> [<https://perma.cc/D3WQ-2TQW>].

145. *History of Changes to the Minimum Wage Law*, U.S. DEP'T LAB., <https://www.dol.gov/agencies/whd/minimum-wage/history> [<https://perma.cc/H97F-JRJK>].

146. Allegretto, *supra* note 144, at 1, 1 n.1 ("The Minimum Wage Increase Act of 1996 froze, in perpetuity, the \$2.13 subminimum wage—thereby eliminating the original Federal Labor Standards Act statute that required the tipped minimum wage to be a certain percentage of the full minimum wage."); see also Susan N. Eisenberg & Jennifer T. Williams, *Evolution of Wage Issues in the Restaurant Industry*, 30 A.B.A. J. LAB. & EMP. L. 389, 392 (2015) ("When Congress increases the federal minimum wage, the maximum permissible tip credit also increases if the direct wage for tipped employees remains unaltered.").

B. Employers of Tipped Workers Can Require Their Workers to Cross-Subsidize Each Other

Unfortunately, the FLSA incentivizes employers to appropriate even more economic benefit from tips by imposing tip pools. By imposing a tip pool, an employer can control their employees' tips in such a way as to make even greater use of tip credits and thus minimize the total wages that they must directly pay their collective workforce. And they do. "The majority of restaurants implement both tip credits and tip-pooling arrangements."¹⁴⁷

Employers have an incentive to make their employees rely on tips because tips can be pooled in ways that minimize total compensation costs. We begin with terminology. Imagine that a customer eats at a restaurant and leaves a \$10 gratuity, either by adding it to the credit card charge or by leaving cash.¹⁴⁸ This is the "tip."¹⁴⁹ The server who receives the tip is the "initial tip recipient." An initial tip recipient might choose to pay a portion of their tips to supportive coworkers (hosts and bussers, for example).¹⁵⁰ We call this "tip sharing." Tip sharing is beyond the scope of this Article, which focuses instead on employer-designed, mandatory tip pools.

147. Eisenberg & Williams, *supra* note 146, at 394.

148. Tip jars left for multiple recipients and compulsory service charges are beyond the scope of this Article.

149. 29 C.F.R. § 531.52 (2025) ("A tip is a sum presented by a customer as a gift or gratuity in recognition of some service performed for him."). Of course, this definition does not use gift in the tax sense since while gifts are excludable from gross income of the recipient according to I.R.C. § 102(a) (2024), tips are gross income to the recipient. Tips are to be distinguished from service charges. WAGE & HOUR DIV., U.S. DEP'T OF LAB., WAGE & HOUR FIELD OPERATIONS HANDBOOK § 30d17 ("A compulsory service charge (generally noted on the menu) which is added to a customer's bill is not part of the server's . . . tip income but, rather, is included with the employer's gross receipts. Therefore, the employer has complete discretion in choosing the manner in which the compulsory service charge is used.").

150. *See, e.g.*, WAGE & HOUR DIV., U.S. DEP'T OF LAB., WAGE & HOUR FIELD OPERATIONS HANDBOOK § 30d07(g) ("The FLSA permits employers to require employees to share or "pool" their tips with other eligible employees [The Wage and Hour Division] distinguishes such arrangements from scenarios in which tipped employees voluntarily share tips with other non-managerial employees, so long as such sharing is free from coercion, outside of any formalized arrangement, and is not a condition of employment.").

Tax on Tips

Survey data indicates that customers want initial tip recipients to retain all their tips. Pew Research “prompted Americans to think of a restaurant with wait staff who work for tips and asked how those tips should be distributed.”¹⁵¹ Responses show that a “broad majority of Americans (72%) say the fairest way would be for each server to keep all of the money they receive in tips. Far fewer say the fairest way would be for tips to be pooled together and then shared among the entire staff (14%) or among all the servers (13%).”¹⁵² Yet initial tip recipients often do not retain all their tips.¹⁵³

The law authorizes employers to design and impose tip pools and to punish employees who do not contribute some—or even all—of their tips for redistribution. Although the FLSA establishes that *collectively* employees own tips received,¹⁵⁴ it unfortunately does not entitle a tipped employee to control or retain tips given to that employee.¹⁵⁵ To the contrary, employers lawfully may¹⁵⁶ (and often do)¹⁵⁷ require employees to contribute their tips to an employer-mandated tip pool. Regulations acknowledge that when an employer imposes a tip pool, “the employer redistributes the tips to the employees.”¹⁵⁸ Still, the “FLSA does not impose

151. DeSilver & Lippert, *supra* note 23, at 11.

152. *Id.*

153. *See supra* note 147 and accompanying text; *see also infra* notes 156-161 and accompanying text.

154. While 29 C.F.R. § 531.54 (2025) rightly states that an employer “may not retain any of the employees’ tips for any” purpose other than the advancement of a valid tip pool, this limitation falls far short of preventing employers from appropriating the economic benefit of tips received by their employees.

155. Eisenberg & Williams, *supra* note 146, at 391 (“In 1974, Congress clarified . . . [that] tipped employees must be allowed to retain 100% of their tips. Perhaps more importantly, Congress added language to section 203(m) carving out an exception to the general rule that employees must retain all tips by recognizing the concept of ‘tip pooling,’ allowing employees to reach an agreement for the ‘pooling of tips among employees who customarily and regularly receive tips.’”).

156. 29 U.S.C. § 203(m)(2)(A) (2024) (providing that *neither* the tip credit against minimum wage requirements nor the requirement that all tips be retained by employees shall “be construed to prohibit the pooling of tips among employees who customarily and regularly receive tips”).

157. *See supra* note 147 and accompanying text.

158. 29 C.F.R. § 531.54 (2025).

a limit on the percentage or amount of the contribution of each employee in valid mandatory tip pools.”¹⁵⁹ Other than notice to employees, the only meaningful limitation on a valid mandatory tip pool is that it can only include those “employees who customarily and regularly receive tips.”¹⁶⁰ As we will soon see, however, this group of employees is broader than it appears. “Unlike voluntary . . . arrangements, an employer can enforce mandatory tip pools and can discipline an employee who fails to share tips with a member of a mandatory pool.”¹⁶¹ Thus, employers have broad discretion to impose tip pools that serve their own interests.

Tip pools allow employers to shift tips between workers to meet the reservation wage (the lowest possible wage a worker would accept for a job) for as many workers as possible, while directly paying as little compensation as possible:

Standard economic logic dictates that employers will spread out aggregate tips over as many workers [as] they can—thereby reducing their wage obligations and effectively “capturing” tips. They will shift work from nontipped to tipped workers until the resulting average wage (combined base wage plus tips) of their tipped workers is at or just above the hourly wage these same workers could get in a nontipped job. For employers of tipped workers to get and keep the workers they need, tipped workers must earn as much as their “outside option,” since, all else being equal (i.e., assuming no important difference in nonwage compensation and working conditions), if these workers could earn more in another job, they would quit and go to that job. But for employers to keep these workers, they do not need to earn any *more* than they could earn in another job (again, assuming all else is equal), since as long as they are earning what they could

159. *Fact Sheet #15: Tipped Employees Under the Fair Labor Standards Act (FLSA)*, U.S. DEP’T LAB. [hereinafter *Fact Sheet #15*], <https://www.dol.gov/agencies/whd/fact-sheets/15-tipped-employees-flsa> [<https://perma.cc/S5VR-AMPE>]; Eisenberg & Williams, *supra* note 146, at 398 (describing that while prior to 2011, employers could only require employees to contribute up to 15% of their total tips, the Department of Labor “removed this 15% limitation in its 2011 amendments”).

160. *See supra* notes 155-156.

161. Eisenberg & Williams, *supra* note 146, at 399.

Tax on Tips

earn in another job, it would not be worth it to these workers to quit.¹⁶²

For example, imagine that 2 servers work the same 8-hour shift, their employer directly pays each server the full \$7.25 hourly minimum wage, and each server has a \$12 hourly reservation wage for the work. During the shift, Server 1 makes \$64 in tips while Server 2 makes \$16. In the absence of a tip pool, the employer would have to pay wages of \$138 or risk losing Server 2 to another job.¹⁶³ Or the employer can require all servers to pool their tips, and then pay wages of only \$112.¹⁶⁴ By denying Server 1 most of their wage surplus and requiring Server 1 to cross-subsidize Server 2's wages, the employer can retain both servers at a lower compensation cost. Tip pools redirect Server 1's surplus to meet Server 2's reservation wage. Indeed, the existence of the tip pool might even help the employer recruit new workers. Of course, the system will collapse if the tip pool reduces Server 1's wages so much that Server 1 quits. But as long as the tip pool keeps Server 1 above their reservation wage, the employer can redirect tips for the employer's own economic benefit at Server 1's expense. If Server 1 knows that neighboring

162. Shierholz & Cooper, *supra* note 16.

163. Each employee must make at least a \$12 hourly reservation wage multiplied by 8 hours, which equals a \$96 reservation wage for the shift. If Employer directly pays Server 1 the \$7.25 hourly minimum wage multiplied by 8 hours, which equals \$58, then together with Server 1's \$64 in tips, Server 1 earns \$122. By earning \$122 for the shift, Server 1 enjoys a \$26 surplus over Server 1's reservation wage of \$96. Since Server 2 makes \$16 in tips, Employer must pay Server 2 the remaining \$80 necessary to bring Server 2 up to the \$96 reservation wage for the shift or risk losing Server 2 to another prospective employer. By paying \$58 to Server 1 plus \$80 to Server 2, Employer pays a total of \$138 for the shift.

164. Each employee must make at least a \$12 hourly reservation wage multiplied by 8 hours, which equals a \$96 reservation wage for the shift. If a pool required servers to equally pool their tips, then Server 1 would contribute \$64 and Server 2 would contribute \$16. The \$80 total tips would be divided equally with each server taking \$40 in tips. Employer must then pay each server the remaining \$56 necessary to bring each server up to their \$96 reservation wage for the shift. By paying \$56 to Server 1 plus \$56 to Server 2, Employer pays a total of \$112 for the shift. While in the absence of a tip pool, Server 1 enjoyed a \$26 surplus from the shift, due to the imposition of a tip pool, neither server enjoys a surplus and Employer cuts total compensation by \$26 from \$138 to \$112.

establishments and other prospective employers also use tip pools, that knowledge will put downward pressure on Server 1's reservation wage.

Employers who do not directly pay tipped workers the full \$7.25 hourly minimum wage can use tip pools to meet minimum wage requirements for as many tipped employees as possible while keeping compensation costs as low as possible. For example, again imagine that 2 servers work the same 8-hour shift. Server 1 makes \$64 in tips while Server 2 makes \$16. To comply with federal minimum wage laws in the absence of a tip pool, their employer must pay total compensation costs of \$59.04 for the shift.¹⁶⁵ Or the employer could impose a tip pool and take tip credits against Server 2's minimum wage for tips redirected from Server 1 to Server 2 through that pool.¹⁶⁶ A pool that simply requires all servers to equally pool their tips would cut the employer's compensation costs to \$36.¹⁶⁷ While employers might pitch tip pools as ways to mitigate servers' risk, counter racial disparities, or encourage collaboration, they also serve employers' financial interests and reduce overall compensation.

Thus far, we have seen the impact of tip pools that, while harmful, are relatively restrained. In the first, the employer did not take tip credits against the minimum wage but used tip pools to meet workers' reservation wages. In the second, the employer took tip credits against the minimum wage but imposed a pool that only included workers who

165. Each employee must make at least the \$7.25 hourly minimum wage multiplied by 8 hours, which equals \$58 minimum for the shift. Server 1 makes more than that based on tips alone. Thus, Employer need only pay Server 1 the \$2.13 hourly subminimum wage multiplied by 8 hours, which equals \$17.04. Since Server 2 makes \$16 in tips, Employer must pay Server 2 the remaining \$42 necessary to bring Server 2 up to the \$58 minimum required for the shift. By paying \$17.04 to Server 1 plus \$42 to Server 2, Employer pays a total of \$59.04 for the shift.

166. 29 C.F.R. § 531.54 (2025) provides that "the amounts received and retained by each individual as his or her own are counted as his or her tips" and the employer may "take a tip credit for the amount of tips each employee ultimately receives."

167. Each employee must make at least the \$7.25 hourly minimum wage multiplied by 8 hours, which equals \$58 minimum for the shift. If a pool required all servers to equally pool their tips, then Server 1 would contribute \$64 and Server 2 would contribute \$16. The \$80 total tips would be divided equally with each server taking \$40 in tips. Employer must pay each server the remaining \$18 necessary to bring each server up to the \$58 minimum required for the shift. By paying \$18 to Server 1 plus \$18 to Server 2, Employer pays a total of \$36 for the shift.

Tax on Tips

directly receive tips from customers. Even in these restrained examples, tip pools require tipped workers to cross-subsidize each other and reduce overall compensation. Unfortunately, employers need not be so restrained with their tip pools. Employers can include workers who do not receive tips from customers in tip pools, take tip credits against the minimum wages of indirectly tipped workers, and pay even less compensation.

Unfortunately, employers can also take tip credits against minimum wage requirements even for front-of-the-house employees who do not receive tips from customers, as long as they receive tips from a tip pool.¹⁶⁸ Labor regulations provide that “both the amounts retained by the waiters and those given the busboys are considered tips of the individuals who retain them, in applying the provisions of section 3(m) and 3(t).”¹⁶⁹ FLSA § 3(t) defines a “tipped employee” as “any employee engaged in an occupation in which he customarily and regularly receives more than \$30 a month in tips.”¹⁷⁰ The \$30 per month in tips need not directly come from customers. To the contrary, FLSA § 3(m) authorizes an employer to take a tip credit for any employee on the basis of tips distributed to that employee from a valid pool.¹⁷¹ Thus, a service helper, busser, food runner, expeditor, barback, or host who exclusively receives tips distributed from a tip pool of at least \$30 per month is a “tipped employee.”¹⁷² And an

168. While taking tip credits for front-of-the-house employees who do not receive tips from customers might appear surprising, it is well-settled law. The Wage & Hour Division advises that employers can take a tip credit against the minimum wage of a barback, for example, who does not receive any tips from customers and “whose primary job duty is to support the bartender.” U.S. Dep’t of Lab., Wage & Hour Div., Opinion Letter (Jan. 15, 2009). It reasons that “the barback in this case may qualify as a tipped employee under the FLSA [even though] the only tips received by this employee are those obtained from the bartenders under” an employer-imposed tip pool because a tipped employee is one who “customarily and regularly receives more than \$30 a month in tips” even if those tips come “exclusively from” employer-designed tip pools. *Id.*

169. 29 C.F.R. § 531.54 (2025).

170. 29 U.S.C. § 203(t) (2024).

171. *See supra* note 141.

172. Eisenberg & Williams, *supra* note 146, at 397 (“Customer interaction is the cornerstone of whether an employee may participate in a tip pool. In the food services industry, courts have permitted the following employees to participate in tip pooling because they have sufficient direct customer contact: (1) wait staff, (2) counter personnel who serve customers, (3)

employer can take tip credits against the minimum wage of any “tipped employee.” Thus, taken together, labor regulations,¹⁷³ FLSA § 3(t), and FLSA § 3(m) authorize employers to convert employees who do not receive any direct tips into “tipped employees” eligible for participation in employer-designed tip pools. Provided their distributions total at least \$5.12 per hour, these employees can then be directly paid a mere \$2.13 per hour instead of \$7.25 per hour.¹⁷⁴ And so, employers do.

By imposing a tip pool that converts front-of-house employees into tipped employees, an employer can meet minimum wage requirements for more workers at the lowest possible compensation cost. Now let’s imagine that 3 servers work the same 8-hour shift and that each server’s tips average \$82. A host and busser work the same shift but do not receive tips. To comply with federal minimum wage laws in the absence of a tip pool, their employer must pay total compensation of \$167.12 for the shift.¹⁷⁵ Or the employer could impose a tip pool. A pool that requires servers to contribute a third of their tips for equal distribution between the host and busser would cut the employer’s compensation costs by about half, to \$85.20.¹⁷⁶

service helpers and bussers, (4) food runners and expeditors, (5) service bartenders, and (6) hosts.”).

173. *See supra* note 169 and accompanying text.

174. *See, e.g.,* Kilgore v. Outback Steakhouse of Fla., Inc., 160 F.3d 294, 300-02 (6th Cir. 1998) (finding that restaurant hosts can be tipped employees whom employers can pay through a combination of a subminimum wage and an employer-imposed tip pool); Marshall v. Krystal Co., 467 F. Supp. 9, 13 (E.D. Tenn. 1978) (finding that bussers can be tipped employees whom employers can pay through a combination of a subminimum wage and employer-imposed tip pool).

175. Employer must pay each server the \$2.13 hourly subminimum wage multiplied by 8 hours, which equals \$17.04 for the shift. Employer must pay the host and busser each the \$7.25 hourly minimum wage multiplied by 8 hours, which equals \$58 for the shift. By paying \$17.04 to each of 3 servers + \$58 to the host + \$58 to the busser, Employer pays total compensation of \$167.12.

176. Employer must pay each employee the \$2.13 hourly subminimum wage multiplied by 8 hours, which equals \$17.04. While each employee must make at least the \$7.25 hourly minimum wage multiplied by 8 hours, which equals \$58 for the shift, even the host and busser make slightly more than that due to distributions from the tip pool. Recall that the tip pool requires servers to contribute a third of their tips for equal distribution between the host and busser. Since 3 servers each contribute \$27.33 for a total of \$82 to a tip pool,

While the tip-pool examples above were designed to give employers significant economic benefit from tips, “standard economic logic dictates that employers”¹⁷⁷ will design their tip pools to reduce their compensation costs. In so doing, employers redirect surplus tips that workers might otherwise have enjoyed. Even if restrained in design, tip pools *generally* cause high-tipped workers to subsidize their coworkers, which economically benefits employers and depresses overall compensation. In contexts where an employer takes tip credits for participants in a tip pool, tip pooling can reduce the employer’s compensation costs for front-of-house workers to just \$2.13 per hour, provided tips are high enough and each worker’s reservation wage is satisfied.

Tip pooling threatens to depress overall compensation to restaurant workers even more during the second Trump administration. Currently, managers¹⁷⁸ cannot be included in tip pools, and back-of-house employees¹⁷⁹ can only be included if the employer directly pays all workers at least \$7.25 per hour. However, during the first Trump administration, the Department of Labor proposed a rule to allow employers who directly pay at least \$7.25 per hour to *retain* tips, announced a nonenforcement policy towards such employers, and sought to authorize the inclusion of back-of-house workers—including dishwashers and cooks—in tip pools.¹⁸⁰ News reports about the then-

the host and busser each take half (or \$41) from that tip pool. Together with the \$17.04 directly paid by Employer, the receipt of \$41 tips brings the host and busser to total wages of \$58.04. Recall that each server directly received \$82 in tips, contributed a third of their tips (\$27.33) to the tip pool, and thus retained \$54.67 in tips (\$54.67 = \$82 - \$27.33). Together with the \$17.04 directly paid by Employer, the retention of \$54.67 tips brings each server to total wages of \$71.71. By paying \$17.04 to each of 3 servers + \$17.04 to the host + \$17.04 to the busser, Employer pays total compensation of \$85.20.

177. See Shierholz & Cooper, *supra* note 16.

178. See *Fact Sheet #15*, *supra* note 159 (“An employer may not require an employee to give their tips to the employer, a supervisor, or a manager, even where a tipped employee receives at least the federal minimum wage (currently \$7.25) per hour in wages directly from the employer and the employer takes no tip credit.”).

179. *Id.* (“[A]n employer . . . may require tipped employees, such as servers, to share tips with non-tipped employees, such as dishwashers and cooks, but only if all workers receive a direct cash wage of at least the federal minimum wage [currently \$7.25].”).

180. Tip Regulations Under the Fair Labor Standards Act (FLSA), A Proposed Rule by the Wage and Hour Division, 82 Fed. Reg. 57395, 57399 (Dec. 5, 2017)

proposed rule allege that “Labor Department leadership . . . shield[ed] the public from estimates that potentially billions of dollars in gratuities could be transferred from workers to their employers.”¹⁸¹ While the proposed rule was rescinded and federal law was amended to clarify that employers cannot take their workers’ tips,¹⁸² changes during the second Trump administration might make tip pools broader, give employers more control over their workers’ tips, or once again adopt a nonenforcement policy toward employers who take their workers’ tips.¹⁸³ Any of these changes would give employers even more benefit from tips at the expense of their workers.

(“[T]he Department is proposing to rescind the parts of its [Obama-era] tip regulations that apply to employers that pay a direct cash wage of at least the full Federal minimum wage and do not take a tip credit against their minimum wage obligations. The Department also issued a nonenforcement policy on July 20, 2017, whereby WHD [the Wage & Hour Division] will *not enforce* the Department’s regulations on the *retention* of tips received by employees with respect to any employee who is paid a cash wage of not less than the full FLSA minimum wage (\$7.25) and for whom their employer does not take an FLSA section 3(m) tip credit either for 18 months or until the completion of this rulemaking, whichever comes first.” (emphasis added)); *Id.* at 57396 (explaining that the proposed “regulation would also make clear that where an employer does not claim the tip credit under section 3(m) and pays a direct wage that satisfies the FLSA’s minimum wage requirements, the treatment and disposition of tips is a matter of agreement between the employer and employees or of state law.”); Tip Regulations Under the Fair Labor Standards Act (FLSA), A Proposed Rule by the Wage and Hour Division, 84 Fed. Reg. 53956, 53957 (Oct. 8, 2019) (proposing a rule to “eliminate the regulatory restrictions on an employer’s ability to require tip pooling when it does not take a tip credit: Such employers may now implement mandatory, ‘nontraditional’ tip pools in which employees who do not customarily and regularly receive tips, such as cooks and dishwashers, may participate.”).

181. Ben Penn, *Labor Department Ditches Data on Worker Tips Retained by Businesses*, BLOOMBERG L., <https://news.bloomberglaw.com/business-and-practice/labor-dept-ditches-data-on-worker-tips-retained-by-businesses>.

182. See 29 U.S.C. § 203(m)(2)(B) (2024), which, as of 2018, provides that “[a]n employer may not keep tips received by its employees for any purposes, including allowing managers or supervisors to keep any portion of employees’ tips, regardless of whether or not the employer takes a tip credit”; and Tip Income Protection (TIP) Act of 2018, H.R. 5180, 115th Cong. (2018), which motivated the 2018 change to § 203(m)(2).

183. See *supra* note 180 (describing the Wage and Hour Division’s July 20, 2017 nonenforcement policy).

Tax on Tips

This Part turned the horizontal equity frame on employers and argued that current tax and labor law already gives employers too many incentives to make their employees rely on tips. State and local tax law encourages employers to make their workers rely on tips by excluding the tip portion of a transaction from tax.¹⁸⁴ Labor law rewards employers who make their workers rely on tips because if workers receive enough tips, employers need only pay them \$2.13 per hour. Further, if employers make their workers rely on tips, employers can control where those tips go. By redirecting tips through a tip pool, employers can ensure that tipped workers each receive their reservation wage at the lowest possible compensation cost, that tipped workers need only be paid \$2.13 per hour, and even that front-of-house workers whom customers do not tip need only be paid \$2.13 per hour. The next Part adds a multi-billion-dollar income tax credit to the list of incentives that employers currently have to make their employees rely on tips. It argues that, if our collective goal is to help tipped workers, that credit should be revised.

IV. AMENDING THE SECTION 45B CREDIT FOR EMPLOYERS OF TIPPED WORKERS OFFERS A BETTER WAY TO HELP TIPPED WORKERS

While federal payroll taxes appear to treat employers of tipped workers and employers of nontipped workers equitably, a multi-billion-dollar federal income tax credit undoes that equity and rewards restaurant employers for making their workers rely on tips. As noted above, both restaurant and grocery employers pay the employer-side federal payroll tax on total wages, including tips, at a combined 7.65% tax rate.¹⁸⁵ Thus, if a restaurant worker and a grocery clerk each earn \$20,000 annually, their employers each pay the 7.65% employer-side payroll tax rate multiplied by \$20,000, which equals \$1,530 in payroll taxes. Horizontal equity is temporarily achieved because Section 3121(q) treats tip compensation as “deemed paid” by the employer for federal payroll tax purposes.¹⁸⁶ However, the employers’ similar tax treatment is undone by the Section 45B credit, and it is to that credit that this Article proposes reform.¹⁸⁷

184. *See supra* notes 133-135 and accompanying text.

185. *See supra* notes 28-34 and accompanying text.

186. I.R.C. § 3121(q) (2024); *see also supra* note 34.

187. *See infra* Section IV.B.

A. Section 45B Is Inequitable and Dishonest

Section 45B gives a dollar-for-dollar credit against a restaurant employer's federal income tax for any so-called "excess employer social security tax" paid by the employer with respect to excess tips.¹⁸⁸ The amount of the credit equals the employer-side federal payroll tax¹⁸⁹ paid on tips to the extent that those tips cause an employee's wages to exceed \$5.15 per hour.¹⁹⁰ Tips needed to bring the employee's direct wages up to a frozen minimum wage rate are not creditable. Although the current federal minimum wage is \$7.25, Section 45B is generous to restaurant employers in that it calculates their income tax credit using a frozen \$5.15, the federal

188. I.R.C. § 45B(a) (2024). The One Big Beautiful Bill Act for the first time extends this credit to employers of tipped employees working in "(i) Barbering and hair care, (ii) Nail care, (iii) Esthetics, [and] (iv) Body and spa treatments." I.R.C. § 45B(b)(2)(B) (as amended by the One Big Beautiful Bill Act, Pub. L. No. 119-21, § 70201(e)(1)(B), 139 Stat. 72, 172 (2025)).

189. Despite the use of the term "excess employer social security tax," the amount of the § 45B credit is for both Social Security and Medicare payroll taxes paid by the employer. *See* I.R.C. § 45B(b)(1) (as amended by the One Big Beautiful Bill Act, Pub. L. No. 119-21, § 70201(e)(2), 139 Stat. 72, 172 (2025)) ("The term 'excess employer social security tax' means any tax paid by an employer under section 3111 with respect to tips received by an employee during any month, to the extent such tips— (A) are deemed to have been paid by the employer to the employee pursuant to section 3121(q) (without regard to whether such tips are reported under section 6053), and (B) exceed the amount by which the wages (excluding tips) paid by the employer to the employee during such month are less than the total amount which would be payable (with respect to such employment) at the minimum wage rate applicable to such individual under section 6(a)(1) of the Fair Labor Standards Act of 1938 (determined without regard to section 3(m) of such Act [allowing tip credits for employers who pay a subminimum wage], and in the case of food or beverage establishments, as in effect on January 1, 2007)."); I.R.C. § 3111(a)-(b) (2024) (imposing both a 6.2% Social Security Tax and a 1.45% Medicare tax).

190. *See* I.R.C. § 3111(a)-(b); JOINT COMM. ON TAX'N, JCX-20-07, TECHNICAL EXPLANATION OF THE SMALL BUSINESS AND WORK OPPORTUNITY ACT OF 2007, at 9 (2007) ("The provision provides that the amount of the tip credit is based on the amount of tips in excess of those treated as wages for purposes of the FLSA as in effect on January 1, 2007. That is, under the provision, the tip credit is determined based on a minimum wage of \$5.15 per hour. Therefore, if the amount of the minimum wage increases, the amount of the FICA tip credit will not be reduced.").

Tax on Tips

minimum wage as of January 1, 2007.¹⁹¹ For full-time work, the \$5.15 frozen minimum wage as of January 1, 2007, multiplied by 2,080 hours equals a \$10,712 frozen annual minimum wage.

Thus, following the example above, if a full-time restaurant worker earns the \$2.13 subminimum wage multiplied by 2,080 hours for a total of \$4,430.40 in direct pay plus \$15,569.60 in annual tips, for total annual compensation of \$20,000, then the first \$6,281.60 in tips will not give rise to a credit, while the excess \$9,288 in tips will give rise to a credit. Bringing the employee's \$4,430.40 direct pay up to a \$10,712 frozen annual minimum wage requires the first \$6,281.60 in tips, which is why those tips do not give rise to a credit. It is the excess \$9,288 in tips, which bring the worker's total wages from a \$10,712 frozen annual minimum wage up to \$20,000 total wages, that give rise to the Section 45B credit. Since the excess employer social security tax is at a rate of 7.65% multiplied by excess tips, which in this example are \$9,288, the restaurant employer in this example is eligible for an income tax credit of \$710.53. While the employer of the restaurant worker and grocery clerk each pay \$1,530 in payroll taxes on their employees' \$20,000 annual earnings, the restaurant employer's federal payroll tax payment is offset¹⁹² by a \$710.53 income tax credit.¹⁹³

191. See JOINT COMM. ON TAX'N, *supra* note 190 (calculating the § 45B credit on the basis of the \$5.15 federal minimum wage that was in effect on January 1, 2007); *supra* note 141 (setting a current federal minimum wage of \$7.25). Note that while restaurant employers calculate their § 45B credit on the basis of an outdated \$5.15 minimum wage (which results in a more generous credit), hair, nail, skin, and body-care employers likely now calculate their new § 45B credit on the basis of the current federal minimum wage. See also I.R.C. § 45B(b)(1)(B) (using the federal minimum wage "as in effect on January 1, 2007," to calculate the credit only for "food or beverage establishments"); *infra* note 193 (showing how the credit is more generous for restaurant employers than for hair, nail, skin, and body-care employers).

192. See Sullivan, *supra* note 28, at 1213 ("[T]he FICA tip tax credit was enacted as part of the Omnibus Reconciliation Act of 1993. It is a credit against income tax, not payroll tax. (It's not to be confused with the 'tip credit,' a term used in labor law for the amount of tips used to satisfy minimum wage requirements.) ... [Instead of exempting tips from employer-side payroll taxes], Congress provided a dollar-for-dollar business income tax credit. The FICA tip tax credit is equal to employee tips less the amount of tips (if any) needed to bring the employee's hourly compensation up to \$5.15 per hour, the federal minimum wage in 1993. If [a restaurant employer] paid [a food and beverage worker] wages of at least \$5.15 per hour, all reported tips

While the grocery worker and the restaurant worker each receive the same wage, pay the same payroll and income taxes, and are eligible for the same Social Security benefits at retirement, their employers are not taxed similarly. The restaurant employer contributes \$710.53 less to federal funds for every worker who earns \$20,000 annually, \$1,320.70 less for every worker who earns \$27,976 annually (the median wage for tipped

would be creditable, and [the restaurant employer's] net tax liability on tips would be zero.”).

193. Restaurant employers calculate their § 45B income tax credit using the \$5.15 minimum wage frozen as of January 1, 2007, which when multiplied by 2,080 hours annually for full-time work, equals \$10,712. Tips needed to bring an employee's direct wages up to the frozen minimum wage rate are not creditable. Tips that exceed that amount are creditable. Thus, a full-time employee who receives \$4,430.40 in direct pay needs the first \$6,281.60 in tips to reach the \$10,712 frozen annual minimum wage. If total compensation is \$20,000, then the excess \$9,288 in tips give rise to the credit. The income tax credit is for the “excess employer social security tax” paid by the restaurant employer, *see supra* note 188 and accompanying text, which here is the 7.65% employer-side payroll tax rate multiplied by \$9,288 excess tips, which equals \$710.53. The employer claims that credit on IRS Form 8846. *About Form 8846, Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips*, IRS, <https://www.irs.gov/forms-pubs/about-form-8846> [<https://perma.cc/M4XC-7RGE>]. Note that with the July 4, 2025, passage of the One Big Beautiful Bill Act, a less generous § 45B income tax credit was extended to hair, nail, skin, and body-care employers. *See supra* note 188. However, for these employers, the credit might be calculated using the current minimum wage of \$7.25 (rather than the January 1, 2007, minimum wage of \$5.15). *See* I.R.C. § 45B(b)(1)(B) (calculating excess based on “the minimum wage rate applicable to such individual . . . and in the case of food or beverage establishments, as in effect on January 1, 2007 . . .”). The current minimum wage of \$7.25 multiplied by 2,080 hours annually for full-time work equals \$15,080. Thus, an employer of a hair, nail, skin, or body-care tipped worker with \$20,000 total compensation might subtract \$15,080 minimum compensation to calculate \$4,920 excess tips. Thus, Section 45B might give that hair, nail, skin, or body-care employer a new income tax credit for the “excess employer social security tax” they pay, which here is the 7.65% employer-side payroll tax rate multiplied by \$4,920 excess tips, which equals \$376.38. Future guidance might reveal whether the One Big Beautiful Bill Act's revisions to Section 45B are interpreted to use a current minimum wage for employers of hair, nail, skin, or body-care tipped workers.

Tax on Tips

workers),¹⁹⁴ and \$1,475.53 less for every worker who earns \$30,000 annually.¹⁹⁵ A restaurant employer pays less tax for each worker who receives tips, even if those tips are exclusively distributions from tip pools.

The Section 45B credit is generous. The U.S. Department of the Treasury's Office of Tax Analysis estimates that from 2025 to 2034, restaurant employers who make their employees rely on tips will pay over \$22 **billion** less in federal income tax due to the Section 45B credit.¹⁹⁶ Tax advisors identify Section 45B as the National Restaurant Industry's "favorite [tax] code provision of all time."¹⁹⁷ However, other than

194. As in the prior example, a full-time employee who receives \$4,430.40 in direct pay needs the first \$6,281.60 in tips to reach the \$10,712 frozen annual minimum wage. If total compensation is \$27,976, then it exceeds the \$10,712 frozen annual minimum wage by \$17,264. The income tax credit is for the "excess employer social security tax" paid by the restaurant employer, which here is the 7.65% employer-side payroll tax rate multiplied by \$17,264 excess tips, which equals \$1,320.70. *See* McDERMOTT, *supra* note 8, at 1 (citing 2023 U.S. Census data that "[t]he estimated median weekly wage for tipped workers was \$538 (including tips)").

195. As in the prior example, a full-time employee who receives \$4,430.40 in direct pay needs the first \$6,281.60 in tips to reach the \$10,712 frozen annual minimum wage. If total compensation is \$30,000, then it exceeds the \$10,712 frozen annual minimum wage by \$19,288. The income tax credit is for the "excess employer social security tax" paid by the restaurant employer, which here is the 7.65% employer-side payroll tax rate multiplied by \$19,288 excess tips, which equals \$1,475.53.

196. *Tax Expenditures Fiscal Year 2026*, OFF. OF TAX ANALYSIS, U.S. DEP'T OF TREASURY tbl. 1 line 162 (Nov. 27, 2024), <https://home.treasury.gov/system/files/131/Tax-Expenditures-FY2026.pdf> [<https://perma.cc/65M9-8SY4>]. The Tax Expenditure budget considers the deduction for payroll taxes paid by an employer as part of a tax baseline, but considers the Section 45B credit as a tax expenditure. *See id.* ("Under the baseline tax system, employer contributions to Social Security represent labor cost and are deductible expenses. Under current law, however, certain employers are allowed a tax credit, instead of a deduction, against taxes paid on tips received from customers in connection with the providing, delivering, or serving of food or beverages for consumption. The tip credit equals the full amount of the employer's share of FICA taxes paid on the portion of tips, when added to the employee's non-tip wages, in excess of \$5.15 per hour. The credit is available only with respect to FICA taxes paid on tips.").

197. *Beware How You Report Tips Post-Covid-19, Tax Experts Say*, NAT'L REST. ASS'N (Aug. 17, 2022), <https://restaurant.org/education-and-resources/resource-library/beware-how-you-report-tips-post-covid-19-tax-experts-say/> [<https://perma.cc/X77J-9QG5>] (quoting National Restaurant Association

encouraging restaurant employers to make their employees rely on tips, it is unclear what behavior this multi-billion-dollar credit incentivizes. Nothing in Section 45B encourages restaurant employers to use their tax savings for the benefit of tipped workers, nor does it incentivize improving poor working conditions associated with the restaurant industry.¹⁹⁸ When viewed in a context in which restaurant employers also avoid collecting state and local sales taxes on the tip portion of transactions, need only pay workers a \$2.13 subminimum wage, and can impose a tip pool that minimizes total compensation costs and requires tipped workers to cross-subsidize their coworkers, the Section 45B credit is exposed as too generous. It is an aggravating factor in the disparate legal treatment of employers of tipped restaurant workers on the one hand and employers of grocery clerks and other nontipped workers on the other.¹⁹⁹

The Section 45B credit, which encourages restaurant employers to make their employees rely on tips, lacks a principled policy justification. If its goal was to provide tax relief to employers of tipped workers, then we should expect it to apply to all employers of tipped workers. It does not.²⁰⁰ Instead, the Section 45B credit singles out for preferential treatment employers of workers who receive tips “in connection with . . . [t]he providing, delivering, or serving of food or beverages,” or the providing of certain hair, nail, skin-care, or spa services.²⁰¹ Employers of tipped hotel workers, casino workers, and taxi drivers are denied the tax benefit, just like all employers who directly pay their workers’ full wages.²⁰²

presenter and tax lawyer, Michael Chittenden); *see also id.* (quoting Chittenden as saying, “I have never met an industry that hugs a provision of the Internal Revenue Code like this industry hugs § 45B.”).

198. *See GATTA, supra* note 127 and accompanying text.

199. *See supra* note 121.

200. *See infra* note 202.

201. I.R.C. § 45B(b)(2) (as amended by the One Big Beautiful Bill Act, Pub. L. No. 119-21, § 70201(e)(1), 139 Stat. 72, 172 (2025)).

202. *See Sullivan, supra* note 28, at 1214 (“The FICA tax tip credit [wa]s available only in the food and beverage industry. That doesn’t sit well with employers of tipped employees in other industries. ‘The restaurants have the credit, and so should you,’ the Professional Beauty Association [told] its members. And for many years that group . . . garnered significant bipartisan support for proposed legislation that would extend the credit to employers in the beauty services industry . . .”). On July 4, 2025, the OBBB extended a less generous credit to hair, nail, skin, and body-care employers. *See supra* note 188. Even after that extension, however, “[i]f the concern is equal treatment of all

Tax on Tips

Finally, the Section 45B credit is dishonest. It allows employers to behave as if they take no beneficial interest in their workers' tips. It would make sense for the credit to relieve restaurant employers of the burden of FICA taxes on their workers' tips if and only if tips were private transactions between customers and tip recipients, in which employers take no beneficial interest. But because tips count towards the minimum wages that employers must pay their workers, employers often capture most of the benefit of their workers' tips.²⁰³ For example, if a tipped worker receives \$6 in average hourly tips, the first \$5.12 of those tips benefit the employer alone,²⁰⁴ while only the remaining 88 cents benefit the worker. Due to minimum wage laws, tips often provide greater economic benefit to employers than workers. For employers who take tip credits to satisfy their minimum wage obligations, or even to reach a worker's reservation wage, tips are not merely transfers between customers and tip recipients.

Similarly, the Section 45B credit allows employers to behave as if they exercise no control over their workers' tips. If tips were merely private transactions between customers and tip recipients, as the credit assumes, then employers could not lawfully take tips from initial recipients and pay them out to other workers. Yet they can and do. Employers frequently impose tip pools²⁰⁵ and face no legal limitation on the percentage of tips they can redistribute through those pools.²⁰⁶ The control that employers exercise by requiring tip pooling stands in contrast to Section 45B's treatment of tips as private transactions between customers and recipients. It also stands in contrast to tax law's definition of tips, which provides that for tips, "[g]enerally, the customer has the right to determine precisely who shall be the recipient of his generosity."²⁰⁷ Most customers

tipped income, it is fair to ask why not extend it to employers of all tipped employees?" Sullivan, *supra* note 28, at 1214. Even after the OBBB, the FICA tax tip credit does "not provide tip credits to employers of casino dealers, valet parking attendants, limousine drivers, or caddies." *Id.*

203. See *supra* notes 141-147 and accompanying text; see also *infra* notes 303-304 and accompanying text.

204. See *supra* note 143 and accompanying text.

205. See *supra* note 147 and accompanying text.

206. See *supra* note 159 and accompanying text.

207. Rev. Rul. 59-252, 1959-2 C.B. 215.

disfavor pooling and instead think the initial recipient should retain all tips.²⁰⁸

The inconsistent treatment of tips as wages that are “deemed paid” by the employer²⁰⁹ on the one hand, and private transactions between customers and tip recipients on the other, undermines the integrity of tax and labor law. As Martin A. Sullivan explains:

Income in the form of tips has a sort of Jekyll and Hyde existence. The IRS strives to treat tips like wages, which employers like when minimum wage laws must be satisfied. But when it comes to fully paying the employer share of FICA taxes, the National Restaurant Association and its many supporters in Congress don’t consider tips to be like wages. You will hear arguments that tips are like gifts and are private transactions between patron and server that shouldn’t give rise to employer tax liability.²¹⁰

If the inconsistent treatment of tips only harmed federal funding, then it might raise fewer objections. Currently, we see expressions of a desire to help tipped workers,²¹¹ but not necessarily to collect more taxes. Unfortunately, the conflicting treatment of tips significantly harms tipped workers. The Section 45B credit incentivizes employers to make workers rely on tips but does nothing to encourage employers to improve working conditions. At the same time, labor law rewards employers who violate customer ideas of fairness by controlling and appropriating most of the economic benefit of their workers’ tips.

B. A Proposal to Make Section 45B More Equitable and Honest

With our attention on the Section 45B credit, we can revisit a previous thought experiment, and now ask: Why should employers who use customer tips to satisfy minimum wage requirements face a lower tax burden compared to employers who pay their workers the full wage directly?

The thesis of this Article is that the Section 45B credit is too generous to employers who, while taking the income tax credit, claim too much benefit from and exert too much control over their workers’ tips.

208. *See supra* notes 152-153 and accompanying text.

209. *See supra* note 186 and accompanying text.

210. Sullivan, *supra* note 28, at 1213.

211. *See supra* notes 1-3 and accompanying text.

Congress should revise Section 45B to allow employers to take the credit only if they: (1) directly pay all their workers the full federal minimum wage at its current \$7.25 per hour (or as it might increase in the future); and (2) allow initial recipients to retain all their tips. The Section 45B credit treats tips as “private transactions between” customers and initial recipients “that shouldn’t give rise to employer tax liability” because they do not benefit the employer.²¹² Thus, in order to be eligible for the credit, employers should be barred from appropriating the economic benefit of tips or exerting control over tips. Either behavior is inconsistent with denying responsibility for taxes on tips.

If Congress fails to limit the Section 45B credit to employers who allow their workers to enjoy the full economic benefit of their tips, then the Department of the Treasury should act. As noted above, Revenue Ruling 59-252 defines “tip” by stating that “[g]enerally, the customer has the right to determine precisely who shall be the recipient of his generosity,” and usurping the customer’s control “creates a serious doubt as to whether the payment is really a tip and indicates that it is in fact a service charge.”²¹³ This Revenue Ruling, together with data that customers prefer for initial recipients to retain all tips,²¹⁴ should be used to recharacterize transfers made through employer-imposed tip pools as service charges rather than tips. Tax law often follows the substance of a transfer over its form,²¹⁵ and the substance of these transfers is that employers—not customers—control who receives them. The Department of the Treasury should announce that, consistent with Revenue Ruling 59-252, transfers made through employer-imposed tip pools will be treated as service charges. Employers cannot take a Section 45B credit for payroll taxes paid on

212. Sullivan, *supra* note 28, at 1213.

213. *See supra* note 35 and accompanying text.

214. *See supra* notes 152-153 and accompanying text. This Author speculates that if surveyed, customers would report that they do not intend for their tips to be credited towards the tipped employee’s minimum wage. *See supra* note 130 (noting strong public support for raising the minimum wage).

215. *See* STEPHEN SCHWARZ, DANIEL J. LATHROPE & BRANT HELLWIG, FUNDAMENTALS OF BUSINESS ENTERPRISE TAXATION 43 (7th ed. 2020) (“Since the early days of the income tax . . . the courts have been willing to go beyond the formal papers and evaluate the ‘substance’ of a transaction. A familiar example is the proper classification of a business arrangement as a sale or a lease. The documents used by the taxpayer may use one label, but the courts are not inhibited from examining the arrangement and restructuring it for tax purposes to comport with economic realities.”).

service charges. Such an announcement would still allow employers to take a Section 45B credit for payroll taxes paid on tips that are, consistent with customer preference, retained by the initial recipient.

Unlike the recently adopted tips-received deduction, revising the Section 45B credit could (1) help even those tipped workers who are paid too little to owe federal income taxes, (2) reduce the incentives that employers currently have to exploit tipped workers by claiming that tips reflect “private transactions between” customers and initial recipients on the one hand, while appropriating the economic benefit of tips and exerting control over tips on the other, and (3) motivate restaurant employers to directly pay more workers the full federal minimum wage and more workers their full reservation wage. Perhaps most importantly, revising the Section 45B credit would harness the behavioral impacts of tax law—not by making tips tax advantaged, thus shifting the economy to greater reliance on risky, variable, and capricious compensation structures, but by shifting the economy to *less* reliance on tips.

Revising the Section 45B credit to incentivize restaurant employers to directly pay their workers the full federal minimum wage and to allow their workers to retain the full economic benefit of all their tips would help tipped workers by improving their working conditions and relieving some of their reliance on tips. At the same time, revising the credit likely will increase tax collections, potentially significantly,²¹⁶ by making restaurant employers retain responsibility for employer-side payroll taxes on their employees’ tips if they pay their workers subminimum wages or impose tip pools.

The increased tax collections from a revised Section 45B credit should be redirected to improve the economic lives of tipped workers in their current jobs, empower their enhanced mobility between jobs and industries, and reduce their reliance on tips. Thus, any increased tax collections from a revised Section 45B credit should be redirected to make the Earned Income Tax Credit more generous, especially for workers without children. The EITC is an especially good way to directly benefit workers because, as a refundable credit, it helps workers who are paid so little that they owe no federal income tax.²¹⁷ As noted earlier, this

216. See *Tax Expenditures Fiscal Year 2026*, *supra* note 196 (estimating that from 2025 to 2034, the Section 45B credit will save restaurant employers over \$22 billion in federal income tax).

217. See *Policy Basics: The Earned Income Tax Credit*, CTR. ON BUDGET & POL’Y PRIORITIES (Apr. 28, 2023) [hereinafter *Policy Basics*], <https://www.cbpp.org/sites/default/files/atoms/files/policybasics-eitc.pdf> [https://perma.cc/8SLW-KJFD].

describes more than one-third of restaurant workers.²¹⁸ And, the EITC does not require that workers remain reliant on tips. To the contrary, the EITC moves with workers, including from tipped to nontipped jobs, as long as they do not shift down the earnings phase-in range, and can help them transition to jobs with better working conditions. Although recipients spend the vast majority of their EITCs on basic necessities like food and housing,²¹⁹ eleven percent spend it on training or education.²²⁰ Thus, the EITC helps workers qualify for and transition to better jobs.

Unfortunately, as currently structured, the EITC provides stingy benefits for workers without children and younger workers²²¹—demographics common among restaurant workers.²²² It is so stingy, in fact, that low-paid workers without children who are at or near the poverty line owe more federal payroll taxes than they receive in EITC, thus “[l]ow-paid workers not raising children are the sole group the federal tax

218. See Tedeschi, *supra* note 49.

219. Mathieu R. Despard, Dana C. Perantie, Jane Oliphant & Michal Grinstein-Weiss, *Do EITC Recipients Use Tax Refunds to Get Ahead? New Evidence from Refund to Savings*, CTR. FOR SOC. DEV. 3 fig.4 (July 2015), https://openscholarship.wustl.edu/cgi/viewcontent.cgi?article=1589&context=cso_research [<https://perma.cc/B78D-XKWH>].

220. *Id.*

221. *Policy Basics*, *supra* note 217, at 3 (“Under current law for tax year 2023, a single adult without children or noncustodial parent working full time, year-round at the federal minimum wage will be eligible for a meager EITC — approximately \$200. (Such an individual would receive a much larger EITC — near the maximum — if they had children.)”).

222. See, e.g., Tedeschi, *supra* note 49 (“The median non-tipped worker in 2023 was 41 years old. The typical tipped worker in contrast was a full 10 years younger: 31 years old. A third of tipped workers are below 25 (versus 12 percent for non-tipped), with 13 percent being teenagers (3 percent for non-tipped).”); *Restaurant Employee Demographics*, NAT’L REST. ASS’N 5 (Apr. 2024), <https://restaurant.org/getmedia/6f8b55ed-5b3f-40f5-ad04-709ff7ff9f0f/nra-data-brief-restaurant-employee-demographics.pdf> [<https://perma.cc/8YL2-8B2C>] (“The restaurant industry employs a much higher proportion of single workers than the overall economy. 62% of restaurant and foodservice employees have never been married – compared to 35% of employees in the total U.S. employed labor force.”); *id.* at 6 (“Only 34% of restaurant and foodservice employees are the heads of their household – compared to 51% of employees in the total U.S. employed labor force.”).

system taxes into or deeper into poverty, mainly because their EITC is so low.”²²³

For one year only, in 2021, lawmakers made the EITC more generous for workers without children, including for workers ages 19 to 24.²²⁴ As a result, “over 17 million people who do important work for low pay” received temporary tax relief,²²⁵ and 200,000 fewer workers were taxed deeper into poverty.²²⁶

Any increased tax collections from reforming the Section 45B credit should be redirected to restore those EITC benefits that, in 2021, proved effective in directly helping workers in tipped and other low-paid jobs. Thus, tipped workers would not just enjoy tax relief now (even if they do not currently pay any federal income taxes); they would continue to enjoy the enhanced EITC even if they transition to a new job with a more stable income. Improving the EITC would make tipped employment more lucrative on an after-tax basis, improve alternative employment opportunities, enhance workers’ bargaining power, and facilitate labor mobility.

223. *Policy Basics*, *supra* note 217, at 3.

224. *Id.* (“For tax year 2021, the American Rescue Plan Act temporarily expanded the EITC for workers without children by raising the maximum from roughly \$540 to roughly \$1,500, and raising the income cap for these adults to qualify from about \$16,000 to at least \$21,000 (\$27,000 for married couples). The Rescue Plan also expanded the age range of eligible working adults without children to include younger adults aged 19-24 (excluding students under 24 who are attending school at least part time), and people aged 65 and older.”).

225. *Id.* (“These changes provided income support to over 17 million people who do important work for low pay. Under the Rescue Plan, the expansion of the EITC for workers not raising children was only in effect for tax year 2021. After the expansion expired, the EITC for workers not raising children returned to an extremely small credit amount — too small even to fully offset federal income and payroll taxes for workers at the federal poverty line.”).

226. *Id.* at 3-4 (“We estimate that roughly 6 million adults aged 19 and older without children (excluding full-time students under age 24) are taxed into, or deeper into, poverty under current law. For 2021, the Rescue Plan’s expanded EITC for this population was estimated to reduce the number of adults without children taxed into or deeper into poverty to roughly 200,000.”).

C. Advantages of Amending Section 45B

Now is an especially good time to make the Section 45B credit more honest and more effective at improving the working conditions of tipped restaurant workers. The recently adopted tips-received deduction has increased attention on the tax treatment of tipped work and will expire in 2028. While lawmakers might adopt tip tax relief for beyond 2028, the “complete and permanent exemption of all federal tax on tips seems unlikely” given the high revenue cost, concerns about horizontal equity between tipped and nontipped workers,²²⁷ and limitations on which tax law changes can be made through the budget reconciliation process.²²⁸ Attention on Section 45B is also high given that on July 4, 2025, the credit was extended—albeit in less generous amounts—to employers of tipped hair, nail, skin-care, and spa workers.²²⁹ Most importantly, politicians did not pitch tip tax relief as a way of helping restaurant employers but rather as a way of helping tipped workers.²³⁰ For these reasons, revising the Section 45B credit has a better chance of improving the working conditions of tipped restaurant workers than does either the tips-received deduction or alternative forms of tip tax relief.

1. Improving Horizontal Equity Between Employers and Jobs

Because many tipped workers already pay no income tax, the Yale Budget Lab predicts that “the direct effect of” a “no tax on tips” policy “on the workforce as it stands today—before accounting for behavioral changes—would be small.”²³¹ Unfortunately, that means that “[t]he larger and far more uncertain effect would stem from behavioral changes incentivized by the bill, such as substitution into tipped employment and tipped income.”²³² By subsidizing tips through tax relief, a “no tax on tips” policy would harm workers by shifting the labor market to increase reliance on tip income and decrease use of fixed wages.

A “no tax on tips” policy likely would make tips more prevalent and fixed wages less prevalent. First, industries that currently rely on fixed

227. Sullivan, *supra* note 28, at 1220.

228. See *supra* note 95 and accompanying text.

229. See *supra* note 188.

230. See *supra* notes 1-3.

231. See, e.g., Tedeschi, *supra* note 49.

232. *Id.*

wages—like the grocery industry—could shift to greater reliance on tips.²³³ “Indeed, the pandemic offers an example of how these norms can change quickly.”²³⁴ Second, workers in fixed-wage jobs could seek employment in restaurant or other tipped jobs,²³⁵ even if those jobs do not take advantage of their work experiences, training, or skills.²³⁶ Third, employers of tipped workers could “better compete” for new workers and more easily (and cheaply) retain existing workers.²³⁷ “This increase in labor supply would drive down the rate of compensation in tipped industries.”²³⁸ Finally, increasing the tax subsidy for tips²³⁹ would allow

233. Alex Muresianu, *Frustrated with Tipping? No Tax on Tips Could Make It Worse*, TAX FOUND.: BLOG (July 23, 2024), <https://taxfoundation.org/blog/tipping-trump-tax-on-tips/> [https://perma.cc/GMZ6-BSGP] (“By making one type of income (tips) exempt from income tax, while other types of income (most importantly, wages) remain taxable, the proposal would make more employees and businesses interested in moving from full wages to a tip-based payment approach. That would mean more service industries adopting the restaurant industry approach of a list price up front and an expected voluntary tip at the end of the transaction.”).

234. “*No Tax on Tips*” *Budget Lab Report*, *supra* note 21.

235. *Id.* at 17; *see also id.* (“By increasing the after-tax return to working a tipped job relative to a non-tipped job, these proposals may encourage some non-tipped workers to look for jobs in tipped industries if they could earn the same amount. For example, a worker who is currently indifferent between a warehouse job that pays \$20/hour and a waiter job that pays \$20/hour including tips would be incentivized to choose the latter due to the new tax preference.”).

236. *See, e.g.*, Hall, *supra* note 20, at 591 (“[L]arge gaps in compensation drive many cooks to switch to a tipped, server position—even though they have invested money and time into culinary education.”).

237. McDERMOTT, *supra* note 8, at 2.

238. “*No Tax on Tips*” *Budget Lab Report*, *supra* note 21, at 17.

239. Recall that the Section 45B credit already subsidizes tips through tax relief. If the current Section 45B credit was combined with a “no tax on tips” policy that encouraged even more tip reliance, the Section 45B credit would become even more costly to federal funding and even more valuable to restaurant employers. *See, e.g.*, McDERMOTT, *supra* note 8, at 2 (“Employers, in turn, could better compete for workers by offering compensation in tips. Employers would also benefit from the share of any foregone employer-side payroll tax they retained, rather than passed on in the form of lower wages.”).

Tax on Tips

employers to directly pay their workers less. As the Budget Lab at Yale explains:

[E]ven if a tax preference would lead to more tips, economic theory tells us that total compensation would remain unchanged. In a conventional score, budget scorekeepers assume that labor markets are competitive (that is, workers generally get paid their marginal product) and that macroeconomic prices remain fixed (that is, aggregate labor income doesn't change across scenarios). This means that any increase in tips would be offset by a reduction in wages. Consider a worker who earns \$25/hr in wages under current law. If we project that they would earn an additional \$5/hr in tips under a scenario where tips are exempt from tax, their wage rate must fall to \$20/hr.²⁴⁰

While not necessarily increasing wages, exempting tips from workers' federal income taxes would shift the composition of wages from fixed pay to variable tips.²⁴¹ As the Sections below will argue, this would subject more workers to racist differences in tipping which are difficult or impossible to legally remediate, make it more costly for workers to self-advocate against sexual harassment, deprive workers of stable and predictable wages, and facilitate increased wage theft. In contrast, reforming the Section 45B credit to encourage employers to directly pay the full minimum wage and to allow initial tip recipients to retain and control all of their tips would help workers by shifting the labor market to decrease reliance on tip income and increase use of fixed wages.

2. Mitigating Racism

Using tax law to reduce reliance on tips is preferable to the tips-received deduction or other perks that will increase such reliance, because tipping "was incubated in a history rife with explicit racism"²⁴² and perpetuates racism currently.²⁴³ Ian Ayres, Fredrick E. Vars, and Nasser Zakariya sketch the racist history of tipping and suggest that "a new

240. "No Tax on Tips" *Budget Lab Report*, *supra* note 21, at 15-16.

241. *Id.*

242. Ian Ayres, Fredrick E. Vars & Nasser Zakariya, *To Insure Prejudice: Racial Disparities in Taxicab Tipping*, 114 YALE L.J. 1613, 1621 (2005).

243. See Ofer H. Azar, *The Economics of Tipping*, 34 J. ECON. PERSPS. 216 (2020), for a history of tipping and a discussion of how tipping reflects racial discrimination.

acronym: “To Insure Prejudice” better describes the function of tipping compared to prior acronyms, which implied that tips encourage promptness or otherwise motivate good service.²⁴⁴ They present data on “1000 tips to taxicab drivers in New Haven, Connecticut in 2001”²⁴⁵ and find that tips continue to perpetuate racism. “White drivers are tipped substantially more than [B]lack (or other) drivers whether measured either in terms of the average tip amount or the average tip percentage. White drivers were tipped 61% more than [B]lack drivers (20.3% versus 12.6%) and 64% more than our ‘other minority’ drivers (20.3% versus 12.4%). Put simply, passengers systematically tipped white drivers substantially more than nonwhite drivers.”²⁴⁶ Notably, customers were 80% more likely to stiff—leave no tip for—African American cab drivers,²⁴⁷ and even customers “who believe they are hardwired fifteen-percent tippers” left larger tips for white cab drivers because, whether consciously or subconsciously, they rounded up their tips for white drivers more often than for nonwhite drivers.²⁴⁸

Studies in the restaurant industry confirm that tipping perpetuates racism.²⁴⁹ Michael Lynn and Michael Sturman collected data on tips during

244. See Ayres, Vars & Zakariya, *supra* note 242, at 1618 (“The word ‘TIP’ is thought by some to have originated in British pubs, where signs with just these three letters were posted on boxes as a reminder that gratuities were welcome; the letters were an acronym for the phrase ‘To Insure Promptness.’ But the evidence from this Essay is suggestive of a new acronym: ‘To Insure Prejudice.’”).

245. *Id.* at 1616.

246. *Id.* at 1627.

247. *Id.* at 1616 (“The propensity to “stiff”—by which we mean to leave no tip—was particularly racialized. African-American drivers were 80% more likely to be stiffed than white drivers (28.3% versus 15.7%).”).

248. *Id.* at 1618 (“Passengers tend to round up their tips (to the nearest dollar above their target level) more often when tipping white drivers than when tipping [B]lack drivers (32.3% versus 24.0%). When confronted with a last-second decision (based on the final fare) about whether to round up or round down, even passengers who believe they are hardwired fifteen-percent tippers may in practice unconsciously allow the driver’s race to impact their rounding decision.”).

249. Janice Compton & Ryan A. Compton, *Disentangling Customer and Employer Discrimination Using State Variation in the Tipped Minimum Wage*, 7 J. ECON., RACE & POL’Y 65, 65 (2024) (“While employers are not legally able to discriminate in hiring and wages, customers can by varying what they tip based on race or gender. The importance of this is significant. There are

lunch shifts in a chain restaurant in the South.²⁵⁰ This data demonstrated that “customers tipped [B]lack servers less than white servers . . . and that this effect was not moderated by customer race,”²⁵¹ indicating that both white and Black customers leave higher tips for white servers. While Lynn & Sturman’s data was limited to a single restaurant, its consistency with the taxicab data indicates “that tipping is likely to have an adverse impact on Black service workers in many settings, but additional research is needed to verify that expectation.”²⁵² In 2014, Zachary W. Brewster and Michael Lynn provided additional research through a “large exit survey of restaurant consumers (N = 378)” who had dined at “a full-service restaurant located in a large city in the Midwest.”²⁵³ This research confirmed the “recently documented effect of service providers’ race on restaurant consumers’ tipping decisions” and again found “that white and [B]lack restaurant customers discriminate against [B]lack servers by tipping them less than their white co-workers.”²⁵⁴ Importantly, they also found “compelling evidence demonstrating that the [B]lack tip penalty is not the result of inter-racial differences in service skills possessed by [B]lack and white servers.”²⁵⁵ To the contrary, “customers with a [B]lack server tended to report that their waiter/waitress exhibited significantly higher levels of subtle service-enhancing behaviors” that were previously

numerous state and federal laws that employers are subject to that are intended to ensure equal opportunities and protection against discrimination for workers. The reliance on tipping however potentially reintroduces possible discrimination back into the labor market realities for many tipped workers as customers are free to indulge their prejudices through the amount they tip.”).

250. Michael Lynn & Michael Sturman, *Consumer Racial Discrimination in Tipping: A Replication and Extension*, 38 J. APPLIED SOC. PSYCH. 1045, 1049 (2008).

251. *Id.* at 1051. Although the finding is arguably explained by the lower scores of perceived service quality that customers left for Black servers, customers’ lower scoring of Black servers is “consistent with negative stereotypes of Black workers, so saying that you gave a Black server a small tip because the service was not excellent does not diminish the appearance of racism.”

252. *Id.* at 1058.

253. Zachary W. Brewster & Michael Lynn, *Black-White Earnings Gap Among Restaurant Servers: A Replication, Extension, and Exploration of Consumer Racial Discrimination in Tipping*, 84 SOCIO. INQUIRY 545, 549 (2014).

254. *Id.* at 553.

255. *See id.* at 546, 549 (explaining that they asked about these cues because they “have been shown to be predictive of customers’ tipping behaviors”).

shown to predict higher tips—including smiling, maintaining eye contact, using names, or repeating customers' orders—"compared with those who were served by a white server."²⁵⁶

Taken together, studies indicate that racism in tipping "is not unique to specific locales"²⁵⁷ and likely cannot be explained by "differences in design and/or execution across studies."²⁵⁸ Racism has a strong enough effect on tipping that it appears to discourage minority workers from entering or staying in tipped employment.²⁵⁹

While some scholars argue that the "finding of a statistically reliable main effect of server race on tipping calls into question the legality of tipping in the United States,"²⁶⁰ and speculate that "minority employees [might even] stand a reasonably likely chance to win a disparate impact suit against an employer,"²⁶¹ others lament that tipping's dependence on customer discretion "stands in the way of legal accountability for the

256. *Id.* at 553.

257. *Id.* at 557.

258. *Id.* at 557.

259. See Compton & Compton, *supra* note 249, at 77 ("[C]onsumer discrimination in tips, in favor of women, has resulted in differences in employment patterns. Compared to men, women are far more likely to be in tipped jobs than similar non-tipped jobs, and this gender gap is exacerbated when the sub-minimum wage falls relative to the minimum wage. We also find evidence of employer discrimination in favor of white women over non-white women and for white men over Black men.").

260. See, e.g., Lynn & Sturman, *supra* note 250, at 1057.

261. Tyler D. Lane, *Are You Ready for the Check?: Employers Face Title VII Disparate Impact Liability for Discriminatory Tipping Practices*, 44 U. DAYTON L. REV. 53, 53-54 (2018).

discrimination that results.”²⁶² The racially discriminatory consequences of tipping are difficult to remedy.²⁶³

3. Mitigating Sexual Harassment and Sexism

Using tax law to reduce reliance on tips is preferable to the tips-received deduction or alternative forms of tip tax relief that would increase such reliance, because “restaurant workers’ dependence on tips as wages is largely to blame for the industry’s high rate of sexual harassment,”²⁶⁴ contributes to wage disparities based on appearance, and contributes to wage disparities based on gender.

Reliance on tips makes workers subservient to customers. As cultural historian Kerry Segrave aptly describes, “[T]ipping ‘makes the daily income of the worker dependent upon his subservience to the passing humor of the customer. It promotes fawning and sycophancy, and kills

262. See, e.g., Lu-in Wang, *At the Tipping Point: Race and Gender Discrimination in a Common Economic Transaction*, 21 VA. J. SOC. POL’Y & L. 101, 103-04 (2014) (“People of color also experience discrimination from both directions and in multiple ways: They are less likely to hold tipped positions; they receive substantially lower tips and are more likely to be ‘stiffed’ (not tipped at all) than white workers when they do hold such positions; and they often receive inferior and humiliating treatment as customers because of negative stereotypes about their tipping practices. Even as the structure of tipped transactions provides incentives and opportunities for servers and customers to discriminate against one another, that structure also stands in the way of legal accountability for the discrimination that results.”).

263. For example, One Fair Wage—a nonprofit organization that advocates for tipped workers—brought suit against Darden Restaurants, Inc. alleging that its cash wage and tipping policies violated Title VII of the Civil Rights Act of 1964 by relying on customer tips “to directly set the wage levels for tens of thousands of its employees without any oversight, because “customer decisions about whether and how much to tip have resulted in employees of color being paid meaningfully less than white employees because of their race.” Complaint at 3, *One Fair Wage, Inc. v. Darden Restaurants, Inc.*, 687 F. Supp. 3d 881 (N.D. Cal. 2023) (No. 4:21-cv-2695) [hereinafter *One Fair Wage Complaint*]. The United States District Court for the Northern District of California dismissed the case on the basis that One Fair Wage lacked standing. See *One Fair Wage*, 687 F. Supp. 3d at 883.

264. Suzanne Specker, “*Hun, I Want You for Dessert*”: *Why Eliminating the Sub-Minimum Wage for Restaurant Servers Will Empower Women*, 19 U. PA. J. L. & SOC. CHANGE 335, 336 (2015).

dignity and independence.”²⁶⁵ This incentivized subservience disproportionately affects women, since “women as servers both are highly dependent on tip income and work in an environment where gender stereotypes are especially pervasive and strong.”²⁶⁶

Sexual harassment is rampant in the U.S. restaurant industry. As management scholars Stefanie K. Johnson and Juan M. Madera explain:

More sexual harassment claims in the U.S. are filed in the restaurant industry than in any other, where as many as 90% of women and 70% of men reportedly experience some form of sexual harassment. While the industry has had its share of high-profile stories ([involving] well-known chefs and TV personalities . . .), even more insidious is the routine harassment of service workers by managers, coworkers, and, importantly, customers.²⁶⁷

Harms to workers range from off-color jokes, to attempts to discuss sex,²⁶⁸ to violent harassment.²⁶⁹

Tipped workers who are directly paid a subminimum wage and must rely on tips are *twice as likely* to be sexually harassed. Restaurant

265. KERRY SEGRAVE, *TIPPING: AN AMERICAN SOCIAL HISTORY OF GRATUITIES* 72 (1998) (quoting William Rufus Scott, *Tipping*, *NEW REPUBLIC*, July 28, 1920).

266. Wang, *supra* note 262, at 103.

267. Stefanie K. Johnson & Juan M. Madera, *Sexual Harassment Is Pervasive in the Restaurant Industry. Here's What Needs to Change*, *HARV. BUS. REV.* (Jan. 18, 2018), <https://hbr.org/2018/01/sexual-harassment-is-pervasive-in-the-restaurant-industry-heres-what-needs-to-change>.

268. *Id.* (“[A] study following 76 female college students working in food and beverage service jobs, mainly restaurants, over a period of three months in 2017 . . . [found that o]ver the three months, the women reported 226 incidents of sexual harassment; 112 of the incidents involved coworkers, 29 involved a manager, and 85 involved customers. . . . [T]he most frequent behaviors selected were when someone at work ‘told suggestive, sexual stories’ (49%), ‘made offensive remarks’ (46%), ‘made crude sexual remarks’ (45%), ‘made sexist comments’ (42%), and ‘attempted to discuss sex’ (33%).”).

269. *See, e.g.*, Julia Moskin & Kim Severson, *Ken Friedman, Power Restaurateur, Is Accused of Sexual Harassment*, *N.Y. TIMES* (Dec. 13, 2017), <https://www.nytimes.com/2017/12/12/dining/ken-friedman-sexual-harassment.html> (describing the “rape room” in New York City’s gastropub, The Spotted Pig, where “normal restaurant rules did not apply . . . [and] guests openly groped female servers.”).

Opportunities Centers United, a nonprofit organization that advocates for restaurant workers, conducted a study and found that “women servers in states where the sub-minimum wage for tipped workers is \$2.13 per hour are *twice as likely* to experience sexual harassment as women servers in states that pay the same minimum wage to all employees [regardless of whether they receive tips].”²⁷⁰ As former restaurant server, then lawyer, Suzanne Specker explains, “This two-tiered wage system creates a unique employment relationship in which servers depend on their customers’ whims for income. As a result, servers are incentivized to silently tolerate harassment for fear of repercussions, such as lost tip income, unfavorable shifts, public humiliation, and even termination.”²⁷¹ A server who self-advocates against sexual harassment faces loss of tip income and a lack of support from managers who “have an incentive to ignore, indulge, or even encourage sexual harassment.”²⁷² While the “two-tiered wage system encourages sexual harassment within the restaurant industry, creating a toxic environment for all restaurant employees,”²⁷³ the harms to women, who represent “two-thirds of all tipped restaurant workers,” are especially severe.²⁷⁴ Employers’ use of “the sub-minimum wage pay structure [is] a clear women’s issue.”²⁷⁵ Reducing reliance on tips would mitigate sexual harassment that pervades the restaurant industry.

Reducing reliance on tips would also reduce wage disparities based on appearance and gender. Women are tipped more than men,²⁷⁶ especially if they are white,²⁷⁷ blond, slender, large breasted, or deemed beautiful by

270. Specker, *supra* note 264 (emphasis added); see also *One Fair Wage* Complaint, *supra* note 263 (“According to empirical and anecdotal data from current and former Darden employees, and supported by studies measuring the impact of wage policies like Darden’s, the sub-minimum wage is the direct cause of, or at least a motivating factor in, a documented increase in sexual harassment. A key reason for this is that the sub-minimum wage puts great pressure on tipped employees to have the customers, rather than Darden, pay employees their legally required wages. . . . Without Darden’s cash wage policy, these illegal effects would be substantially lessened.”).

271. Specker, *supra* note 264.

272. *One Fair Wage* Complaint, *supra* note 263.

273. Specker, *supra* note 264.

274. *Id.*

275. *Id.*

276. See *supra* note 259.

277. See Compton & Compton, *supra* note 249, at 66 (“[W]e find evidence of gender discrimination in tipping that leads to employment differences by

the customers they serve.²⁷⁸ “[T]he restaurant industry is a ‘looks’ industry, in which women are expected to use their appearance as part of the service experience. Restaurants often have strict grooming and uniform policies, requiring employees to maintain certain ‘looks.’”²⁷⁹ When tipped workers look the way that customers and managers think they should, they receive beauty premiums ranging from higher tips to better shifts to more lucrative jobs. One researcher estimates that “attractive” servers receive a premium equivalent to a month and a half of the national median rent, or “17 weeks’ worth of food” for a “high-cost nutritious diet.”²⁸⁰ Of course, tipped workers who are denied beauty premiums receive lower tips, worse shifts, and less lucrative jobs. But even those who receive the beauty premium are harmed because “a culture that emphasizes and rewards looks”²⁸¹ can be exploited by “customers and managers [to] justify sexual harassment.”²⁸² Moreover, “women who are perceived to have used their looks to get ahead” are considered “more ‘deserving’ of sexual harassment.”²⁸³ Reducing reliance on tips would help offset a culture that penalizes tipped workers, whether or not they fail to conform to customer preferences for beauty.

gender. The results suggest that white women benefit from consumer discrimination in tipping.”).

278. FREAKONOMICS: *Should Tipping Be Banned?*, at 7:18-7:39 (Freakonomics Radio Network, June 3, 2013), <https://freakonomics.com/podcast/should-tipping-be-banned-3/> [<https://perma.cc/FY3Y-8RKG>].

279. Johnson & Madera, *supra* note 267.

280. See, e.g., Matt Parrett, *Beauty and the Feast: Examining the Effect of Beauty on Earnings Using Restaurant Tipping Data*, 49 J. ECON. PSYCH. 34, 43 (2015) (“[A]ttractive servers earn approximately \$1,261 more per year than unattractive servers [based on customer ratings of attractiveness], an amount that is equivalent to roughly 1.5 months of median gross rent in the United States or about 17 weeks’ worth of food for an individual following a high-cost nutritious diet as defined by the United States Department of Agriculture.”). For a discussion of the beauty premium, see, for example, DANIEL S. HAMERMESH, *BEAUTY PAYS: WHY ATTRACTIVE PEOPLE ARE MORE SUCCESSFUL* (2011); and Daniel S. Hamermesh & Jeff E. Biddle, *Beauty and the Labor Market* (Nat’l Bureau of Econ. Rsch., Working Paper No. 4518, 1993), <https://www.nber.org/papers/w4518> [<https://perma.cc/S2K5-VYFJ>].

281. See Johnson & Madera, *supra* note 267.

282. *Id.*

283. *Id.*

4. Facilitating Stable and Predictable Incomes

Tax law should aim to reduce the incentives it currently gives employers to make their workers rely on tips, because workers benefit when their compensation is stable and predictable. “Relying on tips to make ends meet can lead to emotional distress for workers, as their income is unpredictable. This can create financial anxiety and job insecurity.”²⁸⁴ As restaurant workers seek to afford monthly rent, food, and utilities, unpredictable tips add risk. Months in which workers receive lower tips “can mean ‘the difference between a subsistence and a living wage,’”²⁸⁵ between housing and food security and insecurity, and between feelings of vulnerability and safety.²⁸⁶

Tipping customers are ill-suited to provide stable wages to restaurant workers. In addition to being influenced by the biases previously discussed,²⁸⁷ customers do not know what tipped workers are being paid by their employers,²⁸⁸ whether the employer takes a tip credit to meet the federal minimum wage, or “how much the customers before and after them felt inclined to tip,”²⁸⁹ all of which can lead to “insufficient tipping.”²⁹⁰ Some customers “tip well” as a matter of habit, while “others

284. Kelly, *supra* note 25.

285. Wang, *supra* note 262, at 103 (quoting Fred Davis, *The Cabdriver and His Fare: Facets of a Fleeting Relationship*, 65 AM. J. SOCIO. 158, 161 (1959)).

286. Suellen Butler & James K. Skipper, Jr., *Waitressing, Vulnerability, and Job Autonomy: The Case of the Risky Tip*, 7 SOC. WORK & OCCUPATIONS 487, 492-93, 499 (1980).

287. *One Fair Wage* Complaint, *supra* note 263 (“But customers are often capricious, not systematic; they are often emotional, not rational; and they often bring conscious and unconscious racial and other biases with them when they eat out. Thus, whether intentional or not, and whether made by customers who have had two bottles of wine or none at all, customer decisions about whether and how much to tip have resulted in employees of color being paid meaningfully less than white employees because of their race.”).

288. Hall, *supra* note 20, at 586.

289. *Id.*

290. *Id.* at 584.

do not leave a tip at all.”²⁹¹ Restaurant workers who rely on tips are deprived of income security.

Finally, by making their employees rely on tips, restaurant employers shift the risk of slow business cycles—or even slow shifts—to their workers. Whereas a grocery employer bears the wage risk of slow business cycles or shifts (fixed hourly wages remain the same even when sales are low), a restaurant employer shifts much of that risk to the tipped employees (who receive less pay when sales are low).²⁹²

The Section 45B credit rewards employers for shifting wage risk to their workers. The tips-received deduction is likely to increase tip reliance, which will expose workers to greater wage risk. In contrast, revising the Section 45B credit would reward employers for protecting their workers with higher fixed pay and reduce the uncompensated risk that restaurant workers bear due to their reliance on tips.

5. Reducing Opportunities for Tip Theft

Tax law should reduce the incentives it currently gives to employers to make their workers rely on tips, because employers can steal tips more easily than they can steal their workers’ fixed wages. Beyond taking a tip credit, some restaurant owners now partake in “tip theft” by “pocket[ing] a proportion, or even all, of the gratuities intended for their servers.”²⁹³ The variable nature of tips makes tip theft hard for workers to detect. Further, while cash tips have declined over the last several decades, billions of dollars of cash tips are still paid,²⁹⁴ and cash tips are easy for employers to steal. Even when tips are documented on credit or debit card charge slips,

291. Basker, Foster & Stinson, *supra* note 17, at 8 (“For workers, tip income is inherently riskier than wage earnings: some patrons tip well, and others do not leave a tip at all.”).

292. To the extent that wages and tips do not fall below \$7.25 in a slow year, the tipped worker bears the risk; to the extent that wages and tips fall below \$7.25 in a slow year, the employer bears the risk because the employer must increase direct payments to ensure that the worker receives the \$7.25 minimum wage.

293. Bobby Ghosh, *New Tipping Trend Hurts Those Who Need Gratuities Most*, BLOOMBERG (Aug. 29, 2023, 7:00 AM), <https://www.bloomberg.com/opinion/articles/2023-08-29/new-tipping-trend-hurts-those-who-need-gratuities-most>.

294. *See supra* note 46.

employers have reduced record-keeping obligations regarding tips.²⁹⁵ In an unusual exception to standard record-keeping requirements, “[e]mployers are expressly excused from any effort to determine whether employees are properly reporting their tips.”²⁹⁶ Without records of both the amount of tips collected by and distributed to each worker through employer-imposed tip pools, it is difficult for workers to prove (or even discover) that their employer has stolen tips from the pool or failed to distribute tips collected on charge slips. It is not surprising, therefore, that “[t]ipped low-wage workers” suffer more wage theft than “their hourly counterparts.”²⁹⁷ Instead of encouraging greater reliance on tips, tax law should discourage wage theft by reducing employers’ current incentives to make their employees rely on tips.

D. Counterarguments Against Amending Section 45B Are Insufficient

1. Legal Requirements Limit Decentralized Business Judgment

When the law requires employers to do something, whether it is to pay a higher minimum wage or allow employees to retain all the tips they collect, that requirement limits the decision-making of local managers, who may know better than the government what works best for their workplaces. However, this Article’s proposal to amend the Section 45B tax credit does not require restaurant employers to pay a higher minimum wage or to refrain from imposing tip pools. To the contrary, it allows employers to continue paying a meager \$2.13 minimum wage and/or to

295. See *U.S. v. Fior D’Italia, Inc.*, 536 U.S. 238, 255–57 (2002) (Souter, J., dissenting) (“The Code imposes a general obligation upon all taxpayers to keep records relevant to their liability [I.R.C. § 6001] states a single, glaring exception Employers are expressly excused from any effort to determine whether employees are properly reporting their tips; the Code tells them that they need not keep the information specific to each employee that would be necessary to determine if any tips fell short of the estimates or outside the wage band. . . . This absolution from recordkeeping is mirrored by the fact that tips are uniquely excepted from the general rule that remuneration must be reported in W-2 statements.”).

296. *Id.*

297. Courtlyn G. Roser-Jones, *Using State and Local Governments’ Purchasing Power to Combat Wage Theft*, 80 WASH. & LEE L. REV. 1937, 1951–53 (2024); see also *id.* (noting that tipped workers experience pervasive wage theft as “over a third of tipped workers surveyed in 2021 reported making below the minimum wage for at least some of their hours worked in the past year”).

continue imposing tip pools, but prevents them from taking a generous tax credit while doing so. Tax credits are matters of legislative grace,²⁹⁸ and that grace is less warranted when a credit is available to only one type of employer.²⁹⁹ Amending the Section 45B credit, which is only available to restaurant employers, so that it is available only to restaurant employers who do not take tip credits or impose tip pools, allows employers to continue exercising their business judgement regarding tip credits or tip pools.

Further, a change to the Section 45B credit would not necessarily supplant the decision-making of local managers. In many restaurants across this country, local managers who would like to pay higher minimum wages or allow their employees to retain all their tips are already prevented from exercising their on-the-ground business judgment. To take a large example, Darden Restaurants, Inc. is a publicly traded corporation that “operates restaurants in all 50 states,” including over 800 Olive Garden restaurants and over 1,000 LongHorn Steakhouse, Yard House, Ruth’s Chris, Cheddar’s Scratch Kitchen, Capital Grille, Chuy’s, Seasons 52, Eddie V’s, and Bahama Breeze restaurants.³⁰⁰ “Darden had sales of \$7.81 billion dollars in fiscal year 2020, which included the first few months of

298. See, e.g., Andy Grewal, *King v. Burwell: Where Did the “Legislative Grace” Canon Go?* YALE J. REG.: NOTICE & COMMENT (November 12, 2014) (“In denying taxpayers’ claims for various deductions and credits offered by the tax code, courts are fond of saying that these are matters of ‘legislative grace.’ Congress, we are told, allows a taxpayer to reduce his tax liability through sheer beneficence, and a taxpayer cannot infer a credit or deduction. Rather, his entitlement to them must be ‘clearly demonstrated.’”); Tax & Accounting Software Corp. v. United States, 301 F.3d 1254, 1261 (10th Cir. 2002) (“[T]ax credits are ‘a matter of legislative grace, and taxpayers bear the burden of clearly showing that they are entitled to them.’”).

299. See *supra* note 202.

300. See *One Fair Wage* Complaint, *supra* note 263, at 4-5 (“[Darden] operates eight prominent restaurant chain brands, including The Olive Garden, LongHorn Steakhouse, and the Capital Grille. As of Darden’s most recent annual report, there were 861 company-owned Olive Gardens in the United States, which makes the Olive Garden the largest full-service-dining Italian restaurant chain in the country. The other seven brands that Darden owns operate another 1,000 or so restaurants. . . . Darden operates restaurants in all 50 states, including approximately 74 Olive Gardens and 25 Yard Houses in California with several thousand Darden employees working in California.”); *Our Company*, DARDEN, <https://www.darden.com/our-company> [<https://perma.cc/7VK4-JNM7>].

the pandemic.”³⁰¹ In its most recent annual report and letter to investors, Darden boasts \$11.4 billion in sales for 2024 and a 50% increase in earnings during the last 5 years alone.³⁰² Darden does not defer to local, on-the-ground business judgement to craft appropriate wage and tip policies. To the contrary, it imposes a corporate-level restriction that prohibits local managers from paying more than the lowest required subminimum wage.³⁰³ “Darden enforces its policy by training local managers not to pay tipped employees a cash wage greater than [is] legally permitted, prohibiting managers from doing the same . . . auditing tipped employees’ cash wage rates, and investigating and potentially disciplining managers who violate the corporate policy and pay tipped employees more than the company-imposed cash wage ceiling.”³⁰⁴ To the extent that a nationally imposed policy imposed by a publicly traded corporation already limits the decentralized business judgment of local managers, a change to tax policy might in some ways better approximate that business judgment.

301. *One Fair Wage* Complaint, *supra* note 263, at 5.

302. *Darden 2024 Annual Report on Form 10-K with Shareholder Letter*, DARDEN 1 <https://investor.darden.com/financials/annual-reports/default.aspx> [<https://perma.cc/24KT-E6B5>] (“While sales results were weaker than we anticipated, earnings exceeded our initial expectations for the year. Total sales grew 8.6% to \$11.4 billion driven by same-restaurant sales growth of 1.6% and sales from 39 net new restaurants. We also closed on the acquisition of Ruth’s Chris Steak House and successfully integrated 78 company-owned restaurants and 5,000 Ruth’s Chris team members into Darden. Ruth’s Chris was accretive to our full-year EPS results by \$0.10. Our sales growth, combined with strong cost management by our teams and the acquisition of Ruth’s Chris, drove \$1.8 billion in EBITDA from continuing operations, an increase of 50% compared to five years ago.”).

303. *One Fair Wage* Complaint, *supra* note 263, at 7 (“Darden’s cash wage policy dictates a common restriction on how local managers are prohibited from exercising their discretion over tipped employees’ cash wage rates, and that directive pervades the entire company. Darden’s policy is a corporate-level instruction to local managers that they must pay tipped employees a cash wage as low as applicable law allows.”); *see also id.* at 22 (“Although in 35 states the wage floor for tipped employees is higher than \$2.13 per hour, and in 7 states there is no distinction for large employers between the minimum wage for tipped employees and non-tipped employees, Darden’s policy of paying the lowest legally-permissible cash wage to tipped employees is applicable nationally to all tipped employees at Darden restaurants across the United States.”).

304. *Id.* at 7.

2. Restaurants Will Close and Displace Workers

The COVID pandemic hit the restaurant industry hard. Readers may worry that, even if a tax incentive against tip credits and tip pools was ordinarily justified, these are not ordinary times. Demanding that restaurants incorporate yet another operational change may be the straw that breaks the camel's back, causing the closure of restaurants and loss of jobs.

First, readers should bear in mind that the COVID pandemic hit restaurant workers—not just owners—hard. Perhaps more importantly, these hard-hit workers face unique barriers to financial recovery because atypically high inflation has significantly eroded the minimum wage. While restaurant owners responded to inflation by raising prices,³⁰⁵ minimum wage workers had no such option. Workers had no way to counter the erosion of wages that they experienced in recent high-inflation times. This makes shoring up the minimum wage particularly important now.

Second, while the COVID pandemic and recent inflation presented challenges for restaurants, whose average net profit margins of 3% to 5% are lower than most small businesses, these conditions also challenged grocery employers, whose average net profit margins of 1% to 3% percent are even lower.³⁰⁶ Horizontal equity supports narrowing a tax credit that favors restaurant employers, who often pay their workers the

305. *Meet the 2023 Top 500: The Biggest Restaurant Chains in America*, NATION'S REST. NEWS (June 22, 2023), <https://www.nrn.com/top-500-restaurants/meet-the-2023-top-500-the-biggest-restaurant-chains-in-america> [<https://perma.cc/7E8J-N5VW>] (“[M]any companies increased menu prices in order to keep up with rising food costs. Increases of 10-15% were common, driving sales growth even as traffic was flat or trending downward.”).

306. *See, e.g., Comparing Average Profit Margin by Industry*, DOOR DASH FOR MERCHANTS: MERCHANT BLOG (July 25, 2023), <https://merchants.doordash.com/en-us/blog/average-profit-margin-by-industry> [<https://perma.cc/MEL5-STEL>] (“In general, a successful small business can expect to make between a 7% and 10% profit margin” and “[f]ull-service restaurants typically see a profit margin between 3% and 5%,” while “[g]rocery stores have especially slim profit margins, ranging from 1-3%.”); *see also* Walter Johnson, *The Industry Standard for Gross Margin in Groceries*, CHRON, <https://smallbusiness.chron.com/industry-standard-gross-margin-groceries-38121.html> [<https://perma.cc/54PF-SC55>] (“For a very long time, the grocery business has maintained extremely low profit margins. While parts of a larger supermarket differ in their margins, the main aisles remain at about 1 percent, the lowest in the economy.”).

Tax on Tips

subminimum wage, over grocery employers, who pay their workers the full federal minimum wage. Unless the closure of a restaurant is more socially harmful than the loss of a grocery store, social-equity concerns also support narrowing the Section 45B credit.

Third, many restaurant employers have recovered following the COVID pandemic. According to *Nation's Restaurant News*, “[R]estaurant leaders have reasons for optimism. American consumers are still clamoring for food away from the home even as prices surge and the economy wavers.”³⁰⁷ For example, of the 500 largest restaurant chains in America, “[a] full 456 chains . . . that’s 91% of them — enjoyed sales growth in 2021”³⁰⁸ Many restaurants are enjoying economic growth.

Fourth, the Section 45B credit is only available to profitable restaurants. The Section 45B credit is not a refundable credit. Just as the lowest-income tipped workers currently do not pay federal income taxes, restaurants operating in the red, or merely breaking even, do not pay federal income taxes and receive no benefit from the Section 45B credit. Thus, revising the Section 45B credit will only affect those restaurants which are profitable enough to owe federal income taxes.

Finally, restaurant employers received generous tax perks through the Tax Cuts Jobs Act and the One Big Beautiful Bill. When, in 2018, the corporate tax rate was slashed from a top rate of 35% to a flat rate of 21%, the many publicly traded corporations that own restaurants, including Darden, Dine Brands (which owns Applebee’s and IHOP),³⁰⁹ Brinker International (which owns Chili’s and Maggiano’s Little Italy),³¹⁰ and Starbucks³¹¹ enjoyed a huge and permanent tax cut.³¹² In contrast to

307. *Meet the 2023 Top 500*, *supra* note 305.

308. *Id.*

309. Dine Brands Global, Inc., Annual Report (Form 10-K), at 5, 30 (Mar. 5, 2025).

310. Brinker International, Inc., Annual Report (Form 10-K), at 4, 23 (Aug. 15, 2025).

311. Starbucks Corp., Annual Report (Form 10-K), at 31 (Nov. 14, 2025).

312. Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 13001, 131 Stat. 2054, 2096 (2017) (amending Section 11 of the Internal Revenue Code to impose a 21% corporate tax). Many fast-food restaurants, like McDonald’s, and fast-casual restaurants, like Subway, are also owned by publicly traded companies, *see* McDonald’s Corp., Annual Report (Form 10-K), at 27 (Feb. 25, 2025); Chipotle Mexican Grill, Inc., Annual Report (Form 10-K), at 24 (Feb. 5, 2025), but this list highlights those at which workers rely significantly on tips. Interestingly, since the slashing of the corporate tax rate, JAB Holding Company (which owns Panera Bread, Einstein Bros. Bagels, and Caribou

temporary tax perks enjoyed by restaurant workers—like the one-year-only 2021 expansion of the EITC—the permanent corporate-rate reduction should more than offset this Article’s proposed revisions to the Section 45B credit. For restaurants that operate as pass-through entities or even sole proprietorships, generous tax perks including the 20% deduction for qualified business income available through Section 199A, and immediate expensing of equipment available through Section 168(k), have helped restaurant owners recover since 2018 and, since recently extended,³¹³ should more than offset this Article’s proposed revisions to the Section 45B credit. In short, tax cuts that, as of 2018, became available to restaurant owners remain available to soften the transition to a narrowed Section 45B credit.

3. Service Will Suffer

Economic theories of tipping hope that the customers act as decentralized monitors of the server’s job performance and tip generously to reward good job performance, or tip stingily or not at all to discourage poor job performance.³¹⁴ However, if the Section 45B credit was justified on the basis that it facilitates efficient monitoring of job performance and encourages good service, then we should expect it to be available to all

Coffee) has recently considered an initial public offering. *See, e.g.,* Joanna Fantozzi, *Panera Brands Reportedly Confidentially Files for IPO*, NATION’S REST. NEWS (Dec. 1, 2023), <https://www.nrn.com/restaurant-segments/panera-brands-reportedly-confidentially-files-for-ipo> [<https://perma.cc/244L-Q56N>].

313. The One Big Beautiful Bill Act, Pub. L. No. 119-21, § 70105, 139 Stat. 72, 161 (2025) extends the 20% deduction for qualified business income available through Section 199A, and § 70301 makes permanent the 100% immediate deduction of qualified business property through Section 168(k).

314. *See, e.g.,* Samuel Estreicher & Jonathan Remy Nash, *The Case for Tipping and Unrestricted Tip Pooling: Promoting Intrafirm Cooperation*, 59 B.C. L. REV. 1, 6 (2018) (“Our argument is that tipping is a valuable economic practice that can benefit both employees and owners. Tipping helps to solve a principal-agent problem between management and workers. When customers tip based upon the quantity and quality of service, they provide an important feedback mechanism concerning employee performance in circumstances where the employer cannot readily monitor that performance. Tipping facilitates ‘buyer monitoring.’”); *see also id.* at 6 (surprising this Author by treating tax avoidance as a partial public policy justification for tipping since, due to underreporting, “cash tips allow the customer to distribute income from the public purse to the direct provider of services”).

employers of tipped workers. Instead, it is only available to restaurant employers.³¹⁵

Further, studies generally indicate that tip size does not correspond primarily to job performance and instead appears related to bill size, customer attributes, and most problematically, customer racism and sexism.³¹⁶ Although this Article does not take up arguments about whether tipping should be abolished,³¹⁷ it argues that current tax subsidies for employers who make their workers rely on tips should be reduced.

In the restaurant industry, scholars have studied tipping extensively and found an “astonishingly low”³¹⁸ relationship between tip size and service quality. “[T]here is only a weak correlation between service quality and tip size. By far the most important factor that determines tip size is the size of the bill and there is no reason to think that the size of the bill is

315. See *supra* notes 201-202 and accompanying text.

316. See, e.g., Compton & Compton, *supra* note 249, at 66 (“[L]ittle of the variation in tips appears to be related to service quality, and this earlier literature makes no mention of race or gender in their analysis with the exception of Banks et al. (2018) who find in their meta-analysis that there is evidence of discrimination against Black servers and in favour of women servers.”).

317. It seems unlikely that tipping will be abolished in the United States. *But see* Ayres et al., *supra* note 242, at 1661 (arguing that, while discretionary tipping appears an inevitable part of the current U.S. economy, “a social practice that today seems an inevitable or inherent part of our economy may not seem so inevitable if we look slightly into the past (or to other parts of the world)”). Interestingly, at least 6 states banned tipping shortly after the practice was introduced in the United States. See, e.g., Cecily Fuhr, *Litigation of Employees’ Wage Claims Arising out of “Tipping Pool” Practices*, in 160 AM. JURIS. TRIALS 195, 195 (2025) (explaining that when tipping initially spread from England “to the United States, it was viewed as unsavory bribery, and inconsistent with the values of a democratic society. In 1904, the Anti-Tipping Society of America included 100,000 members who signed pledges not to tip anyone for a year. In 1909, Washington became the first of six states to pass an antitipping law; however, the new laws rarely were enforced, and by 1926, every antitipping law had been repealed.”). Proposing or evaluating a current-day antitipping law is beyond the scope of this Article, but some of the potential merits of a tipping ban are presented in FREAKONOMICS: *Should Tipping Be Banned?* (Freakonomics Radio Network, June 3, 2013), <https://freakonomics.com/podcast/should-tipping-be-banned-3/> [<https://perma.cc/57BE-26DC>] (“It’s awkward, random, confusing—and probably discriminatory too.”).

318. See *infra* note 322 and accompanying text.

correlated with service quality.”³¹⁹ As discussed previously, customers tip more to white servers³²⁰ and to female servers whom they deem beautiful.³²¹ Michael Lynn, tipping expert and professor of consumer behavior and marketing at Cornell, concludes that the relationship between tip size and service quality is “astonishingly low.”³²² In his view, “[I]t’s absolutely the case that tips are not as strongly related to service as you would expect.”³²³ In one meta-analysis of 7 published and 6 unpublished “studies involving 2,547 dining parties at 20 different restaurants,” he and coauthor Michael McCall found that “the average relationship between tip size and service evaluations was . . . quite small—accounting for less than two percent of the variability in tip percentages.”³²⁴ Another meta-analysis of 14 studies found that the relationship was “so weak as to be meaningless,” suggesting that tips “are not a good way to motivate servers, measure server performance, or identify dissatisfied customers.”³²⁵ These findings are supported by an impressively large study of tipping and driver service quality in 40 million Uber transactions,³²⁶ by other scholars,³²⁷ and by other countries that

319. Margalioth, *supra* note 135, at 125.

320. *See supra* Section IV.C.2.

321. *See supra* Section IV.C.3.

322. *See* FREAKONOMICS: *Should Tipping Be Banned?*, *supra* note 317, at 14:42-15:18 (“I’ve done a lot of research looking at the size of tip and how it relates to the customer’s perceptions of service quality. And a consistent finding is that there is a relationship, people do tip more the better the service they get. But that relationship is very weak. It’s a correlation. The average correlation is 0.2. That means about four percent of the variability of the differences in the percentage tips left by different dining parties can be explained by their service ratings. . . . It’s astonishingly low, isn’t it?”).

323. *Id.*

324. Michael Lynn & Michael McCall, *Gratitude and Gratuity: A Meta-Analysis of Research on the Service-Tipping Relationship*, 29 J. SOCIO-ECON. 203, 211 (2000).

325. Michael Lynn, *Restaurant Tipping and Service Quality: A Tenuous Relationship*, 42 CORNELL HOTEL & REST. ADMIN. Q. 14, 20 (2001).

326. Bharat Chandar, Uri Gneezy, John A. List & Ian Muir, *The Drivers of Social Preferences: Evidence from a Nationwide Tipping Field Experiment 3* (Nat’l Bureau of Econ. Rsch., Working Paper No. 26380, 2019) (explaining that studies indicate that tip size does not depend primarily on job performance). One impressively large study crunched data from more than 40 million trips in the ride-sharing platform Uber and found “that rider effects account for

Tax on Tips

“seem to do just fine” without relying heavily on tips.³²⁸ “To sum up, there is no clear theoretical case that supports tipping on efficiency grounds, and empirical studies find that the tipping effect is either small or non-existent.”³²⁹ Reducing tax subsidies for restaurant employers who make their workers rely on tips should not significantly affect service quality.

CONCLUSION

The current public and political support for tipped workers is well-founded. Tipped workers generally work hard, receive low pay, and experience poor working conditions. Tax law can help improve these conditions by seeking to relieve workers of the harms of relying on tips, rather than encouraging even greater tip reliance.

about three times more of the observed tipping variation than driver effects.” *Id.* For example, in the sample, 60% of Uber customers never tipped and male customers tended to tip more, on average, than female customers. *Id.* at 3-4. These rider effects predicted tipping more than service quality. *Id.* at 30.

327. See, e.g., Orn B. Bodvarsson & William A. Gibson, *An Economic Approach to Tips and Service Quality: Results of a Survey*, 36 SOC. SCI. J. 137 (1999) (finding that service quality explains only slight differences in tip amounts).

328. Ayres, Vars & Zakariya, *supra* note 242, at 1662 (“Other countries without tipping traditions, or without traditions of tipping nearly as significant amounts, seem to do just fine without granting so much payment discretion. Indeed, the earlier discussion on the racial antecedents of U.S. tipping norms raises the possibility that the American practice may be more a vestigial attribute of racial subordination and less a way of giving servers appropriate incentives.”).

329. Margalioth, *supra* note 135, at 126.