Legal Update Article

Chicago City Council Passes Measure to Eliminate the Tip Credit

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The Chicago City Council voted on October 6, 2023, to eliminate the subminimum wage for tipped employees working within Chicago by July 1, 2028. The "One Fair Wage" ordinance will gradually phase out the subminimum wage, also known as the tip credit, over a five-year period starting July 1, 2024.

Currently, employers of covered employees in occupations that customarily earn tips may take a credit against the standard minimum wage rate if those workers earn enough in gratuities to bring them up to Chicago's hourly minimum wage. If employees' tips combined with their direct pay at the subminimum hourly rate do not add up to the standard minimum wage, employers must make up the difference. The subminimum wage for tipped employees is $9.48 per hour, a 40% credit against the standard minimum wage of $15.80 per hour, which applies to employers with at least 21 employees. For employers with more than three but fewer than 21 employees, the subminimum wage for tipped employees is $9.00 per hour, a 40% credit against the standard minimum wage of $15.00 per hour applicable to such employers.

Tip Credit Phased Out

With passage of the ordinance (on a 36-10 vote), the tip credit will be reduced in stages, so that the tip credit to employers may not exceed:

- 40% of the applicable minimum wage rate until July 1, 2024
- 32% of the applicable minimum wage rate on and after July 1, 2024
- 24% of the applicable minimum wage rate on and after July 1, 2025
- 16% of the applicable minimum wage rate on and after July 1, 2026
- 8% of the applicable minimum wage rate on and after July 1, 2027, until and including June 30, 2028.

As of July 1, 2028, employers of covered employees in Chicago will not be able to take a tip credit of any amount. The standard minimum wage rate in effect at that time would apply to all employees, including those in occupations that customarily receive tips. Servers and other employees in customarily tipped occupations, however, would still be entitled to earn and retain their tips.

Challenge for Restaurant Employers

As originally introduced in July 2023, the ordinance provided only a two-year phaseout period. The substitute measure passed on October 6 gives the city's hospitality employers more time to adjust to the anticipated substantial impact on Chicago's restaurant industry. Opposing the measure, the Illinois Restaurant Association cautioned that, by eliminating the subminimum wage, the city is "fundamentally changing the business model of every restaurant in the city" and will result in job cuts and restaurant closures.

Proponents of the Chicago ordinance cite data from other jurisdictions that have eliminated the tip credit suggesting that take-home pay for service workers is higher and staff turnover is lower. However, the restaurant trade group noted that a median tipped worker in a full-service restaurant in the state of Illinois makes $28.48 per hour, while servers in cities that have eliminated the tipped minimum wage often have statistically lower average tip percentages, ultimately reducing take-home pay. The trade group also noted that San Francisco, a city that eliminated the tipped minimum wage, saw an increase in restaurant closures.

Opponents of eliminating the tip credit have cautioned that Chicago restaurants likely will adopt automatic service charges to offset the financial impact, a practice adopted by many restaurants in Washington, D.C., after the tip credit was eliminated there. They also warn that restaurants may respond by eliminating servers altogether (moving to a self-serve, counter model) or relocating to nearby municipalities outside the city.

A Growing Trend

Efforts to eliminate the tip credit have proliferated in recent years, with varied success. Federal legislation that would have eliminated the $2.13 subminimum hourly wage for tipped workers failed in the 2021-22 session. More than a dozen states have legislation pending to eliminate the tip credit, and several states already prohibit the subminimum wage. In November 2022, voters in the District of Columbia passed the "District of Columbia Tip Credit Elimination Act of 2021," which gradually increases the subminimum wage in D.C. to the standard minimum wage of $16.10 per hour in 2027. Voters in Portland, Maine, however, overwhelmingly rejected "Question D," which would have eliminated the subminimum wage for tipped workers at restaurants within the city.

Tip-earning employees often oppose these measures because they typically earn far more in tips than they would if compensated at the standard hourly minimum wage. Further, in recent years, several high-profile restaurants implemented and then abandoned a no-tipping experiment, finding neither servers nor customers liked the model. Some restaurants have adopted the banquet industry's service charge approach (typically an automatic add-on of 18%

or 20% to customers' bills) to ensure servers receive sufficient compensation and to increase pay parity with back-of-house employees who do not collect tips.

Please contact a Jackson Lewis attorney if you have questions about the newly passed Chicago ordinance, strategies for offsetting the effect of the measure, or the use of the tip credit generally.

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Back to top