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Service Charges

Some ideas on surviving in an era of higher wages and other spiraling costs of doing business

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THE INCREASE IN THE MINIMUM wage and, more importantly, the market, particularly in Minnesota, has driven up labor cost in all aspects of the restaurant business; everything from general manager salaries to wait staff. That being said, it doesn't mean all is lost. There are opportunities that can help control labor costs, but more than that, can give the restaurant owner a competitive advantage.

The first thing that's been debated quite a bit is the use of a service charge as opposed to tipping. The reason behind this idea is to deal with the disparity in wages between the back of the house and the front of the house. The issue of tip-sharing is not an area where the employer can get involved. Therefore, there has become a greater and greater trend toward utilization of a service charge.

Guidance is offered under Minnesota statutes, which states that when the establishment elects to use a service charge, the employer must "clearly and conspicuously" notify customers that the service charge is not the property of the employee. This is because they may reasonably construe the service charge as being a payment for the employee's services—in other words, a tip. Further, Minnesota has clarified that "clear and conspicuous notice" must be in a font size that is one-fourth of an inch high if it is on a placard or one-eighth inch or larger letters if on any other kind of written notice.

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Restaurants that have gone to no tipping and imposed a service charge or raised prices to accommodate higher wages have experienced quite a bit of pushback. Other approaches are more moderate, with some stating their charges are used for employee health-care programs or other employee benefits. There doesn't seem to be any guidance as it relates to the use of these terms, but it is clear that you must let the customer know these are not going into the server's pocket, like a tip would.

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Another point to consider is that restaurants struggle with cashing out tips to servers and bartenders every day. This has become common for the independents, where the large chains, particularly national chains, include the tips in the employee's salary, which then requires withholding taxes (but it saves having to have large amounts of cash on hand). Since most tips are paid by credit card, the restaurant is paying basically 3 percent more on the tips because of the credit card fees. Some restaurants have elected to reduce the tips paid out by a percentage, such as 2 percent of the credit card fees, which may not cover all of the restaurant's fees but does certainly handle a portion of the credit card fees.

Other helpful strategies are various kinds of profit participation, particularly the management team, but also a pool for hourly employees where they, in effect, get a bonus, sometimes quarterly, sometimes annually, based on a percentage of the profits. This provides an incentive for employees to stay.

Normally there's a base of profit that the restaurant retains for ownership and a percentage over that profit amount is split on a formulaic basis among the various classes of employees, based on time of service, this approach provides flexibility and can take many forms. It is intended to improve retention.

Finally, I would be remiss if I didn't discuss what happens if the employer participates in tip-sharing.

In a recent discussion with attorneys Joel O'Malley and Joe Schmitt from Nilan Johnson, two experts in the area of tip-sharing and the use of service charges, they had the following advice.

As far as a service charge, make sure you follow the statute making it very clear to the customer that the service charge is the property of the restaurant. They suggested using a placard in the restaurant to reflect that the gratuity is not a tip and is property of the restaurant. It is key to make sure that the font size on the placard follows the guidelines mentioned above and is "clear and conspicuous.

Since this may be difficult, the better approach is to provide the appropriate wording printed on the customer's check.

Above, I discussed incentives restaurant owners could implement, but a word of advice is to tread carefully in this area. Sometimes there is a problem of allocation, which needs to take into account overtime, among other items.

Finally and most importantly, O'Malley and Schmitt recommended wage-an-hour insurance, which can insure against many pitfalls, but to also have an attorney ensure the policy covers things such as tip-sharing issues or other types of wage-an-hour disputes.

It's a tricky area, but as restaurants get more competitive, it's one worth exploring—cautiously. FSN

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