

SEPTEMBER 18, 2025 | WAGE & HOUR COMPLIANCE

Can Service Charges be Distributed to Independent Contractors?

By [Jordan Schwartz](#)

These days, restaurant bills are more confusing than ever. Even as an employment attorney in the hospitality industry, I often find myself scratching my head at the various additional service charges, automatic gratuity charges, surcharges, and other similar “extra fees” that are seemingly increasingly daily as a result of higher food and labor costs and shrinking profit margins experienced by restaurants since the pandemic.

While these charges can be confusing for patrons, complying with the law surrounding service charges and gratuities can be even trickier for restaurants and hotels. Indeed, hospitality employers nationwide have been hit for years with class action lawsuits alleging failure to properly pay/distribute tips, as well as failure to correctly characterize service charges and automatic gratuities. Thus, although this post will eventually delve into the question of whether service charges can be distributed to independent contractors, it is first necessary to provide a brief primer on the difference between tips/gratuities, service charges, and automatic gratuities.

As most of you likely know, a tip (also known as a gratuity) is a voluntary amount of money left by customers as appreciation for the service they received. Tips are typically given directly to service staff and are based on the customer’s satisfaction with their dining experience. Unlike service charges, which are added automatically to the bill, tips are not mandatory; they are generally left to the customer’s discretion. In many restaurants, tips make up a substantial portion of the server staff’s income, providing a source of earnings that supplements their base wage. (Some restaurants implement a tip pooling system, where all tips are collected and then distributed among the staff, including cooks, dishwashers, and other support staff, to ensure a more equitable distribution.)

A service charge, on the other hand, is a mandatory fee added to a customer’s bill. Whereas in the past service charges were typically limited to banquet events, they are now used nearly universally in restaurants to cover costs associated with the meal and/or additional services provided by the restaurant, such as takeout and delivery fees, packaging and transportation costs, catering fees, holiday service fees added during busy seasons, bottle service fees, etc. Unlike tips, which must go directly to employees, the employer retains the service charge and can use it however it sees fit, typically for various operational costs, employee wages, or other expenses.

Adding to the confusion is the term “automatic gratuity,” which is a mandatory percentage, typically added to a

bill for large parties. As the name implies, the customer does not retain discretion whether and/or how much to pay the automatic gratuity. Thus, the name is a misnomer, as it is not truly a "gratuity." As a result, The IRS classifies automatic gratuities as service charges, not tips.

With that backdrop in mind, we can now address a question I recently received from a restaurant asking whether it was permitted to distribute a portion of its automatic service charge to bottle service workers (i.e., independent contractors) who were being brought in for an upcoming event.

As an initial matter, as set forth above, service charge proceeds are the property of the employer to use and distribute in any way it sees fit, including, in this case, to the bottle service workers. Thus, there is nothing per se unlawful about the restaurant distributing the service charge to the bottle service workers working the event.

It is worth keeping in mind, however, that service charges typically are either retained by the employer or distributed to employees (as opposed to independent contractors) and count as regular wages subject to standard tax withholdings. Therefore, by distributing the service charge proceeds to the bottle service workers, the restaurant could be opening itself up to the potential argument that those workers are actually employees, not independent contractors, thereby making the restaurant their "joint employer." To avoid that potential legal claim, the restaurant would want to be careful to make sure that the bottle service worker (and/or that worker's actual employer) has control over her work and is free from the kind of direct supervision that would be given by the restaurant to an actual employee. If that cannot be accomplished, then the restaurant may just want to pay these workers from their general revenue as opposed to from the service charge proceeds.

Additionally, many states have laws about what, exactly, restaurants must disclose to patrons regarding service charges. For example, the District of Columbia has recently become much stricter regarding service charge disclosures. Indeed, in March 2023, the Office of Attorney General provided guidance to District restaurants explaining their legal obligation under the D.C. Consumer Protection Procedures Act (CPPA) to disclose fees, including service fees, in a timely, prominent, and adequate manner. The most applicable portion of the CPPA for this particular question requires that if the proceeds of the service charge are not paid to employees (which is the case here), restaurants must clearly communicate to the guest that the service fee or a portion thereof is not a gratuity and instead will be retained by the restaurant to cover operational expenses, which in this case, means providing pay to the bottle service workers. By clearly communicating this information, a restaurant located in DC can avoid a claim that it is violating the CPPA.

In sum, as mentioned above, there is nothing unlawful about a restaurant distributing a service charge to its independent contractors, so long as it keeps in mind the issues explained in this blog post. However, doing so could open up the restaurant to legal risks that it may not want to take. Thus, the restaurant should have a compelling reason to provide payment on this basis. On a broader scale, the application of laws relating to tips and service charges continues to constantly evolve. Accordingly, for restaurants, hotels and other businesses in the hospitality industry, it is essential to be aware of both state and federal laws on this topic so that tricky and complex issues like the one described above can be addressed in full compliance of the law.

If your business has any questions about legal compliance pertaining to service charges or gratuities, feel free to reach out to someone on our team.

