

Proposition 138
Tipped Workers; Wages
Fiscal Analysis

Estimated Impact

Proposition 138 would amend the Arizona Constitution to allow employers to pay up to 25% less than the state minimum wage to employees who regularly receive tips from patrons (tipped employees) if the employer can establish that, when adding tips received to wages paid, the employee received not less than the minimum wage plus \$2 for all hours worked. Current law allows employers to pay up to \$3.00 less than the state hourly minimum wage to tipped employees as long as the combination of wages and tips at least equals the minimum wage.

The measure's provisions may have an economic impact on state and local revenue collections and state spending. By changing wages and business costs, the proposition may affect individual income tax, corporate income tax and sales tax collections. In addition, the measure's provisions may affect participation in, and the cost of, public assistance programs. The impacts of the proposition on either state and local revenues or state spending cannot be determined in advance.

Analysis

Arizona law requires employers to pay a minimum wage of \$14.35 an hour in 2024. The state minimum wage is adjusted each year for the increase in the cost of living.

The proposed constitutional amendment's 25% minimum wage allowance would take precedence over the current "up to \$3.00 less" statutory allowance. Because the measure's new 25% minimum wage allowance would have disparate impacts on different employees depending on the level of tips they receive, we are unable to determine the overall impact on wages paid to tipped employees in this state.

A change in the level of wages paid to tipped employees in this state would have the following economic, revenue and spending impacts:

- Impact on Businesses – Labor costs for businesses in Arizona would be impacted, which may affect profits, operations activity, and employment levels. While there is considerable academic research on the effect of increases in the hourly minimum wage, research on the effects of the minimum wage tip allowance is more limited.
- Impact on Wage Earners – Tipped employees would experience a direct change in the level of wages received, and there may also be indirect impacts if businesses respond by adjusting their payroll costs, either through a change in employee hours or a change in the number of employees.
- Impact on Consumers – Consumers may be affected by the change in the tipped employee minimum wage if businesses adjust their product prices in response to the associated change in labor costs.
- Impact on State Revenues – A change in the tipped employee minimum wage would have different effects on state individual income and corporate income taxes and sales taxes depending on the overall directional impact on statewide wage earnings. As a result, the overall impact on state revenue collections cannot be determined in advance.
- Impact on State Expenditures – A change in the tipped employee minimum wage could potentially affect participation in a number of Arizona Health Care Cost Containment System (AHCCCS) and Department of Economic Security (DES) programs in which eligibility is determined by income level. This impact cannot be determined in advance.

(Continued)

Local Government Impact

The Urban Revenue Sharing formula distributes 18% of income taxes collected 2 years prior to incorporated cities and towns. Depending on how the change in the tipped employee minimum wage impacts income tax revenues, these distributions could change starting in FY 2027. State sales tax revenues are also shared with local governments. Any change in these collections resulting from the proposition would impact distributions to cities and counties starting in FY 2025.

7/18/24