

One Big Beautiful Bill Act's No Tax On Tips and Overtime Provisions Prompt Important Questions and Considerations for Both Employers and Workers

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On July 4, 2025, President Donald Trump [signed](#) the “One Big Beautiful Bill Act” (OBBBA) into law. The expansive federal tax and spending bill contains two provisions touching on extant wage and hour law that may have significant implications for employers and their pay practices. While no formal guidance yet exists as to how these provisions will be applied, employers are encouraged to proactively consider potential issues and benefits that may arise as employees seek to take advantage of the new federal tax deductions for their earnings.

Chapter 2 of the OBBBA, titled “Delivering on Presidential Priorities to Provide New Middle-Class Tax Relief,” establishes two new temporary above-the-line tax deductions for “qualified tip income” and “qualified overtime compensation.” These deductions are now in effect and will be available through at least the 2028 tax year.

“No Tax on Tips.”

- **What is the new deduction?** Chapter 2, Section 70201 establishes a deduction of up to \$25,000 for “qualified tip income,” which begins to phase out for individuals whose modified adjusted gross income exceeds \$150,000 (\$300,000 for joint filers).
- **Which workers can take advantage of the deduction?** “Qualified tips” are defined in the OBBBA as “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 [of the Treasury].” So, this deduction is available to anyone who is “in an occupation which customarily and regularly receive[s] tips.”

By October 2, 2025, the IRS must publish a list of occupations that fall into this category. It is unclear at this time whether the IRS’s list will be exhaustive or contain catch-all language covering a more expansive but undefined list of jobs for which the tip deduction will be available.

- **What tip income can a worker deduct?** “Cash tips” include not only tips received from customers that are paid in cash or charged to customers, but also tips received under a tip-sharing arrangement (commonly referred to as a “tip pool”). Further, consistent with FLSA regulations, the OBBBA excludes from its definition of “qualified tips” any mandatory service charges or “automatic gratuities” added to a bill by the business or service provider and paid to employees.

It is important to remember, however, that in most states, employees will still be required to pay state income taxes on their tips under applicable state law.

- **What are the new reporting requirements for employers under the OBBBA’s tip deduction provision?** Employers furnishing a Form W-2 to employees or a Form 1099 to independent contractors will be required to provide “a separate accounting of amounts reasonably designated as cash tips” and state the worker’s occupation so that the IRS may determine whether he or she is eligible for the tip deduction. Consistent with

applicable law, and as a matter of best practice, employers should already be tracking the amount of tips a tipped employee receives. But given that covered employees can now deduct such income on their federal tax filings, accurate accounting and recordkeeping will be even more important.

Moreover, employers should be cognizant of employees who may perform dual jobs—e.g., when one is a covered tipped position but the other is not. Guidance on this issue from the IRS may be necessary.

“No Tax on Overtime.”

- **What is the new deduction?** Chapter 2, Section 70202 establishes a new deduction of up to \$12,500 (\$25,000 for joint filers) for “qualified overtime compensation,” which begins to phase out for individuals whose modified adjusted gross income exceeds \$150,000 (\$300,000 for joint filers).
- **What overtime compensation can a worker deduct?** The FLSA requires overtime pay for covered, nonexempt employees at a rate of at least one and one-half times their regular rate of pay for all hours worked over 40 in a workweek. “Qualified overtime compensation” is defined in the OBBBA to mean “overtime compensation paid to an individual required under section 7 of the Fair Labor Standards Act of 1938 that is in excess of the regular rate at which such individual is employed.” In other words, employees may now deduct on their taxes the “half” portion of the “one and one-half times” compensation due to them under the FLSA; they may *not* deduct the entire (regular rate) wage amount for overtime hours worked on which the additional half-time premium pay is calculated.

Employers and employees should also be aware that the OBBBA’s overtime deduction applies only to overtime required under federal law. Overtime premium pay that is required under state but not federal law is *not* deductible on an employee’s federal taxes. Similarly, overtime due according to the terms of a collective bargaining or other company pay provisions is also ineligible for a deduction.

And, as is the case with the new federal tip deduction, employees in a majority of states will still be required to pay state income taxes on any overtime amounts that are now properly deducted on an employee’s federal return.

- **What are the new reporting requirements for employers under the OBBBA’s overtime deduction provision?** Employers furnishing a Form W-2 to employees will be required to specifically report, as a separate line item, the portion of payments that are “qualified overtime compensation” as defined under the OBBBA. Depending on, among other things, the number of employees a company has, the number and types of pay rates a company’s employees receive, and the jurisdictions in which the company’s employees work, this new reporting obligation could be a fairly significant undertaking—particularly for employers whose pay or recordkeeping practices are less sophisticated.

The issue is further complicated by the fact that, as we previously [discussed](#), the FLSA (and some state laws) permit employers to use certain premium pay as a credit or offset towards FLSA overtime owed. How such a practice could impact an employee’s deductions is unclear.

Other Key Considerations For Employers.

- **There is little guidance at this time, but the IRS will offer transition relief for tax year 2025.** Employers will be able to “approximate a separate accounting” of amounts designated as either cash tips or qualified overtime compensation earned prior to January 1, 2026 “by any reasonable method specified by the Secretary.” Employers should stay tuned for further guidance from the IRS.
- **Tips and overtime wages are still subject to Social Security and Medicare taxes.** Employers should continue to withhold these taxes from their employees’ earnings as they have in previous years.

- **Changes may incentivize employees to take advantage of non-taxable compensation.** Employers should be prepared for their employees to seek to take advantage of opportunities for tipped and overtime work, now that these forms of compensation are tax-advantaged. For example:
 - Employees may be encouraged to declare tips that they otherwise would not have, which may help employers comply with minimum wage laws.
 - Employees may be motivated to seek out additional overtime work and earn additional tax-advantaged compensation, which may result in higher payroll costs for the employer (assuming the employer makes such additional overtime work available).
- **Work to ensure compliance with new reporting requirements.** Employers will soon be required to report precisely what portion of an employee's compensation is cash tips and what portion is qualified overtime under the OBBBA. Employers will need to develop systems to accurately track these figures if they have not already done so.
- **Become familiar with new requirements and stay apprised of new guidance.** The OBBBA will inevitably lead to questions from employees who are not familiar with changes in the law. Employers should educate themselves and their employees on the new deductions and be prepared to answer questions when they arise. Employers should also stand by for more guidance from the Treasury Department and adjust their approach to the OBBBA accordingly when new information becomes available.

If you have any questions about the topics discussed in this article, please contact **James P. Looby** at jlooby@vedderprice.com, **Michael D. Considine** at mconsidine@vedderprice.com, or any Vedder Price attorney with whom you have worked.

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