

# OBBBA Tax Deductions for Tips & Overtime Pay

**To help employees understand how the recently passed legislation may impact them, we've compiled some key points from the OBBBA.**

## The “No Tax on Overtime” Provision of OBBBA

**The No Tax on Overtime provision of the recent One Big Beautiful Bill Act (OBBBA), creates a deduction on the employee's tax return for overtime (OT) paid during tax years 2025 through 2028. Simply put, the “half” portion of “time and a half” overtime pay will be excluded from federal tax up to a certain dollar amount.**

### **What does it mean for employees?**

An employee's total OT deduction is capped at \$12,500 (or \$25,000 for married filing jointly). Workers with adjusted gross incomes (AGI) up to \$150,000\* will qualify for the full deduction. For workers with AGIs over \$150,000\*, the allowable deduction is reduced by \$100 for every \$1,000 of income over those thresholds. This does not change or eliminate any tax withholdings from your paycheck; however, you will be able to claim a deduction on your federal tax return beginning this year.

## The “No Tax on Tips” Provision of OBBBA

**Similar to the No Tax on Overtime provision, the Act's No Tax on Tips provision creates a deduction on the employee's tax return for qualified tips received by employees in industries and occupations where it's customary to receive them.**

To qualify, the tip amount must be paid voluntarily, not subject to negotiation, and determined by the customer, not the employer or employee. For example, service charges, like 18% gratuities automatically charged to large parties are not tips, and are treated as wages when paid to an employee and are not subject to the No Tax on Tips deduction. The deduction is allowed for W-2 employees, independent contractors who receive a 1099-K or NEC, and employees reporting tips on IRS Form 4137. Tip deductions are capped at \$25,000, with the deduction slowly phased out for workers earning over \$150,000\*.

**Please note: Employees will still pay all required taxes (including Federal income tax) through payroll for both overtime and tips. These new deductions will be determined and applied by the IRS when employees file their personal tax returns.**

### **When do these changes become effective?**

Since OBBBA has been signed into law with both tip and overtime tax provisions included, it is now in effect and will be retroactive to Jan. 1, 2025. A work-eligible Social Security number is required to claim either of these deductions. Both deductions will be allowed from tax years 2025 through 2028. These deductions do not eliminate payroll taxes for Social Security and Medicare, or state and local tax obligations.

\*\$300,000 AGI for households filing joint returns

# Additional Info on the “No Tax on Tips” Provision

## ***Will this new rule apply to all industries that accept tips?***

As long as the employee is part of an occupation that will be determined by the Treasury Department to be one that customarily receives tips. We should see clarification on this toward the end of 2025.

## ***Are my tips still reported on tax returns?***

Yes. Employees still need to report their tips to their employer, and employers are required to report tips on IRS Form W-2. Tips that are not reported to the employer may still be deductible if employees use IRS Form 4137 to report them.

## ***What impact will this have on my personal tax refund or liability?***

The provision reduces tax liability by an amount equal to reported tips.

## ***Are cash and credit card tips treated differently?***

Credit card tips and cash tips are considered the same under this legislation.

## **What do tax-free tips mean for employers?**

Tips should still be reported and withheld. Due to the way the new rule functions, taxes on tips will be withheld, then removed from the total tax liability when workers file their personal tax returns. Under this provision, employers will need to separately identify total tips reported by employees when they produce the employee's Form W-2.

**Disclaimer - SuretyHR cannot provide legal or tax advice. This document is provided for informational purposes only. Employees and employers should consult with their legal and tax advisors if they have any questions regarding their compliance with the OBBBA.**