

Tax Update: Big Beautiful Tips

On July 4, 2025, the President of the United States signed into law H.R.1, commonly known as the One Big Beautiful Bill Act. This bill contains many new tax provisions, as well as updates to existing. We plan to communicate any changes that affect you as we learn more. Two of these changes are the "no tax on tips" and "no tax on overtime" provisions. Let's discuss how each one affects your employees and business.

No Tax on Tips

No tax on tips is a bit of a misnomer in this case. The final version of this bill does allow employees receiving tips in certain industries to take a tax deduction for some tip income, but it is subject to a cap, an income limit, and applies only to income tax, leaving the tips subject to the Social Security and Medicare taxes commonly referred to as FICA or "employment" taxes.

H.R.1. leaves a lot of unanswered questions that the IRS has 90 days to provide clarification on. The remainder of this analysis will be based on what we do know, with points of uncertainty noted pending IRS clarification.

Who qualifies?

The provision allows for a \$25,000 deduction for "Qualified Tip Income" on the recipient's individual tax return. This deduction is "per return" so the \$25k cap is thought to apply both to single filers as well as those filing jointly. The provision phases out for single taxpayers earning more than \$150k and joint filers earning more than \$300k annually. This deduction will be available to taxpayers regardless of whether they take the standard deduction or claim itemized deductions and does not reduce the deduction.

What counts as a tip?

We do not yet know how Qualified Tip Income will be defined, but we do know that to be considered a "tip" the amount must be voluntarily given by a customer. This means that credit card and cash tips left in your establishments are expected to qualify, but involuntary service charges or "auto-gratuities" are disallowed.

We also expect that this provision will apply to tips received by BOH and other support staff through a tip-out or tip pooling arrangement.

When does this start?

The \$25,000 exclusion is effective 1/1/25, so this will apply to your employees' tip income earned since the beginning of this calendar year.

What do I need to report on my employee's behalf?

Most payroll software will do the heavy lifting here. Ensure that tips are being reported using a "CC Tip" or "Cash Tip" pay type in the payroll software. This will ensure that the amounts are reported on the correct line of Form W-2. Any wages from involuntary service charges and automatic gratuity charges should not be included in these pay types.

Does this affect my FICA Tips Credit?

The FICA Tips Credit available to business tax filers remains intact. Because the deduction applies only to income tax, Qualified Tip Income remains subject to FICA taxation. H.R.1 makes no changes to a business' ability to claim a credit for FICA taxes paid on tips in excess of the federal tipped minimum wage.

As a business owner, does this benefit me?

No. This is a tax benefit to the tipped employee only.

No Tax on Overtime

Similar to the tips provision, the overtime pay deduction allowed under H.R.1 is subject to a cap, an income limit, and exempts certain overtime pay from income tax only.

Who qualifies?

The provision allows for a \$12,500 deduction for a single filer and a \$25,000 deduction for joint filers with overtime income. The provision phases out for single taxpayers earning more than \$150k and joint filers earning more than \$300k annually. Like the tips deduction, this is available to taxpayers regardless of whether they take the standard deduction or itemize.

What counts as overtime?

The H.R.1 overtime deduction is allowed for the "half" portion of "time and a half." As such, it applies to non-exempt, hourly wage recipients who are paid time and half for hours worked over the standard 40 hour work week.

For example, let's say that we have a production employee with an hourly rate of \$20 per hour. If this employee works one hour of overtime paid at \$30 per hour, the additional \$10 is eligible to be taken as an overtime pay deduction. The \$20 normal hourly pay is still subject to income tax and the full \$30 remains subject to FICA taxation.

When does this start?

The overtime deduction is also effective 1/1/25, applying to your employees' overtime income earned since the beginning of this calendar year.

What do I need to report on my employee's behalf?

The details of the exact reporting method for overtime pay subject to the H.R.1 deduction will not be known until the IRS releases further clarification. As of now, overtime pay is not broken out separately on Form W-2, as is done with tip income.

The best thing that you can do now is to ensure that any overtime pay earned by your employees is designated as such in your payroll system. You should expect to see a line for overtime pay in your payroll reports and the employees' pay stubs.

As a business owner, does this benefit me?

No. This is a tax benefit to the employee only.