

The One Big Beautiful Act Explained for Employers: What It Means for Overtime, Tips and Taxes

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On July 4, 2025, President Trump signed the One Big Beautiful Bill Act (OBBBA) into law. It includes two federal tax deductions for a portion of an eligible worker's tips and overtime earnings. Effective for 2025 through 2028, the "No Tax on Overtime" and "No Tax on Tips" provisions of the OBBBA are structured as federal income tax deductions, meaning they each reduce taxable income and, thereby, the tax liability for the employee claiming it. While guidance is still developing from the Internal Revenue Service (IRS), employers should begin preparing for new reporting obligations and consider how these changes may affect payroll practices, employee communications and year-end tax statements.

"No Tax on Overtime"

By way of background, the Fair Labor Standards Act (FLSA) requires that non-exempt employees be paid overtime at 1.5 times their regular rate of pay for any hours worked over 40 in a workweek. Now, under the OBBBA, employees may deduct the extra "half" portion of that overtime pay (the premium above the employee's regular rate for overtime worked) from their taxable income — thereby reducing the amount of federal income tax owed on their wages. Importantly, the deduction does not change how employers calculate or withhold social security or Medicare (FICA) taxes. The full amount of overtime pay (i.e., 1.5 times the employee's regular rate of pay) is still subject to FICA taxes. While employers will not need to change their payroll processing or FICA withholding methods, employers and other payors are required to file information returns with the IRS (or Social Security Administration) and furnish statements to employees showing the total amount of qualified overtime compensation paid during the year.

"No Tax on Tips"

The OBBBA also allows certain employees to deduct "qualified tips" received in occupations that the Secretary of Treasury has listed as customarily and regularly receiving tips on or before Dec. 31, 2024. "Qualified Tips" are voluntary cash or credit card tips, or those distributed through tip pools. The maximum annual deduction is \$25,000 and the deduction may not exceed the individual's net income for self-employed individuals (without regard to this deduction) from the trade or business in which the tips were earned. The deduction is also phased out for taxpayers with modified adjusted gross income over \$150,000 (\$300,000 for joint filers). By Sept. 29, 2025, the Secretary of the Treasury is expected to publish a list of occupations that "customarily and regularly" received tips on or before Dec. 31, 2024. Like the "no tax on overtime" deduction, employers and other payors must file information returns with the IRS (or Social Security Administration) and furnish statements to taxpayers showing certain cash tips received and the occupation of the tip recipient. The deduction likewise does not change how employers calculate or withhold social security or Medicare (FICA) taxes. The full amount of tips is still subject to FICA taxes.

Key Takeaways and Employer Compliance

- Tracking: If not already doing so, employers must separately track FLSA-required overtime premium pay and qualified tips income. Employers should ensure their payroll systems can accommodate new reporting categories and anticipated changes to Form W-2.
- Transition Period: The OBBBA includes a “transition rule,” which permits employers to “approximate” the amount designated as cash tips or qualified overtime compensation pursuant to a “reasonable method” to be specified by the Treasury Secretary for 2025.
- State Tax Considerations: The OBBBA’s new deductions do not affect state income tax obligations. Employers must continue to withhold state taxes on full gross wages and tips.
- Policy Review: Timekeeping and tip reporting policies should be reviewed (and updated if needed) to ensure compliance, including daily tip record submissions and reinforced overtime tracking.

Haynes Boone will continue to monitor developments as the IRS releases additional information and guidance.