





Overtime Pay Tax Deductions

Section 70202 of the OBBBA establishes a new above-the-line tax deduction for qualified overtime compensation. Under the new law, qualified overtime pay is exempt from federal income taxes beginning with the 2025 tax year. Overtime pay will continue to be subject to Medicare tax, Social Security tax, and state and local income tax.

Workers can deduct the federal overtime premium portion of their pay from their federal income taxes only. Note, not all overtime qualifies. Only overtime required under <u>Section 7 of the Fair Labor Standards Act (FLSA)</u> is eligible. Overtime pay required by state laws or union contracts (e.g., daily overtime rules in California, Alaska, Colorado, etc.) does not qualify. Additional details:

- The deduction is capped at \$12,500 per year for single filers and \$25,000 for joint filers; however, married individuals must file a joint return for this section to apply.
- The deduction is subject to a phase-out: for every \$1,000 by which a taxpayer's modified adjusted gross income exceeds \$150,000 (\$300,000 for joint returns), the allowable deduction is reduced by \$100, potentially eliminating the benefit for higher earners.

The overtime tax break is set to expire at the end of 2028.

Tip Tax Deductions

Section 70201 of the OBBBA creates a new above-the-line tax deduction for qualified tips. Eligible workers who receive qualified tips may deduct up to \$25,000 of their tip income when they file their federal income tax return.

The <u>IRS</u> is required to publish a list of occupations that qualify by October 2, 2025. Tips will continue to be subject to Medicare tax, social security tax, and state and local income tax, and the deduction is set to expire at the end of 2028.

Only cash tips (including those paid via credit card or digital platforms) are eligible for the deduction. The tip must be from a job that "customarily and regularly received tips" as of December 31, 2024.

Tips must be reported on a W-2 to qualify. To ensure employees can deduct tips from their federal income taxes in 2025, the tips must be:

- 1. Voluntary: Given by the customer (even if prepaid).
- 2. Reported to the employer.
- 3. Included on the employee's W-2 as tip income

Self-employed contractors (e.g., freelance bartenders) may also qualify if tips are reported on Form 1099 or Form 4137.

Based on <u>historical IRS guidance</u> and industry norms, the following occupations are expected to qualify:

- Restaurant servers
- Bartenders
- Baristas
- Hotel bellhops and concierges
- Valet attendants
- Hairdressers and barbers
- Nail technicians
- Spa and massage therapists
- Casino dealers
- Golf caddies
- Coat check attendants
- Tour guides

These roles typically receive **voluntary cash or charged tips** directly from customers or through tip pooling. Individuals receiving mandatory service charges and gratuities added by a service provider will most likely not be eligible for the deduction, nor will a required gratuity that a restaurant adds automatically to a bill for large parties. Prepaid tips, such as those included in a wedding package, may qualify if they are allocated to individuals and reported on their W-2.

Excluded Professions: Certain fields like accounting, law, health, consulting, and performing arts are **excluded** from the tip deduction.



Student Loan Reimbursement Tax Exclusion

The OBBBA permanently extends the tax exclusion for employer-paid reimbursement of qualified student loans under Code Section 127 and makes the \$5,250 limit subject to annual adjustments for inflation, allowing for increases to this maximum amount.

Paid Family and Medical Leave (PFML) Tax Credit

This temporary tax credit was not only made permanent but also expanded under <u>Section 45S</u>. Under the bill, employers can get a tax credit for wages for a leave period as well as for a portion of insurance premiums paid for an employee on paid family and medical leave. It also extends that credit to states with mandated PFML laws that were not eligible in the past. To be eligible, employers must have a written policy that offers a minimum of two weeks of PFML annually or a policy offering more than their state's mandated leave requirements.

HSA/Telehealth Changes

The bill makes changes to eligibility and reimbursements, including retroactively restoring COVID-era provisions.

- Increased plan eligibility allowing bronze and catastrophic plans in the healthcare marketplace will be treated as an HSA-qualified high-deductible health plan after December 31, 2025.
- HSA-qualified HDHPs will be allowed to cover telehealth expenses prior to the deductible without disqualifying the individual from opening and contributing to an HSA.
- Starting in 2026, the bill allows individuals participating in direct primary care arrangements (often referred to as
 "concierge" medical practices), where individuals pay a fixed monthly fee for primary care services, will become
 HSA-eligible.

Flexible Spending Account Adjustments

The OBBBA provides additional tax relief, beginning in 2026, by increasing the annual employee contribution limit for dependent care flexible spending accounts by 50%. The annual contribution limit for 2026 will be \$7,500 for married individuals and \$3,750 for married individuals filing separately.

Tax Relief for Child Care and Adoption Assistance

Employees receiving childcare and adoption assistance from their employers will benefit from improved tax treatment of these benefits, with the maximum employer-provided childcare credit increasing and the adoption assistance credit becoming partially refundable. Additional details on this are forthcoming.

Trump Accounts

The OBBBA introduced Trump Accounts, which are investment accounts for children under 18. Employers may establish a Trump Account Contribution Program and contribute up to \$2,500 per year on a tax-free basis to employees' qualified dependents. This is contingent upon the employer maintaining a written plan that adheres to non-discrimination rules and providing notices to eligible employees. Employers may make contributions starting on January 1, 2026.

Employer-Provided Meals

Effective January 1, 2026, the OBBBA prohibits deductions for most employer-provided meals, except for meals provided on vessels, drilling rigs, oil or gas platforms, and support camps. This provision will also not apply to restaurants and catering businesses who provide food and beverages to their employees. Under the OBBBA, the 50% deduction for business meal expenses remains, provided that specific provisions are met.

Bicycle Commuting

Effective January 1, 2026, the OBBBA will repeal the tax exclusion for up to \$20 per month bicycle commuting reimbursements.



Employers Checklist

Employers should carefully evaluate the necessary steps to promptly implement these changes. Although we await further guidance on some of these items, the following considerations will help organizations remain compliant with new regulations for W-2 reporting while optimizing employee benefits.

This information is provided as guidance. It is neither meant to be exhaustive nor meant to be construed as legal advice. Always consult with legal counsel regarding your specific circumstances.

- Review and update your payroll systems
 - Avoid bundling tips into wages; report them separately
 - o Ensure pay stubs are compliant with new law
- ✓ Document tip-sharing policies
- Service employers should clearly label gratuities in invoices as "tips for service staff"
- Track which employees worked each event and how tips are distributed
- Report tips on W-2s for employees or 1099s for contractors
- DO NOT consider moving people to exempt status to avoid the changes
- ✓ Employers should continue to withhold federal income taxes on both tips and overtime pay in accordance with existing law through the end of 2025, as workers will likely reconcile any deductions when they file their annual income tax returns.

- Update benefit plan and related documents for upcoming open enrollment.
 - Update FSA and HSA plan documents and payroll systems to accommodate the changes and increases
 - Consider offering these benefits if you do not already
- Evaluate your Paid Family Medical Leave to determine if it qualifies for the credit under Section 45S
- ✓ Work with your finance/tax/accounting group to ensure credits are properly claimed
- Proactively communicate with your employees regarding how these changes may impact them

