

No Tax on Tips or Overtime: What Two Provisions of the Big Beautiful Bill Mean for Employers in 2025

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With the recent signing of the One Big Beautiful Bill Act (OBBA) into law, employers across the country—especially those with hourly employees or employees who receive tips—are facing new tax and compliance obligations. The landmark legislation introduces two major changes:

1. The elimination of federal income tax on certain tips employees receive.
2. A new federal income tax deduction for overtime pay.

These provisions impose new payroll tracking and reporting requirements that will take effect retroactive to January 1, 2025. As a result, employers must act quickly to update their payroll systems and ensure they are fully prepared to comply with the law's complex eligibility rules and IRS reporting standards.

No Tax on Tips

Under the OBBA, employees and self-employed individuals no longer will be required to pay federal income tax on tips received in occupations that the IRS identifies as “customarily and regularly” tipped. This list of qualifying occupations will be released by October 2, 2025, and will be based on roles recognized as tipped as of December 31, 2024. This change is expected to impact significantly industries where tipping is a routine part of compensation, such as hospitality, food service, and personal care.

The new provision applies to voluntary cash and charged tips, which are reported on W-2, 1099, and 4137 Forms. However, the deduction is subject to a cap of \$25,000 per year. For those who are self-employed, the deduction cannot exceed the net income from the business in which the tips were earned. Additionally, this deduction begins to phase out for individuals making more than \$150,000 annually and couples filing jointly making over \$300,000. The deduction is available for both itemizing and non-itemizing taxpayers.

It is important to note that individuals involved in a Specified Service Trade or Business (SSTB) are not eligible for this deduction. SSTBs are certain types of businesses that are excluded from the Qualified Business Income Deduction, such as attorneys, accountants, and doctors. This applies to both self-employed individuals and employees whose employers are SSTBs.

As a result, those employers in industries where tips are common will have to update their payroll systems to track tips separately from regular wages, reflect new withholding tables, and ensure accurate W-2 reporting, with tips and overtime shown distinctly.

No More Tax on Overtime

In addition to the changes affecting tipped income, the OBBBA introduces a tax benefit for hourly workers by effectively eliminating federal income tax on qualifying overtime pay. This new deduction applies to employees and independent contractors for overtime hours worked, while also creating a new set of compliance and reporting obligations for employers. The mention of independent contractors in the overtime provisions of the OBBBA may be a drafting error as independent contractors typically are not eligible for overtime under Section 7 of the FLSA. As with the tip-related provisions, the overtime deduction applies retroactively to January 1, 2025, requiring employers promptly to adjust payroll systems and ensure accurate tracking and documentation of eligible compensation.

Notably, employees earning under \$150,000 annually can deduct up to \$12,500 in overtime pay from their taxable income. For employers, this means that overtime compensation must now be tracked and reported separately on W-2 and 1099 forms. Only the premium portion of overtime pay--the additional 0.5x rate for hours worked beyond 40 per week--qualifies for the deduction.

Accordingly, employers need to track separately the extra 0.5x pay for hours worked over 40/week, not the full overtime wage of 1.5x. Because the law is effective for this year, employers will have to track both tips and their employees' overtime back to January 1, 2025. As a result, employers likely will need to reconfigure and update their payroll systems in order to calculate and isolate overtime premiums accurately, note qualified overtime compensation, and ensure correct reporting to the IRS at the end of the year.

What Stays The Same

Employers still owe Social Security and Medicare taxes on overtime, and there have been no changes to the Federal Unemployment Tax (FUTA). Most public schools are exempt from FUTA--the new law does not change this.

New Jersey's own wage and hour laws remain in effect and unchanged. As of January 1, 2025, the state minimum wage is \$15.49 per hour, and tipped employees must earn at least \$5.62 per hour in direct wages, with employers required to make up the difference if tips do not bring them to the full minimum wage. Furthermore, employers are still required to comply with State overtime rules.

Implications for New Jersey Employers

For employers in New Jersey, especially for those in hospitality, food service, personal care, and retail, these reforms present new challenges.

- Employers must retroactively track tips and overtime from January 1, 2025, requiring immediate payroll system updates.
- Compliance risk increases due to new reporting obligations and eligibility rules.
- Businesses in SSTBs must carefully assess their classification to avoid misapplication of the deductions.

New Jersey employers should consult with payroll providers, tax professionals, and legal counsel to ensure full compliance.

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