OBBBA – "Exempt" Tips and Overtime

The One Big Beautiful Bill Act (OBBBA) was passed with the promise of "No tax on tips or overtime". This is a misrepresentation of what this bill actually does. Here we will review, in short, what this bill actually does (as pertains to tips and overtime), and what is required of you as an employer.

What to do for 2025?

There is no required reporting for "exempt" tips or overtime for the tax year 2025.

Here is a link to the resource page from the IRS: https://www.irs.gov/newsroom/treasury-irs-provide-penalty-relief-for-tax-year-2025-for-information-reporting-on-tips-and-overtime-under-the-one-big-beautiful-bill
And here is a relevant portion from that page:

Transition penalty relief for tax year 2025

Notice 2025-62 PDF provides penalty relief from the new information reporting requirements for cash tips and qualified overtime compensation under the OBBB to employers and other payors for not filing correct information returns and not providing correct payee statements to employees and other payees.

Specifically, **employers and other payors will not face penalties for failing to provide a separate accounting of any amounts reasonably designated as cash tips or the occupation of the person receiving such tips. In addition, employers and other payors will also not face penalties for failing to separately provide the total amount of qualified overtime compensation**. The relief is limited to returns and statements filed and provided for tax year 2025 and applies only to the extent that the person required to make the return or statement otherwise files and provides a complete and correct return or statement.

Treasury and IRS are aware that employers and other payors may not currently have the information required to be reported under the OBBB, or the systems or procedures in place to be able to correctly file the additional information with the IRS, or SSA in the case of a Form W-2, and provide it to employees and other payees. Moreover, **the IRS has announced that Forms W-2 and 1099 for tax year 2025 will not be updated to account for the OBBB-related changes**. Therefore, tax year 2025 will be treated as a transition period for IRS enforcement and administration of the new information reporting requirements for cash tips and qualified overtime compensation under the OBBB.

2026 and Beyond

Qualified Overtime Compensation Reporting

Beginning in 2026, Qualified Overtime Compensation (QOTC) will be required to be reported separately on federal tax forms (like the W2).
This does NOT change tax withholding, there are NO changes to paycheck calculations, this is a federal tax return benefit ONLY!

QOTC is calculated as the premium portion ONLY of any federal overtime paid. Crucially, this excludes any state or municipal, union, or company overtime allotted over the minimum federal premium, and does not include double-time, or any other “enhanced multipliers”. Current guidelines set modified adjusted gross income caps annually at: $12,500 for single filers, and $25,000 for joint filers.

If you are used to entering OT hours as a total for a given pay period, no payroll system will be able to determine which hours qualify for the tax benefit. **Qualifying Overtime MUST be recorded by workweek!** The heavy lifting of this reporting falls on Time & Attendance, as the qualifying hours must be logged by workweek, in accordance with federal overtime rules. We suggest working closely with your Time & Attendance provider to set up QOTC reporting rules accordingly. Once qualifying hours are identified in your Time & Attendance system, Pay-Net can help copy the QOTC amounts to a memo code that will be used to populate Box 12 of the W2 using code ‘TT’, per current IRS guidelines.

Qualified Tips Reporting

Beginning in 2026, Qualified Tips will be required to be reported separately on federal tax forms (like the W2).
This does NOT change tax withholding, there are NO changes to paycheck calculations, this is a federal tax return benefit ONLY!

Qualified Tips do NOT include service charge structures and are limited to those industries and labor positions designated as qualified by the IRS. Current guidelines allow for up to $25,000 in deductible qualified tip income, with phase-out beginning at modified adjusted gross incomes of $150,000 for single filers, and $300,000 for joint filers.

In Pay-Net’s system, Qualifying Tips MUST be paid via earning codes associated with the following types:

- ‘Cash Tips’ – cash reported to the employer, received as tips
- ‘Charged Tips’ – those tips accumulated through electronic transactions
- ‘Banquet Tips’ – cash reported to the employer, received as tips while working a banquet or event
- ***IMPORTANT***: wages paid under earning codes with the ‘Banquet Earnings’ type will NOT be included, as they are deemed “involuntary” or “service charges”, and do not qualify for the tax deduction.

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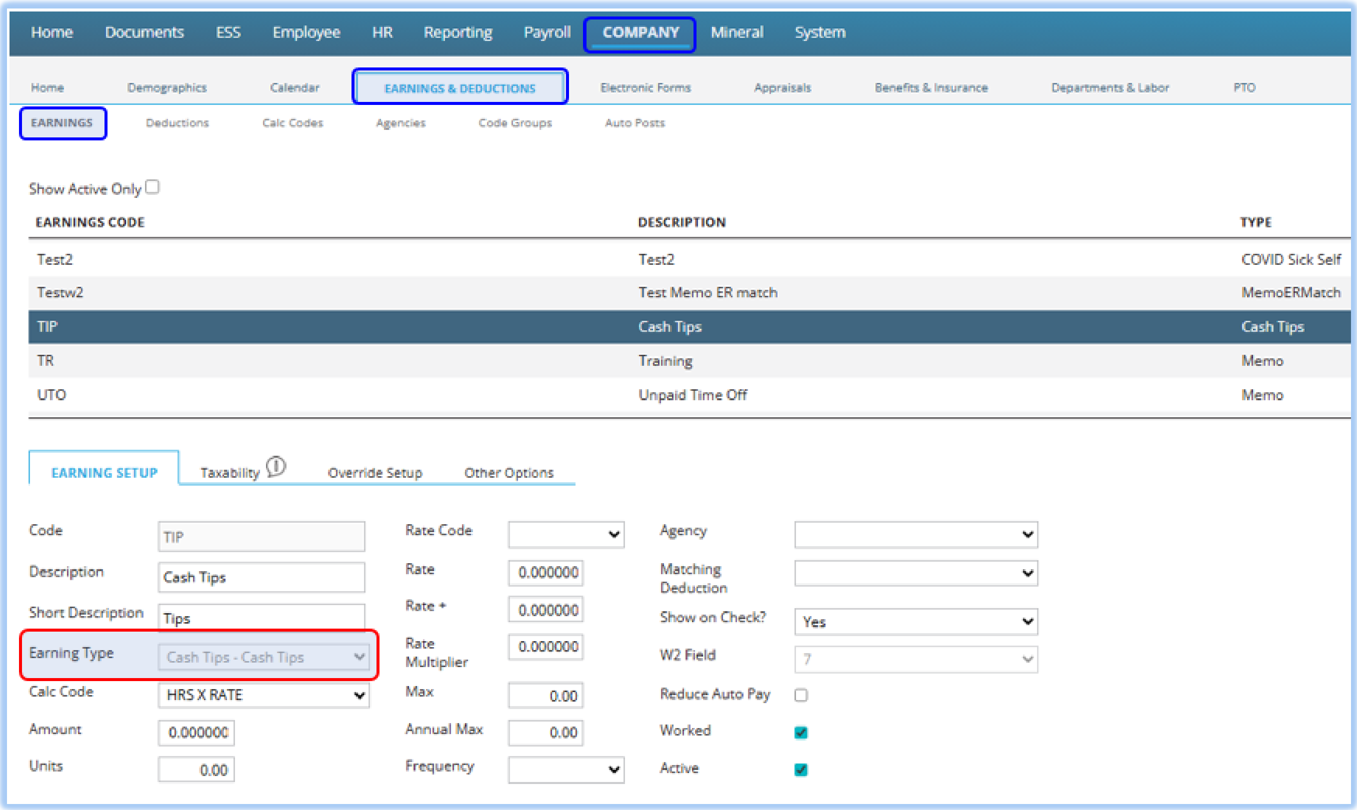
You can review your earning code setups here:



In Pay-Net's system, in order to pull qualified tips into year-end reporting, qualifying employees MUST be designated as such with a proper Standard Occupational Classification (SOC) Code. These codes correspond to designated Treasury Tipped Occupation Codes (TTOC), but are distinct!

You can find a full listing of the qualifying codes here: https://pay-net.zendesk.com/hc/en-us/article_attachments/37213863173143

Once a qualifying Earning Type has been applied to the Tips earning code(s) on the company level, and a qualifying SOC Code has been applied to the position on the employee level, Pay-Net can help copy the Qualified Tips amount to a memo code that will be used to populate Box 12 of the W2 using code 'TP', per current IRS guidelines.

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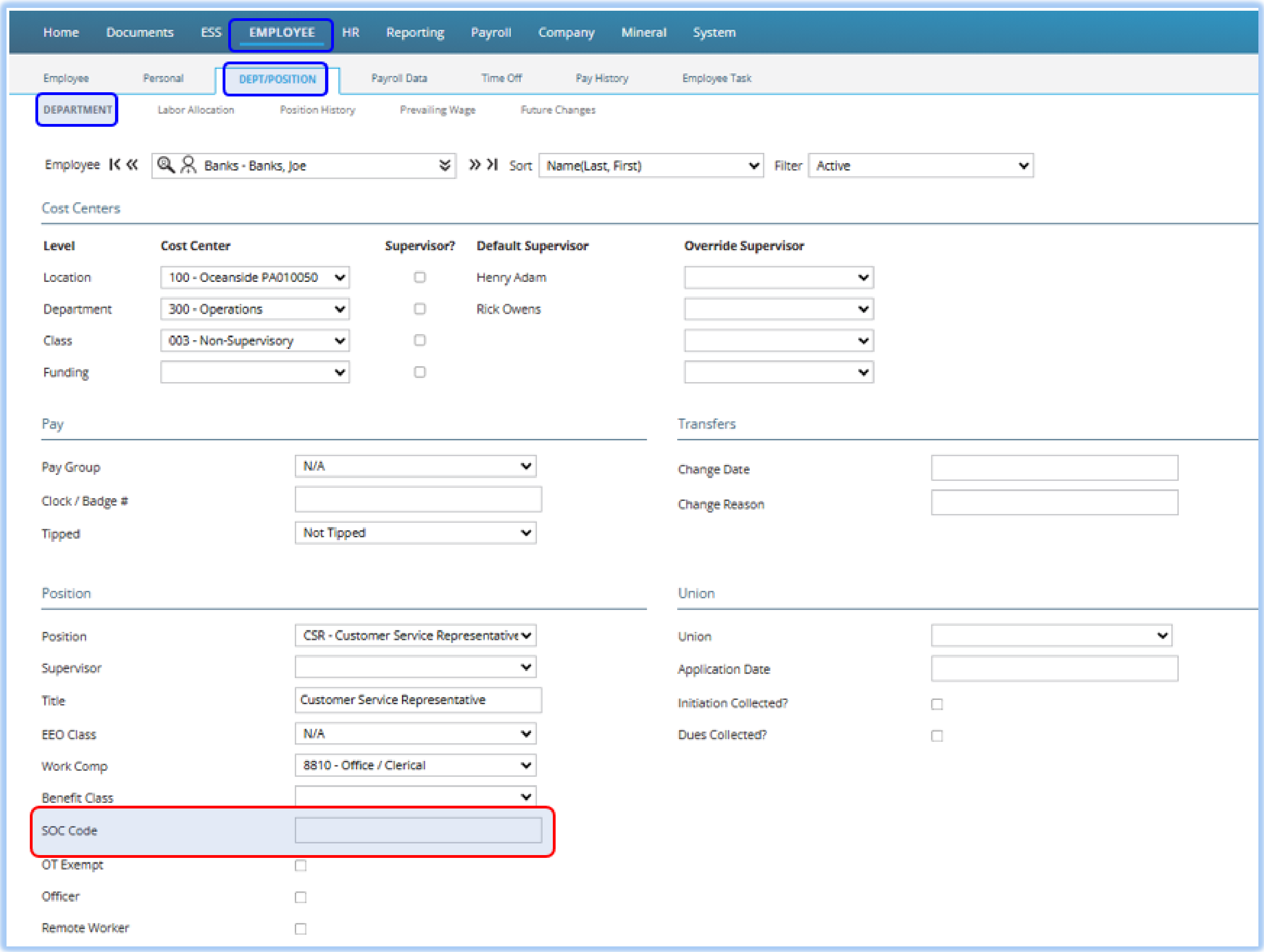
You can populate SOC Codes on employees here:



Additional Resources

- Treasury Tipped Occupation Code (TTOC) Listing
- Guidance for individuals who received overtime in 2025
- Individuals who received tips or overtime during tax year 2025
- OBBBA Provisions, a Comprehensive IRS Summary
- OBBBA IRS YouTube Video Playlist