

Bodman PLC

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No Tax on Tips and Qualifying Overtime: Trick or Treat?

By: John David Gardiner, Member and Chair, Workplace Law Group

In the spirit of Halloween, please consider the below as we approach year end and April 15, 2026.

On July 4, 2025 as part of Public Law 119-21 — aka the One Big Beautiful Bill Act (the “Act”) — Congress enacted above-the-line federal tax deductions that a qualifying employee can claim for the employee’s tipped income, up to \$25,000 per employee / per tax year, and the one-half portion of an employee’s qualifying time and one-half payment for overtime work, up to \$12,500, per employee per tax year. These deductions are retroactive to January 1, 2025, and will remain in place through December 31, 2028.

What we now better understand, based on recent IRS guidance, is the following.

Tips

- Only cash tips are eligible for the deduction. For IRS tax purposes, cash tips include money received in cash, as well as charged tips (like those on a credit or debit card) and tips from a tip-sharing arrangement. Tips must be voluntary and received in an occupation designated by the IRS as one that customarily and regularly received tips on or before December 31, 2024. Mandatory service charges, like an automatic gratuity for a large party, do not count.
- The maximum annual deduction for qualified tips is \$25,000 per individual. For self-employed individuals, the deduction cannot exceed their net income from the business where the tips were earned.
- Income limitations: The deduction phases out for taxpayers with a modified adjusted gross income (MAGI) exceeding \$150,000 for single filers or \$300,000 for married couples filing jointly.
- Excluded businesses: Tips received by employees of a "specified service trade or business" (SSTB), such as law, accounting, or healthcare, do not qualify for the deduction.

Overtime

- The deduction only applies to "qualified overtime compensation," which is defined as the extra "half" portion of time-and-a-half pay required by the Fair Labor Standards Act (FLSA). It does not apply to regular pay or to bonus overtime pay not mandated by the FLSA.
- The annual deduction limit is \$12,500 for individuals and \$25,000 for married couples filing jointly.
- Similar to the tip deduction, the overtime pay deduction phases out for taxpayers with a MAGI over \$150,000 for individuals or \$300,000 for joint filers.

Tax Considerations

- Deductions apply only to federal income tax.
- FICA withholdings remain applicable to all wages, including tips and overtime.

Recommendations

- **Employers:** Businesses must continue to withhold and pay FICA taxes on all wages and reported tips. Employers are now required to separately report qualified tips and overtime premium pay on Form W-2 for tax years 2026–2028 to enable employees to claim the deductions. For the 2025 tax year, employers may use a "reasonable method" to approximate and report these amounts, as directed by anticipated future IRS guidance.
- **Employees:** To claim the deduction, employees must report all qualifying tips. In that withholding was not adjusted for 2025, employees likely will realize a tax benefit when they file their tax return in early 2026. For 2026 and later, employees can use a revised Form W-4 to adjust their withholding based on the estimated deductions.

Please try to avoid getting spooked out and consider consulting with the author, John David Gardiner (jgardiner@bodmanlaw.com | 616-205-3123), the Co-Chair of Bodman's Business Tax Group, Wayne Roberts (wroberts@bodmanlaw.com | 616-205-1872), or another ghoulish member of Bodman's [Workplace Law Group](#) as the need arises. Bodman cannot respond to your questions or receive information from you without establishing an attorney-client relationship and clearing potential conflicts with other clients. Thank you for your patience and understanding.

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