

Gibbons Corporate & Employment News

A Primer for Employers on OBBBA's No Tax on Tips Law

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The Statutory and Regulatory Regimes Under OBBBA and Proposed IRS Regulations

The much publicized No Tax on Tips Law is found in a new Section 224 of the Internal Revenue Code as enacted by Section 70201(a) of H.R. 1, One Big Beautiful Bill Act (OBBBA), Public Law No. 119-21, and signed into law by President Trump on July 4, 2025. It provides a deduction for qualified tips and is retroactively effective for tips earned on or after January 1, 2025. The law sunsets for taxable years beginning after December 31, 2028. Just as the law was a campaign issue in the 2024 presidential race, it will undoubtedly be a campaign issue in the 2028 presidential race.

On September 19, 2025, in the morning on the last Friday of the summer, the Internal Revenue Service released proposed regulations that identify the occupations eligible for the deduction and provide a definition of qualified tips.

Taxpayers may rely on the proposed regulations for taxable years beginning after December 31, 2024, and on or before the regulations are published as final regulations in the Federal Register. Taxpayers are entitled to this reliance as long as they follow the proposed regulations in their entirety and in a consistent manner.

The law provides an above-the-line deduction for itemizers and non-itemizers for any taxable year of up to \$25,000 per tax return. This limit applies regardless of a taxpayer's filing status. A married taxpayer must file a joint return to qualify for the deduction. This means that if both partners of a married couple earn qualified tips, there is up to one \$25,000 deduction.

A \$100 deduction provides a \$10 tax cut for taxpayers in the lowest 10 percent bracket and a \$37 tax cut for taxpayers in the highest 37 percent bracket. The deduction phases out by \$100 for each \$1,000 by which a taxpayer's modified adjusted gross income (MAGI) exceeds \$150,000 for single filers and \$300,000 for joint filers. The phase-out occurs after applying the \$25,000 limit to the deduction.

A taxpayer who takes the full \$25,000 deduction and does not exceed \$150,000 of MAGI and is in the 24 percent bracket has a \$6,000 tax cut.



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For a single person seeking to claim the full \$25,000 deduction, the deduction becomes zero at \$400,000 of MAGI, and for a married couple the deduction becomes zero at \$550,000 of MAGI. Modified adjusted gross income means a person's adjusted gross income increased by any amount excluded under Section 911 (foreign earned income), 931 (income effectively connected with a trade or business in a U.S. possession), and 933 (income from sources in Puerto Rico).

For qualified tips received by an individual engaged in his or her own trade or business other than as an employee, the deduction is allowed only to the extent the taxpayer's gross income from the trade or business, including the qualified tips, exceeds the sum of the deductions, other than the deduction allowed for qualified tips, allocable to the trade or business.

The deduction for qualified tips applies in addition to the standard deduction.

The deduction is limited to qualified tips reported on Form W-2, 1099, or 4137 (Social Security and Medicare Tax on Unreported Tip Income). A taxpayer must have a Social Security number to claim the deduction. Taxpayers with an Individual Taxpayer Identification number, rather than a Social Security number, cannot claim it. Persons eligible for a Social Security number are U.S. citizens, lawful permanent residents, and non-immigrant visa holders authorized to work in the U.S. by the Department of Homeland Security. Accordingly, those present in the U.S. illegally cannot claim the deduction.

Married taxpayers must include the Social Security number of the taxpayer who has received the qualified tips. A Social Security number is required of both taxpayers only when both have qualified tips for which they are claiming the deduction.

Qualified tips are still subject to withholding for the employee's share of Social Security and Medicare taxes. The employer must pay the employer's share of Social Security and Medicare taxes on qualified tips.

Finally, qualified tips are eligible for elective employee salary deferral contributions, non-elective employer contributions, and matching employer contributions to 401(k) plans. Employers do not have to amend their plan documents to change the definition of compensation to allow for these contributions on qualified tips.

What is the Deduction For?

The deduction is for qualified tips. Section 224(d)(2)(A) provides that the tip must be paid voluntarily without consequence in the event of nonpayment, not be the subject of negotiation, and be determined by the payor. The proposed regulations also provide that qualified tips must be paid without compulsion. Service charges, automatic gratuities, and any other mandatory amounts automatically added to a customer's bill by the vendor or establishment are not qualified tips regardless of whether they are subsequently distributed to employees. If a customer is expressly provided an option to disregard or modify amounts added to a bill, these amounts are not mandatory amounts and can be qualified tips.

The following examples of qualified tips are found in the proposed regulations:

Customer E dines at Restaurant X with a party of eight people. E's bill for food and beverages for the party of eight includes a "recommended tip" equal to 18 percent of the price for food and beverages. However, there is a line for the customer to subtract (including to zero) or add to the recommended tip amount before paying the bill. Customer E subtracts 3 percent from the recommended tip amount resulting in a tip of 15 percent of the price for food and beverages. Customer E had a right to determine the additional amount, and he was expressly provided the option to disregard or modify the "recommended tip" amount. Under these circumstances, the recommended 18 percent amount is not a service charge. Rather, the 15 percent amount that the customer voluntarily paid without compulsion is a qualified tip.

Customer F has a meal at Restaurant Y. The server presents the bill for the meal to Customer F on an electronic handheld point of sale (POS) device. The POS device

includes the charge for each food and beverage item and the applicable tax. The POS device prompts Customer F to leave a tip and provides the following options: 15 percent, 18 percent, 20 percent, other, and no tip. Customer F selects 18 percent and pays the total balance via credit card through the POS device. Customer F had a right to determine the additional amount, and Customer F was expressly provided the option to leave no tip. Under these circumstances, the 18 percent amount is a qualified tip.

The following examples of mandatory amounts that are not qualified tips are found in the proposed regulations:

Restaurant W's menu specifies that an automatic 18 percent charge will be added to all bills for parties of six or more customers. Customer D's bill for food and beverages for her party of six includes the 18 percent charge on the "tip line," and the total includes this amount. Restaurant W distributes this amount to the wait staff and bussers. Customer D did not determine the amount of the additional charge, nor was Customer D expressly provided an option to disregard or modify the amount. Under these circumstances, the 18 percent charge is not a qualified tip.

Customer F has a meal at Restaurant Y. The server presents the bill for the meal to Customer F on an electronic handheld POS device. The POS device includes the charge for each food and beverage item and the applicable tax. The POS device prompts Customer F to leave a tip and provides the following options: 15 percent, 18 percent, and 20 percent. Customer F must select a "tip amount" before paying the bill. Customer F selects 15 percent and pays the total balance via credit card through the POS device. Customer F did not voluntarily determine the amount of the additional charge because Customer F was forced to select an amount greater than zero. Customer F was not expressly provided an option to disregard or modify the amounts presented. Customer F did not make the payment free from compulsion. Under these circumstances, the 15 percent charge is not a qualified tip.

Customer F has a meal at Restaurant Y. The server presents the bill for the meal to Customer F on an electronic handheld POS device. The POS device includes the charge for each food and beverage item and the applicable tax. The POS device prompts Customer F to leave a tip and provides the following options: 15 percent, 18 percent, and 20 percent. Customer F must select a "tip amount" before paying the bill. Customer F selects 18 percent and pays the total balance via credit card through the POS device. Customer F did not voluntarily determine the lowest required amount (15 percent) of the additional charge because Customer F was forced to select an amount greater than zero. Customer F was not expressly provided an option to disregard or modify the amounts presented. Customer F did not make the payment of 15 percent free from compulsion. Under these circumstances, 15 percent of the charge is not a qualified tip. However, the 3 percent additional amount is a qualified tip because Customer F voluntarily, without compulsion, paid the 3 percent additional amount.

In addition to large dining party automatic gratuities, other examples of service charges commonly added to a customer's check that are mandatory amounts and not qualified tips are:

1. Banquet event fees;
2. Cruise trip package fees;
3. Hotel room service charges; and
4. Bottle service charges by nightclubs and restaurants.

Employees who enter into a Tipped Employee Participation Agreement as part of the Tip Reporting Determination Agreement (TRDA) program or a Model Gaming Employee Tip Reporting Agreement as part of the Gaming Industry Tip Compliance Agreement (GITCA) program may determine the amount of qualified tips using the applicable tip rate in their agreement, and amounts reported on Form 4137 in lieu of reporting actual tips received.

As an anti-abuse rule, the proposed regulations provide that a tip received by an employee or other service provider who has an ownership interest in or is employed by the payor of the tip is not a qualified tip.

Qualified tips do not include amounts received for: a service the performance of which is a felony or misdemeanor under applicable law; prostitution services; and pornographic activity. The proposed regulations do not define pornographic activity. Examples of illegal services are counterfeiting and fencing stolen goods, drug dealing, and unlicensed sales.

Qualified tips must be cash tips, which are tips received from customers or, in the case of an employee, through a mandatory or voluntary tip-sharing arrangement, such as a tip pool. Cash tips are paid in a cash medium of exchange, such as cash, check, credit card, debit card, and gift card. They also include tangible or intangible tokens that are readily exchangeable for a fixed amount in cash, such as casino chips, and any other form of electronic settlement or mobile payment application denominated in cash. They do not include items paid in any medium other than cash, such as event tickets, meals, services, or other assets that are not exchangeable for a fixed amount in cash, such as most digital assets. Employers can take the position that cash tips include digital tokens on streaming platforms and stablecoin tip payments with a fixed value.

Who Gets The Deduction?

The deduction applies to taxpayers who work in an occupation that customarily and regularly received tips on or before December 31, 2024. This limitation is designed to prevent taxpayers, especially those in highly paid occupations, from reclassifying wages as tips to obtain the deduction.

A qualified tip does not include a tip paid in the following specified service trades or businesses as defined in Section 199A(d)(2) of the Code:

1. In the fields of accounting, actuarial science, athletics, brokerage services, consulting, financial services, health, law, and performing arts;
2. In any trade or business in which the principal asset is the reputation or skill of one or more employees or owners; or
3. That consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities.

If the individual performs services as an employee, the relevant trade or business is the trade or business of the employer. An amount received by an employee performing services for an employer in the course of a specified service trade or business operated by the employer is not a qualified tip, regardless of whether the trade or business or an owner of the trade or business is eligible for a deduction under Section 199A, and regardless of whether the employee is performing services in an eligible occupation or whether that occupation is a specified service trade or business.

The following examples of tips paid in specified service trades or businesses are found in the proposed regulations:

Self-employed Comedian C performs a stand-up comedy routine at Performance Venue V. The audience members at Performance Venue V give Comedian C cash tips after the performance. The cash tips are not qualified tips because they are received in the course of Comedian C's trade or business in the performing arts. Such cash tips are not qualified tips notwithstanding the fact that Comedian C's occupation of comedian is included in the Treasury Tipped Occupation Code (TTOC) category of Entertainers and Performers on the list of occupations that customarily and regularly received tips on or before December 31, 2024.

Pianist P is an employee of Hotel H. Hotel H does not operate a specified service trade or business. Pianist P plays the piano in the lobby of Hotel H. Hotel H's patrons often leave cash tips in a jar on the piano for Pianist P. The cash tips are qualified tips, even though the tips are received for services in the performing arts, because Pianist P is performing services as an employee, the employer is not operating a specified service trade or business, and Pianist P's occupation of piano player is included in the TTOC category of musicians and singers.

Bartender B is an employee of Company R. Company R does not operate a specified service trade or business. Theater T enters into a contract with Company R to provide bartending services during the intermission of certain live performances at Theater T. During the intermissions, Bartender B receives cash

tips from patrons at Theater T. The cash tips are qualified tips because Bartender B is performing services as an employee, the employer is not engaged in a specified service trade or business, and the employee's occupation of bartender is included in the TTOC category of bartenders.

The proposed regulations contain a list of the jobs eligible for the deduction. The list contains 68 TTOC Occupation Titles divided into eight industry categories: beverage and food service; entertainment and events; hospitality and guest services; home services; personal services; personal appearance and wellness; recreation and instruction; and transportation and delivery. The chart below sets forth commonly tipped jobs in each category. A link to the full list at Table 1 of Proposed Treasury Regulation §1.224-1(f) is found at <https://public-inspection.federalregister.gov/2025-18278.pdf>

Common Jobs Covered By The No Tax On Tips Law Under IRS Proposed Regulations

Beverage and Food Service bartenders, wait staff, and food servers (non-restaurant)	Entertainment and Events digital content creators (streamers, podcasters, and social media influencers) (except pornographic activities); gambling dealers, dancers, musicians, disc jockeys (except radio), ushers, lobby attendants, and locker room, coatroom, and dressing room attendants	Hospitality and Guest Services bellhops, baggage porters, concierges, and maids	Home Services home maintenance and repair workers, and home cleaning service workers
Personal Services nannies and babysitters, personal care and service workers, and event officiants	Personal Appearance and Wellness barbers, hairstylists, shampooers, manicurists, makeup artists, massage therapists, exercise trainers and group fitness instructors, and tattoo artists	Recreation and Instruction golf caddies, tour guides, and sports and recreation instructors	Transportation and Delivery parking and valet attendants, taxi and rideshare drivers, chauffeurs, shuttle drivers, and goods delivery workers

What are the Employer's Withholding and Reporting Obligations?

For 2025, employers generally will continue to withhold federal income tax as they have prior to OBBBA's enactment. For 2026, the IRS plans to issue revised income tax withholding tables.

Employees that want to account for the qualified tip deduction in the income tax withheld for the remainder of 2025 must submit a new 2025 Form W-4 to their employer. Employees can manually use the IRS deductions worksheet and input the result in Step 4(b) of the 2025 Form W-4. The IRS Tax Withholding Estimator has not yet been updated to reflect the qualified tip deduction.

The IRS plans to issue transition relief for employers to report qualified tips for 2025 to enable them to reasonably approximate the amount of qualified tips.

Employees will take the deduction on their Form 1040. The IRS has issued draft Schedule 1-A (Form 1040), Additional Deductions, for 2025 on which taxpayers determine modified adjusted gross income in Part I and the qualified tip deduction in Part II.

Employers will report both qualified tips and nonqualified tips as part of taxable wages in Box 1 of Form W-2 (Wages, tips, and other compensation), Box 5 (Medicare wages and tips), and Box 7 (Social Security tips). Employers enter the amount of any uncollected social security tax and Medicare tax in Box 12.

The IRS has issued a draft Form W-2 for wages earned in 2026 that employers will distribute to employees in January 2027. Employers use Box 12 to report an employee's qualified tips using code TP. The draft form includes a new Box 14b for employers to report an employee's qualifying occupation, which is referred to as the TTOC. The

proposed regulations set forth this code for each occupation eligible to receive qualified tips.

Employers that distribute service charges to employees should treat them the same as regular wages for withholding and reporting requirements as provided in Publication 15 (Circular E), Employer's Tax Guide.

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