



2025 Tip and Overtime Deduction Update

Timeline and Deadlines

The law takes effect January 1, 2025 for wages and tips earned after that date. Employers have a transition year (2025) to prepare. Full mandatory reporting, including separate boxes on employee W-2s for 'qualified tips' and 'qualified overtime,' is expected to begin for the 2026 tax year (W-2s issued January 2027) once IRS forms are finalized.

What to Track Separately

Qualified Tips: Voluntary amounts freely given by customers. Do not include service charges, banquet fees, or automatic gratuities. **Qualified Overtime Premiums:** The extra half pay above regular rate for time-and-a-half. Example: If an employee earns \$20/hr and is paid \$30/hr for overtime, only \$10/hr qualifies.

Payroll and W-2 Adjustments

Prepare payroll systems to track qualified tips and qualified overtime as distinct pay elements. For 2025, show these amounts on paystubs and include a year-end statement or a Box 14 note on the W-2 so employees have documentation. Update for new 2026 W-2 codes/boxes once the IRS publishes final instructions.

Labor Law Still Applies

OBBBA changes tax rules, not wage rules. Employers must still ensure tipped employees earn at least minimum wage after tips, make up the difference if not, and file Form 8027 if applicable.

Recordkeeping Expectations

Maintain for at least four years: daily tip reports (voluntary vs. automatic), payroll journals, proof of service charges paid as wages, and documentation explaining how tips are defined internally.

Best Practices

Talk to your payroll provider about system updates. Update employee handbooks to clarify voluntary vs. automatic tips. Train managers to record correctly. Encourage employees to keep their own tip logs. Keep digital copies of paystubs and reports.

Timeline Recap

January 1, 2025: Start tracking separately. Late 2025: IRS issues final W-2 format guidance. 2026: New W-2 reporting expected to be fully mandatory.

Final Reminder

Starting clean in January will make 2025 reporting smoother and protect both you and your employees. Contact Elise for help updating your tracking system.

Best,

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Note: This overview is for educational purposes only. Please consult a qualified tax professional for personalized advice.