

EMPLOYER REQUIREMENTS DUE TO OBBBA



The [One Big Beautiful Bill Act \(OBBBA\)](#), signed into law on July 4, 2025, introduces new federal income tax deductions for eligible employee overtime pay and tips. This legislation, which applies to tax years beginning in 2025, requires employers to make significant changes to their payroll and reporting procedures.

Overtime Pay Deduction

The OBBBA provides a temporary deduction for the premium portion of an employee's overtime pay.

- **Eligibility:** The deduction is only for the "premium pay" on overtime hours worked over 40 hours in a week, as defined by the [Fair Labor Standards Act \(FLSA\)](#). If a state or union contract provides a higher overtime rate, only the FLSA-mandated premium portion is eligible for the deduction. For example, if an employee's regular rate is \$10/hour and their overtime rate is \$15/hour (time-and-a-half), the deductible amount is the \$5/hour premium.
- **Deduction Limits and Phase-Outs:** The deduction is capped at \$12,500 for single filers and \$25,000 for joint filers. This amount is reduced by \$100 for every \$1,000 that the employee's gross income exceeds \$150,000

(\$300,000 for joint returns).

Tips Deduction

The law also allows for a deduction for tips received by workers in "traditionally and customarily tipped industries."

- **Eligibility:** The deduction is available for tips earned in industries that the Treasury Department is required to list by October 2, 2025. It applies to both employees and non-employees (e.g., independent contractors working through third-party settlement organizations).
- **Deduction Limits and Phase-Outs:** The maximum deduction is \$25,000. Similar to the overtime deduction, this amount is reduced by \$100 for every \$1,000 that the employee's gross income exceeds \$150,000 (\$300,000 for joint returns).

Employer Responsibilities and Reporting

Employers need to adjust their procedures to comply with the new law, especially regarding payroll and tax reporting.

- **W-2 Reporting:** Employers must report the deductible amount of overtime and tips on [Form W-2](#). This is a new requirement, as these amounts were not previously tracked separately. For tips, employers also need to identify the qualifying occupation.
- **Federal Withholding:** Employee federal income tax withholding should be updated to account for these new deductions. For the 2025 tax year, the IRS has provided a transition rule that allows employers to use a reasonable method to approximate the deductible amounts for both overtime and tips.
- **Payroll Coordination:** It's crucial for employers to work closely with their payroll providers to ensure these new requirements are met accurately and on time. This proactive coordination will help prevent a chaotic rush at year-end. Note that payroll taxes (Social Security and Medicare) still apply to the full amount of tips and overtime.

Taking Action Now

The OBBBA's immediate effective date means employers cannot afford to wait. Those who act quickly to update their payroll systems and reporting procedures will not only ensure compliance but also provide valuable tax benefits to their employees. Employers should schedule meetings with their payroll providers and tax advisors this month to develop an implementation plan.

While the Treasury Department has until October to finalize the list of qualifying tipped industries, employers in traditionally tipped sectors should begin preparing now. If you have questions about implementing these new requirements, [contact your BMF tax advisor](#) to ensure your business turns regulatory compliance into a competitive advantage.