Understanding HB 1: New Federal Tax Breaks for Tips and Overtime

On July 4, 2025, President Donald Trump signed the One Big Beautiful Bill Act (HB 1) into law. This legislation introduces tax relief for many who earn tips or overtime pay. The law takes effect January 1, 2025, and it runs through December 31, 2028, unless extended.

While we await full IRS guidance, this article details what we know so far.

Tax Break for Tipped Workers

Workers in industries like restaurants, salons, or hospitality, where tipping is common, may now deduct up to $25,000 in qualified tips from their federal taxable income. For married couples filing jointly, the deduction is $50,000 if both spouses earn income from qualified tips.

What is a Qualified Tip?

To qualify, tips must be:

- Earned in an occupation that traditionally receives tips.
- Voluntary (not mandatory service charges).
- Reported on a valid tax form, such as:
    - Form W-2 (for employees).
    - Form 1099 (for certain contractors).
    - Form 4137 (for reporting unreported tips).

What is Not a Qualified Tip?

This deduction does not apply to:

- Mandatory service charges like automatic 20% gratuities. These are treated as regular wages and are not deductible under HB 1.
- The deduction begins to phase out for individuals earning more than $150,000 (or $300,000 for joint filers).

Tax Break for Overtime Pay

HB 1 also offers a new deduction for employees who earn overtime pay. You can deduct up to $12,500 in qualified overtime earnings or $25,000 for joint filers if both spouses earn overtime.

What Qualifies?

- Overtime must meet the federal definition under the Fair Labor Standards Act (FLSA §7).
- Only the overtime premium is deductible. For example, if you earn 1.5x your hourly rate, only the extra 0.5x counts toward the deduction.

Important: State laws, such as Washington's, may define overtime differently, but only the federal definition applies for this deduction.

Payroll Taxes Still Apply

While these deductions lower your income tax, they do not reduce Social Security or Medicare taxes.

Reporting Requirements for Employers

To comply with HB 1, employers must update payroll systems to separately report qualified tips and overtime on Form W-2.

Both the tip and overtime deductions are above-the-line. This means you don't need to itemize to claim them; they reduce your taxable income directly on your standard return. Married couples must file a joint return to claim the full deduction.

What's Next?

The IRS has until October 2, 2025, to issue detailed guidance, including:

- A list of occupations that qualify as tipped occupations.
- Clarification for self-employed individuals.
- Instructions for employers on how to report tips and overtime properly.

We will keep this page updated as new information becomes available.

Jamie Penry, CPA,
is a tax principal at Clark Nuber PS.

For more information, please contact us at **ClarkNuber.com.**