

What the OBBBA Changed

The **One Big Beautiful Bill Act**, passed in July 2025, introduced two landmark provisions that directly impact hospitality employers and their employees:

No Federal Income Tax on Tips

- Employees can **exclude up to \$25,000 in reported tips annually** from **federal income tax**.
- Applies to all **legally reported tips** starting January 1, 2025.
- **FICA (Social Security & Medicare taxes)** still apply — only income tax is excluded.
- Employees must still **accurately report tips** to employers through payroll systems.

No Federal Income Tax on Overtime Pay

- Overtime wages (hours worked over 40/week) are **excluded from federal income tax** for qualifying employees.
- Like tips, this applies only to **overtime earnings**, not base wages.
- Also effective for tax years **2025 through 2028**.

Actions Hospitality Businesses Should Take

Update Payroll Systems

- Ensure your payroll provider is aware of the OBBBA provisions and tracking tips/overtime correctly.
- Tips and OT must still be reported for **FICA and wage compliance**, even if not taxed federally.
- Be sure to **itemize tip and OT income separately** for employees on pay stubs and W-2s.

Maintain Tip Logs & Audit Trails

- Reinforce existing tip-reporting procedures to ensure accuracy and compliance.
- If using tip pooling, clearly document amounts and allocations to ensure IRS defensibility.

Educate Employees

- Employees will want to understand the new tax benefits — and their responsibility to **report all tips properly**.
- Clarify what counts as a tip (voluntary amounts left by the customer), vs service charges (which are not exempt).

Track Overtime by Pay Category

- Overtime should be clearly tracked and categorized in your timekeeping software.
- This will ensure accurate tax treatment and simplify end-of-year W-2 reporting.

Common Pitfalls to Avoid

- **Failing to update payroll software:** May result in incorrect W-2s or missed tax benefits for employees.
- **Misclassifying service charges as tips:** Service charges are **not** eligible for exemption and are still taxable.
- **Assuming FICA taxes are also exempt:** They are not — both employer and employee FICA obligations still apply.

Why it Matters

- These provisions **lower tax burdens for your team**, improving morale and retention.
- Employers who accurately track & educate will be seen as **trusted, compliant operators**.
- Missed tracking or reporting puts your restaurant at risk for IRS audits or back taxes.