IRS Issues Proposed Rules Clarifying the “No Tax On Tips” Provisions Under President Trump’s One Big Beautiful Bill

Labor & Employment Law Update

By Rebecca Bush and Kevin Kleine on September 30, 2025

On Friday, September 19, 2025 the Internal Revenue Service (IRS) issued proposed regulations clarifying the “no tax on tips” provisions under President Trump’s One Big Beautiful Bill Act (OBBBA).

Starting January 1, 2026, eligible tipped workers can deduct up to $25,000 each year in “qualified tips” from their federal taxable income through December 31, 2028. This will allow eligible tipped workers to take home more income each year. The deduction is retroactive to the beginning of the 2025 tax year, meaning it can be used by tipped workers to deduct qualified tips in the 2025 tax year. But the catch is that your payroll systems need updates NOW in order to properly track and report this new benefit for employees.

Action Items: What Employers Need to Do Now

Don’t wait until December. Your payroll systems need updating in order to separately track and report “qualified tips” on W-2 forms. The House Budget Committee Report makes clear that qualified tips must be separately accounted for on reporting statements.

Contact your payroll provider as soon as possible to ensure they can:

- Track qualified tips separately from other compensation.
- Apply correct withholding (remember, FICA taxes still apply to tips).
- Generate compliant year-end forms with separated tip reporting.

Remember, these changes do not alter current state income tax obligations for withholdings. The deduction applies *only* to federal income tax.

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Who's Eligible?

The Treasury Department has created a new system of Treasury Tipped Occupation Codes (TTOCs) to identify eligible workers. The good news? The list is broader than you might expect.

However, there are limitations. If your business qualifies as a "specified service trade or business" under section 199A(d)(2), your tipped employees can not use the deduction. That includes businesses in health, law, accounting, consulting, financial services, and several other professional fields.

What Qualifies as a Tip?

Not every gratuity counts. The proposed regulations clarify the distinction.

Qualified tips must be:

- Paid voluntarily without any consequence in the event of nonpayment.
- Given in cash or cash equivalent (including credit cards and electronic payments).
- Reported on proper tax forms (W-2, 1099-NEC, 1099-K, or Form 4137).
- Received by employees with valid Social Security numbers (ITINs do not qualify).

What doesn't count:

- Mandatory service charges.
- Tips from illegal activities.
- Tips where the recipient owns part of the business paying them.
- Non-cash tips (event tickets, meals, services).

For example, the 18 percent automatic gratuity for large parties? *Not* a qualified tip unless customers can modify or decline it.

Key Limits and Phase-Outs

The deduction provides substantial tax relief, but with important limitations, such as:

- ***Maximum annual deduction*:** $25,000 per taxpayer (regardless of filing status).
- ***Income phase-out thresholds*:** Begins at $150,000 modified adjusted gross income (MAGI) for single filers, $300,000 for joint filers.
- ***Phase-out rate:*** Deduction reduced by $100 for each $1,000 over the threshold.

The good news for employers is that the deduction phase out and limits do not affect your ability to claim the tip credit, as long as they otherwise meet requirements of the proposed regulation.

Important Compliance Notes

Proposed Regulations Can Be Relied Upon: Employers and employees can rely on these proposed regulations until final regulations are published, provided they follow them consistently and correctly. This means you do not have to wait for final rules to begin implementing the required changes.

Public Hearing Scheduled: The IRS will hold a public hearing on these regulations on October 23, 2025. Written comments must be submitted within 30 days of publication (by October 22, 2025).

Future Guidance Expected: The IRS has indicated that additional guidance is forthcoming on the mechanics of eligibility determination and implementation procedures.

The Complete List: Who Qualifies for the Deduction

The proposed regulations establish Treasury Tipped Occupation Codes (TTOCs) organized into eight categories:

- 100s – Beverage and Food Service
- 200s – Entertainment and Events
- 300s – Hospitality and Guest Services
- 400s – Home Services
- 500s – Personal Services
- 600s – Personal Appearance and Wellness
- 700s – Recreation and Instruction
- 800s – Transportation and Delivery

For a more detailed list, refer to Table A within the proposed regulations.

Bottom Line

The proposed regulations provide clarity on the tip income tax deduction, offering eligible workers up to $25,000 in annual tax-free tip income through 2028. Tips must be voluntary, properly reported, and received by workers in Treasury-designated occupations. The phase-out provisions target the benefit to middle-income earners, while specified service businesses are excluded.

For employers, this means updating payroll systems to separately track qualified tips on W-2s. These are administrative changes that do not affect tip credit rules or state tax obligations. These proposed regulations can be relied upon immediately, with final regulations expected after the October 23, 2025 public hearing.