

IRS Provides Critical Transition Relief for New Tips and Overtime Reporting Requirements: What HR Needs to Know Now

Labor & Employment Law Update

By Rebecca Bush on November 6, 2025

The clock is ticking on 2025 payroll reporting, but the IRS just threw employers a lifeline.

If your organization has been struggling to understand how to implement the new tips and overtime reporting requirements from the One Big Beautiful Bill Act (OBBA), you can breathe a temporary sigh of relief. The IRS has issued Notice 2025-62, providing penalty relief for the 2025 tax year while employers adapt to the tax reporting changes.

What Changed With the OBBA

When President Trump signed the OBBA into law on July 4, 2025, it created significant new tax deductions for American workers:

TIPS DEDUCTION: Up to \$25,000 annually for qualified tips (with income phase-outs starting at \$150,000).

OVERTIME DEDUCTION: Up to \$12,500 for individuals (\$25,000 for joint filers) for qualified overtime pay under the FLSA, with phase-outs beginning at \$150,000 (\$300,000 joint).

Both provisions are retroactive to January 1, 2025, creating an immediate implementation challenge for employers mid-year. Here's the catch, though: for employees to claim these deductions, employers must report tips and overtime separately on W-2s and information returns. This isn't just a nice-to-have. It's a requirement under sections 70201 and 70202 of the OBBA.

The Implementation Challenge

The OBBB amendments require employers and payors to:

- Separately track and report “qualified” tips on Forms W-2, 1099-MISC, 1099-K, and 1099-NEC;
- Report the occupation codes for employees receiving tips;
- Separately identify qualified overtime compensation; and
- Update payroll systems to capture this granular data.

The problem? Most payroll systems weren’t designed to segregate tips by occupation or separately track FLSA overtime versus regular wages. Even more challenging, the IRS has already announced that the 2025 versions of Forms W-2 and 1099 won’t include fields for this new information.

IRS Transition Relief: What’s Covered

Notice 2025-62 provides comprehensive penalty relief for tax year 2025. Specifically, the IRS will not impose penalties under sections 6721 or 6722 if employers fail to:

FOR TIPS REPORTING

- Provide separate accounting of cash tips on information returns;
- Include occupation codes for tipped employees;
- Separately report tips on Forms 1099 for contractors; and
- Include tip-specific information required by third-party settlement organizations.

FOR OVERTIME REPORTING

- Separately report qualified overtime compensation on W-2s;
- Provide distinct overtime accounting on 1099 forms; and
- File information returns with separate overtime designations.

This relief applies ONLY to 2025 returns and requires that employers otherwise file complete and correct returns. This means the total compensation amounts must still be accurate, even if tips and overtime aren’t separately identified.

Bottom Line for HR

The IRS transition relief removes the immediate compliance sword hanging over employers’ heads, but employers should not mistake this reprieve for permission to ignore the requirements entirely. Employees expecting to claim these valuable deductions will need the information from you, penalty or not.

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In addition, employers should use this transition period wisely to upgrade payroll systems, establish tracking procedures, educate managers and employees, and prepare for full compliance in 2026.

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