

No Tax on Tips---Sort of....read on....

On July 4, 2025, the President signed the One Big Beautiful Bill Act (often called the OB3, OBBBA, or Public Law 119-21). The law has many beneficial tax extensions from the Tax Cuts and Jobs Act of 2017 (TCJA) and ends some other tax benefits.

This update includes the changes to Tip Income. The IRS will come out with regulations and guidelines as to how this new law will be applied and administered. The below is an outline of the new law and might be adjusted and expanded based on IRS notices.

Tip Income

For tax years 2025 through 2028, if a taxpayer works in an industry where receiving tips is a customary part of doing business, the new law allows some or all of the tips to be excluded from taxable income. A few requirements:

- 1) This exclusion is allowed for both employees and the self-employed person (for the self-employed person, the IRS will no doubt issue guidance)
- 2) The tip income must be included on a tax document of some sort (such as a W-2, Form 4197, Form 1099-NEC, Form 1099-K, etc.). This means that social security and Medicare tax is being paid on these tips.
- 3) Up to \$25,000 can be excluded from income for a tax return for all filing statuses except married filing separately. There is **no exclusion** for married filing separate returns.
- 4) The tip received must be voluntarily given by the customer. So, for example, some restaurants charge a flat 20% surcharge for groups of 8 or more instead of allowing the customer to tip. This surcharge is not eligible for the exclusion.
- 5) The exclusion gets phased out by \$100 for each \$1000 the taxpayer's adjusted gross income (AGI) exceeds \$150,000 (single or head of household) or \$300,000 (married filing joint).
- 6) While the restaurant industry comes to mind, beauty service professions such as hairdressers, barbers, spas, estheticians, etc. are **specifically included** in the tax law. In addition, the IRS has until early October to list other occupations that would qualify; , perhaps bellhops, rideshare and cab drivers, and other service-based jobs. Specified Service Business, such as attorneys, medical professions, accounting, etc. are specifically excluded.
- 7) Tip behavior cannot be created. This is to prevent creative accounting where instead of having a \$15 breakfast and leaving a \$5 tip, I get breakfast at my local "greasy spoon" for \$3 and leave a \$17 tip.

Example: Carla worked at the "Cheers" bar in Boston for many years. Eventually she learned to be nice, courteous, and even smiled on occasion. So, in addition to her

hourly wages that Sam paid her, she earned a lot in tips. In 2025, Carla worked 1500 hours earning \$20 an hour (\$30,000) and also earned \$40,000 in tips, of which she reported to her employer. Her W-2 showed \$70,000 of wages with \$40,000 in box 7, "Social Security Tips".

If Carla had no other income and was Single or Head of Household, she would be able to exclude \$25,000 from her tax return. However, Carla also taught a "Miss Manners" class on the side and earned \$94,000 from that, giving her an AGI of \$164K, or \$14K over the threshold. Her tip exclusion would be reduced by \$1400 since her AGI exceeded \$150K allowing only \$23,600 to be excluded from income.

