

Employees Who Receive Qualified Tips and Qualified Overtime Pay

Cross References

- Notice 2025-69

Under the One Big Beautiful Bill Act (OBBBA), an income tax deduction is available for qualified tips that are received during the tax year by individuals in an occupation that customarily and regularly received tips on or before December 31, 2024. The deduction is limited to \$25,000 per year, and begins to phase-out when modified AGI exceeds \$150,000 (\$300,000 MFJ).

OBBBA also made available an income tax deduction for qualified overtime compensation, defined as overtime compensation that is in excess of the regular rate at which the individual is paid. The deduction is limited to \$12,500 per return (\$25,000 MFJ), and begins to phase-out when modified AGI exceeds \$150,000 (\$300,000 MFJ).

Under Notice 2025-62, the IRS stated that the Forms W-2 and 1099 for tax year 2025 will not be updated to account for the OBBBA-related changes. Employers will not be penalized for failing to provide a separate accounting of any amount reasonably designated as qualified tips or qualified overtime pay. However, employers and other payors are encouraged to provide such information to employees and payees by means of either an online portal, additional written statements, or by including the information in Box 14 of the employee's Form W-2.

Due to the fact that employers and payees are not required to provide this information for 2025, the IRS has issued Notice 2025-69 as guidance for taxpayers to determine the deductions they are allowed for tax year 2025 for qualified tips and qualified overtime pay.

Qualified tips. To determine qualified tips received by an employee:

- 1) Use the total amount of social security tips reported in box 7 of the Form W-2,
- 2) Use the total amount of tips reported by the employee to the employer on all Forms 4070, *Employee's Report of Tips to Employer* (or any similar substitute form used to monthly report tips to the employer), or
- 3) If an employer voluntarily chooses to report the amount of an employee's cash tips in box 14 of Form W-2 (or on a separate statement), the employee may use this amount in determining the amount of qualified tips for tax year 2025.
- 4) In addition to these three options, employees may also include any amount listed on line 4 of the 2025 Form 4137 filed with the employee's 2025 income tax return (and included as income on that return).

Although the occupation of an employee receiving tips may not appear on the Form W-2, the employee is still responsible for determining whether the tips received by the employee were received in an occupation that customarily and regularly received tips on or

before December 31, 2024. Some employers may choose to provide this information to employees using box 14 of Form W-2, in which case employees may rely on that information.

If the taxpayer is a non-employee who receives qualified tips, the non-employee may:

- 1) Use amounts included in the total amounts reported as other income on Form 1099-MISC, nonemployee compensation on Form 1099-NEC, or payment card/third-party network transactions on Form 1099-K furnished to the non-employee, and
- 2) Calculate the amount of qualified tips using earnings statements or other documentation such as receipts, point-of-sale system reports, daily tip logs, third party settlement organization records, or other documentary evidence that corroborates the calculation of the total amount of qualified tips for tax year 2025.

Non-employee payees may also consult with the payor regarding any available information that may assist in determining and documenting the amount of qualified tips.

Notice 2025-69 includes the following examples:

Example #1

Employee A is a restaurant server. The amount reported in A's Form W-2 box 7 is \$18,000 of social security tips. A did not report any additional tips on Form 4137. A may use \$18,000 in determining the amount of qualified tips for tax year 2025.

Example #2

Employee B is a bartender. During tax year 2025, B reports \$20,000 in tips to B's employer on Form 4070. B's 2025 Form W-2 reports \$200,000 in box 1, an amount in excess of the social security wage base, and \$15,000 in box 7. Additionally, B reports \$4,000 of unreported tips on Form 4137, line 4, and includes this amount in income on B's Form 1040. B may use either the \$15,000 in box 7 of the Form W-2, or the \$20,000 of tips reported to B's employer on Forms 4070 in determining the amount of qualified tips for tax year 2025. Regardless of the option chosen, B may also include the \$4,000 of unreported tips from Form 4137, line 4, in determining the amount of qualified tips.

Example #3

Individual D is a self-employed travel guide who operates as a sole proprietor. In 2025, Individual D receives \$7,000 in tips from customers paid through a third-party settlement organization as defined in section 6050W(b)(3). For tax year 2025, Individual D receives a Form 1099-K from an online booking platform that is a third-party settlement organization as defined in section 6050W(b)(3) showing \$55,000 of total payments. The Form 1099-K does not separately identify the tips. However, Individual D keeps a log of each tour that shows the date, customer, and tip amount received. Because Individual D has daily tip logs substantiating the \$7,000 tip amount, D may use the \$7,000 tip amount in determining qualified tips for tax year 2025.

Author's Comment

The House Budget Committee report on the OBBBA (H. Rept. 119-106) specifies that the tip amounts included on reporting statements (for example, Form 1099) must be separately accounted for on the statements in order to take the deduction. The OBBBA revisions to sections 6041, 6041A, and 6050W further require the statements to provide either a separate accounting or the portion of the amount designated as tips. The OBBBA revision to section 6051 follows the existing statutory structure of enumerating each separate category of amounts to be listed on the Form W-2. Thus, it appears that cash tips received by a sole proprietor from customers when no 1099 is issued are not qualified tips.

Qualified overtime compensation. If an employer does not provide the employee with the amount of qualified overtime compensation, either in box 14 of the W-2 or on a separate statement, the employee may:

- 1) Treat the separate accounting requirement as satisfied if the qualified overtime compensation is included in the total income reported on the W-2, and
- 2) The amount of qualified overtime compensation can be determined on other documentation such as earnings or pay statements, invoices, or similar statements that support the determination, using a reasonable method.

The following reasonable methods are allowed.

If the individual is paid overtime compensation at a rate of one and one-half times the individual's regular rate for hours worked in excess of 40 hours in a workweek and receives a statement covering the entire 2025 tax year that separately accounts for the overtime premium, which is generally, the "half" portion of the "one and one-half times" amount [the Fair Labor Standards Act (FLSA) Overtime Premium], the individual may use that separate amount.

Example #1

Individual A has access to a payroll system that shows totals of amounts paid to Individual A in 2025, including the FLSA Overtime Premium paid during 2025. In 2025, Individual A is last paid wages on December 22, 2025, for the payroll period beginning on November 30, 2025, and ending on December 13, 2025. The payroll system shows \$5,000 as the "overtime premium" that Individual A was paid during 2025. For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual A may include \$5,000 (the FLSA Overtime Premium).

If the individual is paid overtime compensation at a rate of one and one-half times the individual's regular rate for hours worked in excess of 40 hours in a workweek and receives a statement covering the entire 2025 tax year that does not separately account for the FLSA Overtime Premium, but does include an entry showing the aggregate dollar amount of the FLSA Overtime Premium combined with the portion of the individual's

regular wages for the hours worked over 40 in a workweek, the individual may use one-third of that aggregate dollar amount.

Example #2

Assume the same facts as in Example #1 except that Individual A's pay stub, shows a total "overtime" amount of \$15,000 (which is the FLSA Overtime Premium combined with the portion of the individual's regular wages for the hours worked over 40 in a workweek). For purposes of determining the amount of qualified overtime compensation received in tax year 2025, the individual may include \$5,000 (the FLSA Overtime Premium, computed by dividing \$15,000 by 3).

If the individual is paid overtime compensation at a rate in excess of one and one-half times the individual's regular rate for hours worked in excess of 40 hours in a workweek (for example, two times the individual's regular rate), and receives a statement covering the entire 2025 tax year that separately accounts for the portion in excess of the employee's regular rate, the individual may multiply that separate amount by an appropriate fraction to approximate the FLSA Overtime Premium (for example, if overtime is paid at a rate of two times the regular rate, the appropriate fraction is one-half) and use the product.

Example #3

Individual B's employer has a practice of paying overtime at a rate of two times an employee's regular rate of pay and Individual B was paid \$20,000 in overtime pay under that practice, although the FLSA (29 USC § 207) only requires Individual B's employer to pay at one and one-half times the employee's regular rate. Individual B's last pay stub for 2025 shows "overtime premium" of \$10,000 paid in 2025 (which is Individual B's overtime premium paid at a rate of two times the individual's regular rate). For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual B may include \$5,000 (\$10,000 divided by 2).

If the individual is paid overtime compensation at a rate in excess of one and one-half times the individual's regular rate for hours worked in excess of 40 hours in a workweek (for example, two times the individual's regular rate), and receives a statement that does not separately account for the FLSA Overtime Premium but does include an entry showing the aggregate dollar amount of overtime compensation at that higher rate for the hours worked over 40 hours combined with the portion of the individual's regular wages for the hours worked over 40 in a workweek covering the entire 2025 tax year, then the individual may multiply the aggregate dollar amount by an appropriately smaller fraction (for example, if overtime is paid at a rate of two times the regular rate, the appropriate fraction is one-fourth) and use the product.

Example #4

Assume the same facts as in Example #3 except that Individual B's pay stub shows a total "overtime" amount of \$20,000 (which is Individual B's overtime premium paid at a rate of two times the individual's regular rate of pay combined with the portion of the individual's regular wages for the hours worked over 40 in a workweek). For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual B may include \$5,000 (the FLSA Overtime Premium, computed by dividing \$20,000 by 4).

If the method for determining the amount of qualified overtime compensation described in examples 2 or 4 above would result in underestimating the employee's qualified overtime compensation (for example, because the individual's regular rate is increased by a nondiscretionary bonus), the individual may adjust the method to take the difference into account.

If the individual is paid overtime compensation at a rate described in the examples above but does not receive any statement covering the entire 2025 tax year separately accounting for the FLSA Overtime Premium, the aggregate dollar amount of FLSA overtime, or the aggregate dollar amount of overtime compensation paid at a higher rate, the individual may use a reasonable method that takes into account (1) the regular rate under the FLSA (29 USC § 207(e)) paid to the individual by the employer (or a reasonable approximation of this amount), and (2) the individual's hours of service in excess of 40 hours in a workweek (or a reasonable approximation if the individual does not have records of actual hours of service) for purposes of determining the amount of qualified overtime compensation. A reasonable method includes requesting information from the individual's employer and using the information provided by the employer for purposes of calculating the deduction.

If an individual's employer satisfies the requirements under 29 USC section 207 by operation of another subsection of the FLSA other than 29 USC section 207(a), including but not limited to public sector employees in fire protection and law enforcement, employees of a political subdivision of a State or an interstate governmental agency who receives compensatory time off in certain circumstances in lieu of cash overtime compensation, and employees of hospitals of certain residential care facilities, the individual must compute the amount of overtime compensation by operation of the different overtime rules used in the relevant provision of 29 USC section 207 that apply to the individual and may use any reasonable method contained in this notice that takes those alternative overtime rules into account.

Example #5

Individual C works in law enforcement and is paid \$15,000 of total annual overtime pay on a "work period" basis of 14 days that complies with section 207(k) of the FLSA. For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual C may include \$5,000 (\$15,000 divided by 3).

Example #6

Individual D works for a state or local government agency that gives compensatory time at a rate of one and one-half hours for each overtime hour worked under 29 USC section 207(o). In 2025, Individual D was paid wages of \$4,500 with respect to compensatory time off taken in accordance with section 207(o). For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual D may include \$1,500, one-third of these wages for purposes of determining qualified overtime compensation under section 225(c).