GUIDE

No tax on tips and overtime, for employers

From 2025 through 2028, workers can deduct up to $25,000 of qualified tips and up to $12,500 of overtime premium pay on their federal return. Tax still comes out of every paycheck. What changes for you as the employer is reporting, with new W-2 codes for 2026 that your payroll has to fill in.

QUICK FACTS

- **Years.** 2025 through 2028
- **Tips.** Up to $25,000 per return
- **Overtime.** Up to $12,500, or $25,000 on a joint return, of the premium part only
- **Phase-out.** Above $150,000 of income, $300,000 for joint filers
- **Employer job.** Report qualified tips (code TP) and qualified overtime (code TT) on 2026 W-2s

What are the new deductions?

RULE	QUALIFIED TIPS	QUALIFIED OVERTIME
Most you can deduct	$25,000 per return	$12,500, or $25,000 joint
What counts	Voluntary cash and card tips, including tip pools, in an occupation on the IRS list of tipped jobs	The extra half in time-and-a-half that federal law requires
Phase-out	Above $150,000 of income, $300,000 joint	Above $150,000 of income, $300,000 joint
Years	2025 to 2028	2025 to 2028
Where it's claimed	Schedule 1-A of the worker's Form 1040	Schedule 1-A of the worker's Form 1040

Workers get both deductions whether they itemize or take the standard deduction. They need a valid Social Security number.

General information, not tax advice for your situation.

Do I stop withholding tax on tips or overtime?

No. Nothing changes on the paycheck. You still withhold federal income tax, Social Security and Medicare on tips and overtime, and you still pay the employer share. The deduction happens when the worker files their return. Employees who expect a big deduction can lower their withholding with a new Form W-4.

States decide for themselves. Some follow the federal deductions and many don't, so check before you change anything on the state side.

Which overtime counts?

Only the premium the Fair Labor Standards Act requires, which is the extra half of pay for hours over 40 in a week. Say someone earns $30 an hour and works 10 overtime hours at $45. They earn $450 of overtime pay, but only the $150 premium ($15 times 10 hours) is qualified overtime.

Overtime paid only because of state law, a union contract or company policy, like daily overtime or double time, doesn't count. Salaried employees who are exempt from overtime rules don't get the deduction.

Which tips count?

Tips have to be voluntary, from a customer, in a job the IRS lists as customarily tipped, like servers, bartenders, hairstylists and delivery drivers. Cash tips, card tips and tip-pool shares all count. Automatic service charges, like an 18% charge added to large parties, are wages, not tips, and don't qualify.

The FICA tip credit on Form 8846 is a separate break for restaurant employers, and it still applies.

What goes on the 2026 W-2?

- **Box 12, code TP.** Qualified tips.
- **Box 12, code TT.** Qualified overtime, the premium part only, even above $12,500.
- **Box 14b.** The code for the employee's tipped occupation.

For 2025, employers didn't have to report these separately, and many gave workers a separate statement instead. From 2026 it's required, so your payroll has to tag tips and split the overtime premium on every pay run, not just at year-end.

What should I set up now?

1. Make sure your payroll software, like Gusto or ADP, has the 2026 updates turned on.
2. Tag every tip as cash, card or tip pool, and keep service charges separate.
3. Check which employees are non-exempt, and that overtime is figured at the federal rate.
4. Assign each tipped employee their occupation code.
5. Tell your team what changes and what doesn't, so nobody expects a bigger paycheck.

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