

One Big Beautiful Bill Update: Qualified Tips and Qualified Overtime

The One Big Beautiful Bill (OBBBA), enacted in July 2025, introduced two new tax deductions for individuals, effective for tax years 2025 through 2028:

Qualified Tips

- Annual Deduction Cap: \$25,000 (Married taxpayers must file a joint return)
- Modified Adjusted Gross Income (MAGI) Phase-Out: \$150,000 (\$300,000 filing jointly)
- *Qualified tips* refer to voluntary cash or charged tips received by individuals in occupations that customarily and regularly receive tips. *Mandatory service charges or automatic gratuities do not qualify for this deduction.*
- A preliminary list of qualifying occupations is available on the Department of the Treasury's website: [Tipped-Occupations](#).
- For tax years 2026 - 2028, qualified tip amounts will be reported on the W-2 in Box 12 with code TP. The Tipped Occupation Code (TTOC) to identify the employee's specific service role will be reported in Box 14b.

Qualified Overtime

- Annual Deduction Cap: \$12,500 (\$25,000 filing jointly)
- Modified Adjusted Gross Income (MAGI) Phase-Out: \$150,000 (\$300,000 filing jointly)
- Qualified overtime is the *premium portion (0.5)* of overtime compensation paid in accordance with the [Fair Labor Standards Act \(FLSA\)](#) for working more than **40 hours in a workweek**. This amount does not include overtime earned due to special/ contractual agreements, overtime paid to many agricultural workers, or overtime earned due to state-specific laws. For example, California overtime based on working over 8 hours in a day, double-time over 12 hours in a day, or any hours worked on the seventh consecutive day is not considered "qualified overtime" under the new law.
- For tax years 2026 – 2028, qualified overtime premium amounts will be reported on the W-2 in Box 12 with code TT.

Since the OBBBA was passed in July 2025, the IRS recognized that payroll systems and Form W-2s could not be updated in time to meet the reporting requirements, so they provided a tiered implementation approach to roll out these changes.

For Tax Year 2025

The IRS delayed reporting requirements for employers until the 2026 tax year and provided transition and penalty relief for 2025 ([Treasury, IRS provide penalty relief for tax year 2025 for information reporting on tips and overtime under the One, Big, Beautiful Bill | Internal Revenue Service](#)).

- The IRS also allowed reasonable methods for estimating tip and overtime deductions ([Treasury, IRS provides guidance for individuals who received tips or overtime during tax year 2025 | Internal Revenue Service](#))
 - For Qualified Tips, employees in qualified tipped occupations could use tips reported in box 7 of the W-2 to report the deduction
 - For Qualified Overtime, the IRS allowed employees to use IRS formulas to help calculate their qualified overtime deduction.
- For the 2025 tax year, employers **will not face penalties** ([Relief from Certain Penalties Related to Information Reporting Required in Connection with No Tax on Tips and Overtime: Notice 2025-62](#)) for failing to separately report the new required information in 2025.

Important Update for Tax Year 2026

For tax year 2026, employers **will be required** to report information on Qualified Overtime and Qualified Tips on Form W-2. Qualified Overtime will be reported on the W-2 in Box 12 using code TT, and the Qualified Tips will be reported in Box 12 using code TP. In addition, the Treasury Tipped Occupation Code (TOOC) for the employee will need to be reported in Box 14b for tipped employees.

Recording Qualified Overtime

Innovative Business Solutions has recently added a new memo code **OBBBA Qualified Overtime Premium** to track qualified overtime premiums under the One Big Beautiful Bill Act (OBBBA) and to report overtime premium amounts in Box 12 with code TT on the W-2 in 2026.

This new memo code is non-compensable, informational only, and will not appear on employee pay statements; however, it will appear on payroll reports for tracking and reconciliation purposes.

Please note that not all overtime qualifies for this federal deduction, as some states (including California) have overtime laws that differ from federal regulations, and there may be overtime that is paid to employees based on contractual/special agreements, which may affect how you use the **OBBBA Qualified Overtime Premium** memo code.

For example, if an employee works 10 hours per day, 4 days a week, they've worked a total of 40 hours. No federal overtime is owed, but California law requires 8 hours of daily overtime pay. In this scenario, since no hours qualify for federal overtime, no hours or amounts should be reported under the OBBBA Qualified OT Premium memo code.

Before using this code to track the qualified overtime premium hours and amounts for your employees, you should consult with your legal advisor to ensure that you understand what hours and amounts qualify for the deduction.

The sole purpose of this new code is to report the \$ amount of the eligible premium portion for W-2 Box 12 code TT disclosure.

Please also note that, while the new memo code allows both hours and amounts to be specified, entering hours is optional. The \$ amount specified must be accurate to ensure accurate W-2 reporting.

It is the client's responsibility to review and validate the \$ amounts throughout the year and ensure that all amounts are entered in a timely manner before the end of the year. Failure to enter and validate the \$ amounts for qualified overtime before year-end may result in costly penalties and/or amendments to W-2s.

If you use our Time and Labor Management (Webtime) module

- New calculation rules will be applied to calculate **OBBBA Qualified Overtime Premium** hours and include them on pay statements. Once transferred to the pay statements, employee pay rates are applied to calculate the premium portion for the deduction. In some cases, the applied rate may need to be adjusted, particularly when additional pay components in payroll affect the regular rate of pay used to calculate the overtime premium.
- The **OBBBA Qualified Overtime Premium** amounts for manual checks, separate checks, and additions to pay affecting regular rate of pay (RROP) calculations that do not originate from the transferred timesheet must be entered and calculated manually.
- Innovative is in the process of activating this functionality for Time and Labor Management (Webtime) clients. Once the configuration is complete, you will be contacted by a support representative to go over the details.

If you are only using our Payroll (WebPay) module and NOT using our Time and Labor Management (Webtime) module

- The **OBBBA Qualified Overtime Premium** memo code is available now for your use.
- You may enter or import the **OBBBA Qualified Overtime Premium** hours and amounts to pay statements with each payroll, monthly, quarterly, or annually, whichever works best for your process. If you prefer to report these hours in bulk at periodic intervals, Innovative can provide an import template.

Recording Qualified Tips

Existing earning codes used for recording and payment of tips have already been modified to place applicable amounts in Box 12 on the W-2 using code TP. We will notify clients when the Treasury Tipped Occupation Code (TTOC) is available in the system for specifying the appropriate occupation code for tipped employees.

If you have any further questions, please reach out to our support team at Innovative by emailing ibssupport@ibspayroll.com.

Thank you for being a valued customer. We appreciate your business.

RESOURCES

[Wages and the Fair Labor Standards Act | U.S. Department of Labor](#)

[One, Big, Beautiful Bill provisions – Individuals and workers | Internal Revenue Service](#)

[Treasury, IRS provide penalty relief for tax year 2025 for information reporting on tips and overtime under the One, Big, Beautiful Bill | Internal Revenue Service](#)).

[Treasury, IRS provides guidance for individuals who received tips or overtime during tax year 2025 | Internal Revenue Service](#)

[Relief from Certain Penalties Related to Information Reporting Required in Connection with No Tax on Tips and Overtime: Notice 2025-62](#)

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