

## **Alert | Tax/Restaurant Industry**



**May 2025**

### **No Tax on Tips Provision Included in the House Ways and Means Committee's 2025 Tax Bill**

On May 14, the House Ways and Means Committee approved the Make American Families and Workers Thrive Again Act, which contains a no tax on tips provision. This Ways and Means Committee bill is the starting point in what may be an arduous journey through Capitol Hill, so the final version of no tax on tips may look different than this committee bill. Some no tax on tips highlights include:

- Eligible employees would be able to deduct “qualified tips” to determine taxable income.
- Qualified tips are cash tips (whether paid by cash, credit card, or debit card) in an occupation that traditionally and customarily received tips.
- The secretary of the Treasury would be required to publish a list of traditional tip-receiving occupations within 90 days of the president signing the Act.
- Qualified tips must be paid voluntarily without any consequence in the event of nonpayment, may not be subject to negotiation, and must be determined by the payor.
- The recipient of the tips must not be a “highly compensated employee,” which for 2025 is an employee who earns \$160,000 or more.
- The deduction for qualified tips would be allowed for non-itemizers.

- Because no tax on tips would be structured as an employee deduction, tips would continue to be included in the base for FICA taxes (Social Security or Medicare tax).
- The employer would still be required to report the qualified tips on the W-2 provided to the employees.
- This deduction for qualified tips would be allowed for the 2025 through 2028 tax years (four years only).

While the bill does not limit the amount of tips that may be deducted (*i.e.*, subject to tax-free treatment), as bills previously introduced, it does eliminate the deduction for highly compensated employees as discussed above.

The bill has other details, including a limitation provision on persons who engage in a trade or business who also receive tips – for example, a chef who cooks the food for a dinner party at a private residence. In such a case, such person's deduction for tips would be limited to the amount that their gross receipts exceed the cost of providing the service, such as food and beverage cost.

Once again, this is subject to change as Congress may look to reduce the cost of this and the other tax cuts in the bill. But, if the current no tax on tips bill is passed and signed into law without material changes, there may be a scramble during the 90 days after it is signed for the Treasury Department to determine which occupations traditionally receive tips and would be allowed the benefit of no tax on tips.

### State Tax Issues

- Considering the potential revenue implications of the Act, states would have to decide whether to conform (or decouple) from any change in the federal policy. Depending on the revenue implications, not all states may choose to conform, creating additional compliance and administration issues as state and federal taxing authorities would use divergent definitions of income.
- Despite the revenue and compliance challenges a no tax on tips policy may create, almost a dozen states have introduced proposed bills at the state level for consideration during the 2025 legislative session (Arizona,<sup>1</sup> Kentucky,<sup>2</sup> Kansas,<sup>3</sup> Maryland,<sup>4</sup> Nebraska,<sup>5</sup> New Jersey,<sup>6</sup> New York,<sup>7</sup> North Carolina,<sup>8</sup> Oregon,<sup>9</sup> South Carolina,<sup>10</sup> and Virginia<sup>11</sup>). To date, none of these proposals have passed.

### Other Issues and Industry-Specific Considerations

- Regardless of how any no tax on tips initiative(s) takes shape, any change in tip taxation would impact reporting. The **IRS estimates** that tips are underreported to the tune of tens of billions of dollars every year. Enacting such a policy may create an incentive to broaden the understanding of a gratuity as much as possible. This may lead to reporting inconsistencies regarding the proper wage/tip classifications.

<sup>1</sup> See HB 2081, which would exempt tips for state income tax purposes.

<sup>2</sup> See HB 26, which would exempt tips and overtime compensation for state income tax purposes through 2029.

<sup>3</sup> See HB 277, which would exempt up to \$25,000 of tips for state income tax purposes starting in 2026.

<sup>4</sup> See HB 1400/SB 0823, which would have exempted tips for state income tax purposes.

<sup>5</sup> See LB 28, which would have created a deduction for tips from taxable income for state income tax purposes starting in 2025.

<sup>6</sup> See S 3741/A 5006, which would exempt tips for state income tax purposes starting in 2026.

<sup>7</sup> See S 587/A 05856, which would exempt tips for state income tax purposes starting in 2025.

<sup>8</sup> See HB 11, which would exempt tips, overtime pay and up to \$2500 of an annual bonus for state income tax purposes.

<sup>9</sup> See SB 560, which would exempt tips for state income tax purposes from 2026 through 2031.

<sup>10</sup> See H 3520/S 0534, which would exempt tips for state income tax purposes.

<sup>11</sup> See HB 1965, which would provide a deduction for tips and overtime from state taxable income starting in 2025.

- The no tax on tips promise might also lead to friction among the different classifications of employees in a very industry-specific manner. In the restaurant industry, for example, highly tipped employees, such as front of house restaurant, bar workers, or employees participating in a tip pool in a restaurant with significant tips would seem to be the most significant beneficiaries of the legislation. “Lightly tipped” employees, such as tipped quick service and fast casual restaurant workers, may receive modest or no benefits. In addition, non-tipped employees and restaurant managers, who may be legally precluded from receiving tips due to laws and regulations prohibiting tip sharing with management-level personnel, would receive no benefits from the legislation. Restaurant employers may be faced with requests for compensation increases from these employees, or a declining interest from restaurant workers in working their way up into management-level roles, if the compensation and income boost from tax-free tips is more attractive than the management compensation.
- The change of a no tax on tips policy—either at the federal or state level—should be of interest for restaurant employers of tipped employees. Although the policy may benefit some restaurant workers, the legislation may present challenges to restaurant owners/operators who have experienced significant price and wage inflation, including historic increases in wages and benefits in many parts of the country over the past several years, while operating expenses and pressures have increased considerably. In addition, “tip credits,” which permit an employer to pay tipped employees a reduced hourly wage based upon the tips received by such employees in most U.S. states, have been challenged in parts of the country.

While the no tax on tips policy may provide significant tax savings to select tipped workers, the legislation may create challenges for restaurant owners and other businesses with workers designated by the Treasury Secretary to be a traditional tip-receiving occupation. As this policy begins to unfold, restaurant owners should be aware of and engage—at both the federal and state level—to try and shape these policies to address these issues.

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