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The Big Beautiful Bill brings big changes. This whitepaper will give you clarity on permanent tax rule extensions, actionable insights into new overtime and tip deductions, and guidance on preparing payroll systems for 2026 and beyond.

The Big Beautiful Bill Explained for HR and Payroll Managers

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The One Big Beautiful Bill Act's Impact on Employers and Payroll (2025 & Beyond)

The One Big Beautiful Bill Act (OBBBA) of 2025 is a sweeping U.S. tax law that brings significant changes for employers and payroll systems. It permanently extends many tax provisions from the Tax Cuts and Jobs Act (TCJA) and CARES Act that were set to expire at the end of 2025. At the same time, OBBBA introduces new temporary tax benefits (like "no tax on overtime" and "no tax on tips") that affect how employee earnings are handled, reported, and eventually taxed. This technical overview reviews the key provisions from OBBBA, verifies their accuracy against credible sources, and explains how they will affect employers' payroll operations and compliance.

Background: TCJA, CARES, and the OBBBA

The Tax Cuts and Jobs Act (2017) lowered individual and business tax rates, but many individual tax cuts (including payroll-related items) were set to sunset after Dec 31, 2025. The CARES Act (2020) provided temporary payroll relief (like allowing tax-free student loan payments by employers), also slated to expire at 2025's end. Payroll professionals were facing a "steep cliff" of expiring provisions, meaning older rules would snap back in 2026.

The OBBBA (signed July 4, 2025) was designed to resolve these uncertainties for payroll. It makes many of the TCJA/CARES changes permanent, so they will not expire in 2026. This offers much-needed clarity for employers and HR/payroll systems. However, OBBBA also adds new programs – some temporary – which, while employee-friendly, introduce fresh compliance questions. Below we break down the major OBBBA changes affecting payroll and employers, and how to prepare for each.

Permanent Changes Under OBBBA (No Action Needed if Already TCJA-Compliant)

OBBBA permanently codifies several payroll-related tax rules that employers have already been following under TCJA. These will not expire after 2025, so payroll systems generally do not need a major reconfiguration for these items (unless you had built in an automatic 2026 rollback). **Key permanent changes include:**

- **Federal Income Tax Brackets Stay at TCJA Levels**. The seven-tier tax rate schedule from TCJA is made permanent, preventing a reversion to pre-2018 rate. Notably, the top tax rate remains 37% instead of rising back to 39.6% in 2026. (Inflation adjustments will continue as usual each year.) In short, individual withholding tax tables will continue with the same brackets as current law, providing stability.

- **Supplemental Wage Withholding Rates Unchanged**. Employers can continue to use the optional flat 22% federal withholding rate for bonus pay and other supplemental wages (as introduced by TCJA). This 22% flat rate will not revert to 25%. The mandatory withholding rate on annual bonus amounts over $1 million remains 37% (tied to the top bracket). In other words, "bonus" and lump-sum withholding rules stay exactly as they have been since 2018.

- **Backup Withholding Stays at 24%**. Backup withholding (for certain payments where a payee's taxpayer ID is not provided) was 28% pre-TCJA and dropped to 24% under TCJA. OBBBA locks it in at 24% going forward. (Payroll departments rarely handle backup withholding on wages, but this matters for any miscellaneous payments to individuals without TINs.)

- **Moving Expense Reimbursements Remain Taxable (Except Military/Intel)**. The tax exclusion for employer-paid moving expenses will not return for most employees. Under TCJA, this benefit was suspended through 2025; OBBBA permanently eliminates it for the private sector. Thus, reimbursed relocation costs will continue to be treated as taxable wages on the W-2. Only certain employees in the Armed Forces (and now the Intelligence Community) are eligible for a moving expense exclusion going forward. (OBBBA expanded the military exception to cover CIA and other intel agency personnel moving between assignments.)

- **Bicycle Commuting Benefit Permanently Repealed**. The quirky $20/month tax-free bicycle commuting reimbursement (suspended in 2018–2025) is now fully eliminated by OBBBA. Come 2026, it will not come back. Employers who encouraged biking to work should note that any such payouts must remain taxable to the employee (although parking or transit pass benefits up to the monthly limits are still allowed pretax under Section 132).

- **No Change to Transit and Parking Benefits (Still Tax-Free to Employees, Not Deductible to Employer)**. Employees can still pay for transit passes or parking up to the inflation-adjusted monthly limit pretax (currently ~$300/month) – OBBBA did not undo this benefit. However, as under TCJA, employers cannot deduct these commuter benefit expenses on their business taxes. OBBBA effectively makes that TCJA disallowance permanent as well. (In practical terms: This is status quo; just be aware the employer's tax credit/deduction for offering transit benefits remains eliminated.)

- **Personal Exemptions Permanently Eliminated.** OBBBA confirms that the personal exemption (the amount per dependent that was $4,050 in 2017) is gone for good. TCJA had set personal exemptions to $0 through 2025; without OBBBA, they would have revived in 2026. Now they will not. Impact: The old Form W-4 (from 2019 and earlier), which was based on claiming personal allowances, is effectively obsolete. The IRS had grandfathered those older W-4s just in case the law reverted, but with OBBBA's permanence, we expect the IRS to fully phase out pre-2020 W-4 forms in the near future. Employers should prepare for guidance on converting any remaining "allowance-based" withholding setups to the current W-4 system.

- **Employer Tax Credit for Paid Family Leave Made Permanent**. (Update for employers offering paid FMLA) The tax credit for providing paid family and medical leave, originally a pilot program through 2025, is now permanent after 2025. Starting in 2026, eligible employers can continue to claim this

credit each year. OBBBA also slightly expands how the credit can be calculated (including allowing it for employer-paid insurance premiums for family leave). Payroll Impact: This does not affect withholding or pay slip calculations, but it is a valuable ongoing credit to factor into benefit planning.

In summary, the payroll tax landscape in 2026 will look the same as in 2025 for the above items. By cementing TCJA-era rates and rules, OBBBA spares employers from a bunch of abrupt changes. There is no need to revert tax tables or re-enable old exclusions. However, make sure your payroll configurations do not automatically roll back any TCJA settings at year-end 2025 – they should remain in effect.

"No Tax on Overtime" (2025–2028): New Temporary Deduction for Overtime Pay

One of OBBBA's headline provisions is often touted as "**No Tax on Overtime**." In reality, employees will still have income tax withheld on overtime wages as usual, but a special deduction on their tax return will effectively exempt some of that income from federal tax. This provision is retroactive to January 1, 2025, and expires after 2028, giving four years of potential tax relief for eligible workers.

- **What it does**: For tax years 2025 through 2028, individuals can deduct up to $12,500 of "qualified overtime" pay from their taxable income each year (the cap is $25,000 for those married filing jointly). In other words, an employee's overtime earnings – up to that limit – will not count toward their taxable income on Form 1040. Higher earners are phased out of this deduction: the benefit starts to phase out once modified AGI exceeds $150,000 (single) or $300,000 (joint), disappearing entirely for those above the threshold. Importantly, taxpayers do not need to itemize deductions to claim this – it is an "above-the-line" adjustment available to anyone who qualifies.

- **Which overtime pay qualifies**? The law tightly defines "qualified overtime" to prevent abuses. Only overtime pay required under federal law (FLSA) counts toward the deduction. The Fair Labor Standards Act (FLSA) requires overtime at time-and-a-half for hours over 40 in a workweek for non-exempt employees.

Thus, the OBBBA deduction only covers the extra half-time premium portion of overtime pay:

- **Example:** An employee's normal rate is $20/hr. Their FLSA-mandated overtime rate is $30/hr (time-and-a-half) for hours over 40/week. For each overtime hour, only the extra $10 (the premium above the regular $20) is considered "qualified overtime" for the deduction. The base $20 is regular pay not eligible for this particular deduction.

- **Overtime that is not required by FLSA is not deductible**: Many employers pay overtime in situations not mandated by federal law – e.g., daily overtime (over 8 hours a day) as required by some states, or overtime-like premiums per union contracts or company policy. Those extra amounts do not qualify for the federal deduction unless they also coincide with FLSA overtime. So, for instance, an

overtime premium paid for working on a weekend, or for working 50 hours when the employee is exempt from FLSA, would not be eligible. Only true FLSA overtime hours count. In short, if you pay an overtime premium beyond federal requirements, that portion is still taxable income to the employee (no special deduction).

- **Non-exempt W-2 employees only**: The deduction applies to W-2 wage earners who are eligible for overtime. Self-employed individuals or independent contractors cannot deduct any "overtime," and salaried exempt employees (who do not earn overtime) obviously do not benefit. Also, those who file "Married Filing Separately" are not allowed to use this deduction (an incentive to file jointly if eligible).

- **Impact on payroll withholding**: There is no immediate change to how payroll calculates taxes on overtime pay. Overtime wages remain fully subject to federal income tax withholding (and FICA taxes) during the year. The "no tax" benefit is delivered later when the employee files their tax return. In essence, employees will get a refund or reduction in tax at filing time for the taxes that were withheld on their qualifying overtime. Employers should not stop withholding or alter the W-2 for this in 2025 – doing so would be premature and noncompliant.

- **However, payroll does have new reporting obligations**: Starting in 2025, employers need to track and report the amount of "qualified overtime pay" for each employee. OBBBA mandates that Form W-2 must show the total qualified overtime wages (separately from regular wages). Currently, W-2 forms do not break out overtime, so this is a new requirement. The IRS has already stated it will update forms and guidance by 2026 to accommodate this.

- **Transition relief for 2025**: Because the law kicked in mid-year 2025, the IRS announced that Form W-2 for 2025 will not be redesigned – employers will not have an official box for overtime on the 2025 W-2. Instead, OBBBA allows employers to use a "reasonable method" to approximate and report 2025 overtime amounts to employees and the IRS. Essentially, you should keep good records of overtime hours/pay, and be prepared to supply that info (perhaps in an accompanying statement). Formal W-2 reporting of overtime will likely begin for 2026 W-2s, once the IRS provides a dedicated field.

Action Items for Employers (Overtime Deduction):

- **Tracking**: Ensure your timekeeping/payroll system can identify FLSA-qualifying overtime pay separately from regular earnings. You may need to adjust how overtime is coded, especially if you also pay other premiums. Only the FLSA 0.5x premium portion should count for this purpose. Many payroll systems are updating reports for "qualified overtime." Work with your provider to capture this data for 2025 onward.

- **Employee Communication**: Be ready for questions. Employees might hear "no tax on overtime" and expect no withholding on their OT checks. You will need to clarify that paychecks will still have withholding; the benefit comes at tax filing time as a deduction or refund. Encourage employees to consult a tax advisor if they want to adjust their Form W-4 withholding in anticipation of a big deduction (though no specific W-4 adjustments exist yet for this, employees with heavy overtime could claim an extra deduction via the W-4 Step 4(b) for "other deductions" in 2026).

- **Stay Tuned**: The IRS will issue guidance on exactly how to report overtime on 2026 W-2 forms and how withholding tables might change. OBBBA instructs that by 2026 the IRS should adjust tax withholding methods to account for this overtime deduction (perhaps a new form or worksheet). Keep an eye out in late 2025 for any pilot updates to Form W-4 or withholding tables. (For 2025, as noted, no changes to tables – treat overtime as normal wages for withholding.)

In summary, the "No Tax on Overtime" rule is a win for eligible employees – effectively putting money back in their pockets at tax time – but it adds administrative work for employers. Payroll teams should set up robust overtime tracking and employee education now to smoothly implement this temporary change through 2028.

"No Tax on Tips" (2025–2028): New Temporary Deduction for Tipped Income

The OBBBA also delivers on a promise of "no income tax on tips" for employees in tipped industries. Similar to the overtime provision, this is implemented as a tax deduction for the employee rather than an upfront exemption, and it is effective 2025 through 2028.

- **What it does:** For 2025–2028, tipped employees can deduct up to $25,000 of qualified tip income from their taxable income each year. This deduction also phases out for high earners starting at $150,000 of income (or $300,000 for joint filers). In other words, many servers, bartenders, and other tipped workers will owe no federal income tax on a substantial portion of the tips they receive when they file their 1040. As with overtime, this is an above-the-line deduction available regardless of whether the person itemizes deductions.

Which tips qualify? Not every gratuity or service charge is eligible. OBBBA narrowly defines "qualified tips" to ensure the deduction targets traditional tipping situations:

Tips must be voluntary payments from customers in an occupation that customarily and regularly receives tips. Essentially, the worker has to be in a job like waiter/waitress, barista, hair stylist, taxi driver, bellhop, etc., where tipping is an established practice. By early October 2025, the Treasury will publish an official list of which occupations are considered tipping-eligible under this law.

Only cash or charge tips count – not mandatory fees. A tip must be freely given by the customer (and the amount determined by the customer). If a restaurant adds a fixed 18% "service charge" to a bill, for example, that does not count as a tip for this deduction. Similarly, auto-gratuities, delivery fees, or any sum that an employer dictates or negotiates in advance is not a "tip." Qualified tips = true tips.

The tip income must be properly reported to the employer. Employees are already required by law to report their cash tips to their employer by the 10th of each month if $20 or more was received in the prior month. That practice remains crucial. Unreported (under-the-table) tips will not magically become deductible – in fact, if an employee fails to report tips and later declares them on their tax return, they face FICA tax assessments via Form 4137 and IRS notices to the employer. Employers should reinforce tip reporting policies so that all qualified tip income is on record.

Certain workers are excluded: OBBBA explicitly bars some types of employees from the tip deduction. Self-employed individuals cannot claim it (a freelance hairdresser who keeps their own tips, for instance, cannot deduct those tips). Additionally, employees who work for a business that is a "specified service trade or business (SSTB)" under IRS rules (the same category used in Section 199A for pass-through deductions) are not eligible. SSTBs include fields like law, accounting, consulting, performing arts, financial services, etc.. This rule seems aimed at preventing high-earning professionals from reclassifying bonuses or client gifts as "tips." For most traditional tipping jobs, SSTB will not apply, but be aware of this nuance (e.g., a casino croupier's tips might qualify, but a consultant who gets an honorarium labeled as a "tip" would not).

Impact on payroll and reporting: Tips, unlike overtime, have always required special handling in payroll. Employees must report tips to the employer, and the employer must withhold income tax and FICA on those tips (even if the tips themselves are not directly paid by the employer). OBBBA does not change the immediate payroll tax treatment of tips: all cash tips reported are still subject to federal withholding, Social Security (up to the annual wage base), and Medicare taxes – just as before. The "no tax on tips" benefit will come at tax filing time for the employee, via a deduction on their 1040.

However, similar to overtime, there will be new annual reporting requirements. Employers will need to report total "qualified tips" on Form W-2 for 2025 and later. Currently, Box 7 of the W-2 reports allocated tips (in certain large restaurant scenarios), but there is not a standard box for all tips received. We expect the IRS to modify the W-2 to show tips that qualify for this deduction. For 2025, the IRS has indicated they will not rush changes to the forms – likely they will use a similar transition approach as overtime, where any 2025 tip reporting might be in a supplemental form or just rely on employer records. By 2026 W-2s, plan for an official field for tip amounts.

Action Items for Employers (Tips Deduction):

- **Tracking Occupations**: Identify which of your roles might qualify as "customarily tipped." If you have employees in gray areas, watch for the Treasury's occupation list due by October 2025. You may need to adjust payroll settings to flag those employees for tip reporting.

- **Tip Reporting Systems**: Continue enforcing accurate tip reporting. If you do not already, consider implementing electronic tip reporting tools (many POS systems allow servers to declare tips per shift). OBBBA's rules do not change the mechanics but do raise the stakes for accuracy. The IRS requires that if electronic tip reporting is used, it must ensure the data truly comes from the employee and keep logs of access. Review your process to ensure compliance (e.g., unique logins for employees reporting tips, audit trail of submissions).

- **Employee Communication**: Let your tipped staff know that "no tax on tips" does not mean no withholding on tips. You will still withhold taxes on their reported tips as before. The benefit will come at year-end when they file taxes and may get a big deduction/refund. As with overtime, employees might choose to adjust their W-4 in 2026 to account for anticipated deductions (once IRS provides guidance on doing so).

- **Budget for FICA on unreported tips**: As a reminder, if an employee underreports tips and then claims them via the tax deduction, the IRS will bill you the employer FICA on those tips later (via a Section

3121(q) notice). It has always been the case, but with a new deduction, some employees might be tempted to only report tips at year-end. Discourage this – it does not help them (they cannot deduct what they did not report as income), and it leaves you with unexpected payroll tax bills.

- **Bottom line**: The "No Tax on Tips" deduction is a major benefit for tipped employees, potentially exempting up to $25k of their tip income from federal tax each year. For employers, it means making sure tip reporting is thorough and ready to be reported on W-2s. The day-to-day payroll process for tips (collection, withholding, depositing) stays the same, but year-end reporting and employee guidance are the new wrinkles.

Additional Changes Effective 2026 and Beyond

Beyond the headline "no tax" provisions, OBBBA brings several other changes in 2026 that employers should prepare for:

Dependent Care FSA Limit Increase (2026). For the first time since 1986, the annual limit for Dependent Care Assistance Plans (DCAP) will increase. Starting January 1, 2026, employees can contribute up to $7,500 per year to a dependent care FSA (up from the long-standing $5,000 cap). The limit for married filing separately will be $3,750 (was $2,500). Notably, this new DCAP limit is not indexed to inflation, so it will remain $7,500 until Congress changes it again. Payroll impact: Update benefit enrollment materials and cafeteria plan documents for 2026 to reflect the higher cap. Payroll systems must allow the higher pre-tax withholding amount. This is a positive change for employees with child care expenses, effectively increasing their tax-free reimbursement by 50%.

Educational Assistance and Student Loan Repayment – Now Permanent and Indexed. Under current law, employers can provide up to $5,250/year tax-free educational assistance to an employee (e.g., tuition, training costs). The CARES Act expanded this to include student loan repayments by the employer, but that was set to expire in 2025. OBBBA makes the student loan repayment feature permanent beyond 2025. Employers may continue to help pay employees' student loans (up to the annual $5,250) tax-free. Additionally, starting in 2027, the $5,250 limit will be indexed for inflation. This means the cap will start rising modestly each year after 2026. Payroll impact: Companies offering educational assistance or student loan payment benefits can now treat those payments as non-taxable indefinitely, with increasing limits over time. Ensure your payroll knows to exclude such payments from wages (up to the limit) and that any cap increase is applied each year from 2027 onward.

"Trump Accounts" – New Child Savings Accounts (2026). OBBBA creates a new type of tax-advantaged savings program informally dubbed "Trump Accounts," which are essentially a special IRA-like account for children under 18. Key features:

The federal government will seed each account with $1,000 for every child born 2025–2028. Anyone (including employers or family) can contribute up to $5,000 per year per child into the account. Contributions

are pre-tax (similar to an IRA contribution). Funds are invested and grow tax-deferred. At age 18, the balance rolls into the child's own IRA.

These accounts launch in July 2026, so employers might start seeing employees who want to contribute on behalf of their dependents. Payroll impact: While contributions will not be via payroll deduction (not like a 401k), some employers might opt to contribute as a benefit (OBBBA allows employer contributions). If you decide to contribute (say, $1,000 per employee's newborn), those would be tax-free payments. Payroll/HR should establish a process to handle any employer-funded Trump Account contributions and the necessary reporting. Also, be aware these accounts are protected from federal/state levy, meaning creditors (including IRS) generally cannot seize these funds.

Form 1099 Reporting Thresholds Change (2026). Businesses must issue 1099 forms to certain payees each January. OBBBA makes two big adjustments:

- **1099-NEC / 1099-MISC Threshold**: Starting with payments made in 2026, the threshold for issuing a Form 1099-NEC or 1099-MISC to a payee will be $2,000, up from the old $600. This dramatically reduces the volume of 1099s businesses need to send. Beginning in 2027, the $2,000 threshold will be indexed for inflation as well. Example: If you pay an independent contractor $1,500 in 2026, you will no longer need to send a 1099-NEC for that – $1,500 is below the new cutoff. (Of course, the income is still taxable to the contractor; just no IRS form.) This is a welcome relief for accounting departments.

- **1099-K Threshold (Third-Party Processors)**: OBBBA also reverts the Form 1099-K reporting threshold back to $20,000 and 200 transactions. A 2021 law had dropped it to a strict $600 (causing much alarm for Venmo/Etsy users), but OBBBA undoes that. So, starting 2023 and beyond, payment apps and platforms will only issue 1099-Ks if a payee exceeds both $20k in volume and 200 transactions, the same standard that existed pre-2022. Impact: This adds consistency and will prevent many casual sellers or gig workers from getting unnecessary 1099-K forms. Employers may want to communicate this to any contractors or vendors concerned about the $600 rule; it is no longer going into effect.

- **Employer Credit for Childcare Facilities Increased (2026)**. (For employers providing on-site daycare or sponsoring childcare.) OBBBA raises the maximum Employer-Provided Child Care Credit to $500,000 of qualifying expenses (up from $150,000), and up to 50% credit rate for small businesses. If your company invests in childcare for employees, more of those costs can be offset by this credit. This is a niche change – consider consulting your tax advisor if relevant.

- **Various Other Tax Changes (not exhaustive):** OBBBA is a huge law with other provisions (e.g., changes to SALT deductions, energy credits, executive comp deduction aggregation, etc.), but the above are the most directly relevant to payroll operations. One more notable permanent change: the personal tax exemption for seniors – OBBBA permanently eliminated personal exemptions but added a temporary extra deduction for seniors (up to $6,000 through 2028). This does not affect payroll withholding directly (since it is claimed at tax time), but senior employees might see a difference in their net tax outcomes.

State Tax Considerations: Will States Follow OBBBA's Lead?

Federal tax changes often have ripple effects on state income taxes, since many states use federal definitions of income as a starting point. Employers need to be aware that not all states will conform to these new provisions. Key points:

- **Rolling vs. Static Conformity:** Some states automatically conform to the current Internal Revenue Code. For example, Illinois, New York, Colorado, and others adopt federal tax changes immediately. In those states, the OBBBA provisions (like no tax on overtime/tips) would flow through to state taxes unless the state legislature intervenes. Other states (e.g., California, New Jersey) have tax codes that fix conformity to an earlier date – they will not recognize OBBBA changes until they update their laws. A few states (e.g., Mississippi, NJ) do not reference the federal code at all, so they make independent rules.

- **Federal Taxable Income vs. Adjusted Gross Income**: States also differ in whether they base taxes on federal taxable income (after deductions) or on federal adjusted gross income (before deductions). This matters for the overtime and tip provisions, which are deductions affecting taxable income. States using federal taxable income (such as Colorado, Iowa, Montana, North Dakota, etc.) would automatically exclude overtime and tip income if they conform to post-OBBBA law. States using federal AGI would not automatically exclude those amounts, since the deductions happen later in the federal calculation; they would likely still tax the overtime/tips unless they pass a special deduction.

- Some States Are Decoupling from "No Tax on Overtime/Tip." Concerned about losing revenue, certain states are legislating to add back these deductions. Colorado was the first: it passed HB 1296 (2025), which requires overtime pay to be added back into Colorado taxable income (effectively nullifying the federal overtime deduction for Colorado income tax). This law means that in Colorado, employees will still pay state tax on overtime even though they get relief federally. This move is being challenged in court as a possible violation of Colorado's constitution, and there is even a proposed ballot initiative to overturn it and allow the overtime (and tip) exclusion at the state level. Other states may take a wait-and-see approach, but employers should watch their state tax authorities closely. It is possible you will need to report and withhold differently for state versus federal on these wage types if states decouple.

- **State Withholding Impact**: If your state does conform to OBBBA, they may eventually adjust state withholding rules to accommodate (or they might not bother, relying on employees to adjust their forms on their own). If your state decouples, you might need to continue including overtime pay in state taxable wages even if federal starts excluding it on the W-4 or tables. This could complicate payroll calculations for multi-state employers. For now, most states have not fully addressed it, given the law's newness.

- **Moving Expenses and Other Fringe**: Note that some states never conformed to the federal elimination of moving expense deductions. For instance, New York, California, Pennsylvania, and others have allowed moving expense deductions even after 2018. OBBBA's permanent federal ban will not automatically change those states' rules. So, in those states, there might still be tax-free moving reimbursements at the state level. Keep track of these discrepancies – your payroll system might need to treat certain fringe benefits as taxable for federal but non-taxable for state.

- **Overtime Definition Differences**: A tricky aspect is that some states have different overtime rules (e.g., California's daily overtime after 8 hours). The federal deduction only applies to FLSA-required overtime. So, an employee in California who works 10 hours in a day will earn 2 hours of overtime pay due to state law – but if they only worked 40 hours that week, federally that is not overtime. The portion of overtime pay not required by FLSA will not be deductible federally. If California decides to implement a similar deduction on the state return, it could define it differently or match the federal definition. This is just to flag that employees in certain states might be confused why some "overtime" is still taxed. Payroll may need to explain this nuance and ensure precise tracking of what counts as FLSA overtime.

Employer Takeaway: Stay informed on your state's response to OBBBA. We have gained clarity at the federal level, but state tax law may diverge:

Check with your state revenue department or payroll tax guru for any bulletins on OBBBA conformity. Be prepared to update state withholding calculations or employee communications if (when) your state enacts changes. For multi-state payroll, this could get complex – consider a matrix of each state's stance on these 2025+ federal changes.

Recap:

1. Permanent Extensions (No Reversion in 2026):

- **Tax Rates & Brackets:** The TCJA's lower income tax brackets (top rate 37%) are now permanent – they will not revert to 39.6% in 2026. [1] Standard deductions and credits enhancements from 2017 are also locked in.
- **Supplemental Withholding**: Flat 22% optional withholding on bonuses stays (was to revert to 25%). The >\$1M bonus rate remains 37%. No payroll system change needed for tax rates. [2]
- **Fringe Benefits**: Moving expense reimbursements remain taxable for non-military (TCJA suspension made permanent). The \$20/month bicycle benefit is permanently repealed. [3] Commuter transit/parking benefits remain tax-free to employees (but still not deductible to employers).
- **Personal Allowances**: Personal exemptions stay $0 (TCJA rule made permanent).[^^] Pre-2020 W-4 tax withholding forms that used allowances may be phased out by IRS since allowances no longer apply.

2. "No Tax on Overtime" (2025–2028 Deduction):

- **Employee Tax Break**: Employees can deduct up to \$12,500 of FLSA-required overtime pay from their taxable income each year 2025–2028 (joint filers up to \$25k). [4] This covers the “half-time” premium for hours >40/week. High earners (>$150k single) phase out.
- **Payroll Impact**: No change in paycheck withholding – overtime still taxed normally during the year. [5] The benefit is claimed on the employee’s tax return. Employers must track total qualifying OT pay and (eventually) report it (IRS will add a W-2 field). For 2025, the IRS offers transition relief for reporting – use “reasonable methods” to estimate and inform employees of their eligible overtime amount. [6]
- **Action**: Ensure time-tracking differentiates FLSA overtime vs. other extra pay (only FLSA overtime qualifies). Educate employees: they will get the benefit at tax time, not in each paycheck.

3. “No Tax on Tips” (2025–2028 Deduction):

- **Employee Tax Break**: Tipped workers can deduct up to \$25,000 of qualified tips from taxable income (2025–2028). [1] Applies to occupations “customarily tipped” (IRS will publish list by Oct 2025). Must be voluntary tips (no service charges). Phases out >$150k income.
- **Payroll Impact**: Continue normal tip reporting and withholding (income tax and FICA). The deduction is taken on the tax return. Track total tips per employee; new reporting required on W-2 or a separate statement. [1]
- **Action**: Reinforce accurate tip reporting from employees (unreported tips cannot be deducted and still incur back taxes). Prepare to provide year-end statements of total reported tips.

4. Other Changes Starting 2026:

- **Dependent Care FSA Limit**: Increases to \$7,500 (from \$5,000) for 2026 and beyond. [5] Update open enrollment materials and payroll deduction limits for Dependent Care Assistance Plans.
- **Education Assistance**: The \$5,250/year tax-free education/Student Loan repayment benefit is now permanent beyond 2025. Plus, starting 2027, this limit will index to inflation (rising slightly each year). [7] Ensure payroll excludes up to the new limit each year.
- **“Trump Accounts” for Minors**: New child IRA accounts begin mid-2026. Each child born 2025–2028 gets \$1,000 seed from the government. Contributions up to \$5k/year (pre-tax) allowed. [8] Employers may contribute (up to \$2.5k) as a benefit, tax-free to the employee. (Optional for employers – consider if it fits your benefits strategy.)
- **1099 Reporting Thresholds**: For payments in 2026 onward, Form 1099-NEC/MISC threshold is \$2,000 (up from \$600). [9] Also, the 1099-K lower threshold (third-party payments) reverts to \$20k & 200 transactions (cancelling the planned \$600 rule). [9] This will reduce forms your finance team must issue. Adjust vendor payment tracking systems accordingly.
- **Employer Tax Credit:** Paid Family Leave credit (for providing paid FMLA) is made permanent past 2025. If you offer paid leave, continue claiming this credit. Also, the Employer Child Care facility credit limit rises dramatically (to \$500k of expenses) – beneficial if your company provides on-site daycare or similar support. [10]

5. State Tax Alert:

Many states automatically adopt federal tax code changes (rolling conformity), which means overtime/tip deductions could apply for state taxes. But states worried about revenue might “add back” those amounts.

Colorado already passed a law (HB 1296) to tax overtime for state taxes even though it is tax-free federally. Employers in CO should plan for state taxable wages to include overtime amounts that are federally deducted.

Other states with fixed conformity (e.g., CA, NY) will not automatically adopt OBBBA until they update their laws, so overtime and tips remain taxed by those states for now.

- **Action**: Check each state where you operate. You may need to adjust state withholding or communicate differences to employees. For example, a California worker's overtime might be deductible federally but still fully taxed by CA.

OBBBA provides welcome relief and clarity for payroll – no 2026 tax rate hikes, and new tax breaks for employees. Payroll teams should update systems for 2026 limits, start capturing overtime/tip data in 2025, and watch for IRS form changes and state guidance. These steps will ensure accurate withholding and reporting, keeping your company compliant and your employees informed about their tax benefits.