

HRW CLIENT ALERT

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The Impact of the One Big Beautiful Bill Act (OBBBA) on Employers

In this Client Alert, we describe some of the ways the recently enacted One Big Beautiful Bill Act (OBBBA) will impact employers.

Tax Provisions:

The tax provisions of the OBBBA are some of the most-anticipated changes.

1. No tax on overtime pay

Beginning in 2025, an employee who works “qualified overtime” is eligible to deduct up to \$12,500 on their federal income taxes.¹ For married persons filing jointly, the maximum deduction increases to \$25,000; however, married persons who do not file jointly cannot get the deduction at all. The allowable deduction is reduced (but not below zero) by \$100 for each \$1,000 that the employee’s modified adjusted gross income exceeds \$150,000 (\$300,00 for married persons filing jointly).

It is important to note that the deduction only applies to overtime required under the Fair Labor Standards Act (FLSA) that is in excess of the individual’s regular rate (i.e., only the “half” of “time and a half”). State-mandated overtime or contractually required overtime that is not also required under the FLSA (for example, same day overtime in states such as California and Colorado, or under a collective bargaining agreement) does not count.

This provision is temporary, only affecting tax years 2025 through 2028, and will need to be extended by Congress to continue.

2. No tax on qualified tips

Beginning in 2025, an employee who receives “qualified tips” is eligible to deduct up to \$25,000 on their federal income taxes. Unlike with overtime, the maximum deduction amount is not increased for married persons filing jointly, but married persons must still file jointly to be eligible for the deduction. Once again, the allowable deduction is reduced (but not below zero) by \$100 for each \$1,000 by that the employee’s modified adjusted gross income exceeds \$150,000 (\$300,00 for married persons filing jointly).

For a tip to be considered qualified, it must be received by the employee in an occupation which “customarily and regularly received tips on or before December 31, 2024.” The law requires the Secretary of the Treasury to publish a list of such occupations within 90 days of the law’s enactment (that is, by October 2, 2025).

¹Other federal payroll taxes, such as Social Security and Medicare taxes, will still apply to all wages, including overtime pay and tips.

The law additionally provides that tips are not considered “qualified” unless they are paid voluntarily without any consequence for nonpayment, are not subject to negotiation, and are determined by the payor. Thus, for example, if a restaurant requires all groups of more than a certain size to pay a minimum gratuity of 18%, the individual may only be permitted to take a deduction for amounts voluntarily paid in excess of that amount. Tips paid to employees in a specified service trade or business (SSTB), as that term is defined in the Internal Revenue Code, also do not qualify for the deduction. Examples of SSTB’s include healthcare, law, accounting, performing arts, athletics, and investing.

Like the no tax on overtime pay, this provision is also temporary, only affecting tax years 2025 through 2028.

For both these tax provisions, employers will need to adjust payroll systems to track qualified overtime and tips which could increase administrative complexity for payroll and human resource departments. For more information and an IRS fact sheet, visit <https://www.irs.gov/newsroom/one-big-beautiful-bill-act-tax-deductions-for-working-americans-and-seniors>.

Benefits Provisions:

1. Dependent Care

The OBBBA increases the employee contribution limit to dependent care employee flexible spending accounts from \$2,500 to \$3,750 for an employee filing separately and from \$5,000 to \$7,500 for an employee filing jointly with a spouse.

2. Health Savings Accounts

The OBBBA gives employees with Health Savings Accounts (HSAs) more options as to how pre-tax dollars may be used. For example, employees enrolled in ACA marketplace plans known as bronze or catastrophic plans will become eligible to contribute to HSAs beginning in 2026.

These benefits may be more attractive to employees, especially those who can now participate in HSAs who could not before.

Immigration Enforcement:

Another big-ticket item in the OBBBA was an increase in funding for immigration enforcement, through multiple federal agencies such as Immigration and Customs Enforcement (ICE) and the Department of Homeland Security (DHS). Included in this allocation is funding for additional ICE agents and \$29.9 billion specifically targeted toward ICE’s enforcement and deportation operations.

It is anticipated that this funding may dramatically increase the number of I-9 audits to which employers are subject as well as increased ICE raids at workplaces. Therefore, it is a good idea for employers to be familiar with their and their employees’ rights and responsibilities, have clear procedures in place in case of an audit or raid, and conduct a check of their current compliance with immigration law.

Changes to Medicaid:

Finally, the OBBBA adds minimum work requirements for those receiving Medicaid benefits. As a condition of eligibility for medical assistance, an individual must demonstrate “community engagement” as determined in accordance with criteria established by the Secretary of the Treasury through regulation. Community engagement is defined to include up to 80 hours per month of work, community service, work programs, educational programs, or any combination of such activities.

Community engagement can also be established by having a monthly income that is not less than the federal minimum wage multiplied by 80 or, for seasonal workers, an average monthly income over the preceding six months that is not less than 80 times the minimum wage. The community engagement requirement applies to all individuals receiving Medicaid unless an exemption applies (for example, if the individual is receiving inpatient hospital services).

These new requirements may result in increased human resources involvement when it comes to verifying or documenting employee hours. It could lead to more people seeking employment, especially for low-skill and lower-paying jobs, but on the flip side, could result in persons losing coverage due to their inability to demonstrate compliance with the requirements.

Employers should be aware that the OBBBA will change certain aspects of doing business. Some impacts, like updating payroll and accounting, are fairly benign. Others, like how to respond to increased ICE presence, are thornier.

If you have any questions regarding how to interpret any provisions in the bill, please contact:

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