

# Employer Guidance: “ No Tax on Tips”

*Payroll handling, employee expectations, and what to do now*

## What “No Tax on Tips” means

The concept generally refers to a federal income tax benefit tied to certain tip income. In practice, these programs are usually implemented as a deduction or credit claimed on an individual’s tax return - not as a change that automatically stops payroll withholding overnight.

- It does not typically eliminate the requirement to report tip income.
- It does not typically change Social Security/Medicare (FICA) treatment of tips.
- Employees usually see the benefit when they file their annual tax return (refund increases or taxes owed decrease), depending on their personal situation.

## How tips are currently handled through payroll

Most payroll systems treat reported tips as taxable wages for reporting purposes. Employers generally:

- Collect employee-reported tips (and/or capture charged tips) through the normal reporting process.
- Include tip amounts in taxable wages for W-2 reporting.
- Withhold applicable taxes based on pay, W-4 settings, and available withholding fields.
- Even when employees receive tips in cash, the tips are still reportable. Employers may need to withhold taxes from other wages (or handle shortfalls) if there is not enough cash wage to cover withholding on tips.

## Why taxes may still be withheld during the year

Payroll withholding is designed to prepay an employee’s expected federal income tax liability. If a tip-related tax benefit is claimed on the tax return (rather than excluded from wages in payroll), withholding may still occur throughout the year.

- Payroll engines withhold based on current IRS withholding tables and what is on the employee’s Form W-4.
- System fields may not support a real-time ‘tip deduction’ in withholding until official payroll guidance and vendor updates are released.
- FICA generally still applies to tip wages, so employees may continue to see Social Security and Medicare withholding on tips.

## How employees may ultimately receive the tax benefit

If eligible, employees generally receive the benefit when they file their annual federal tax return:

- The return includes the employee's total reported tips for the year.
  - The employee claims the applicable tip-related deduction/credit (if available and if they qualify).
  - That can reduce taxable income or tax due, which may increase a refund or reduce a balance due.
  - Because each employee's tax situation is different, encourage employees to consult a tax professional for personal advice.
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## Employer action checklist (recommended)

- Keep tip reporting processes consistent and well-documented (employee tip reporting, POS tip capture, tip pooling records, etc.).
  - Confirm your payroll provider's configuration for tips and ensure tips are included correctly on the W-2.
  - Prepare employee-facing communications that set expectations: withholding may continue; benefit may show up at filing time.
  - Monitor guidance from the IRS and your payroll vendor for any required configuration changes.
  - Route employee questions to HR/Payroll and avoid giving individual tax advice.
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### Questions/Support

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