

## Proposed Regs Map Out Qualified Tips and Jobs for Tax Deductions

by Trevor Sikes and Alexander Rifaat

Cash, checks, gift cards, and even casino chips could be qualified tips that are eligible for tax deductions under proposed regulations issued by Treasury and the IRS.

The proposed regs (REG-110032-25), released September 19, set forth a wide-ranging scope of what is and isn't an eligible tip for purposes of tax deductions by defining qualifying payment methods, exclusions, and jobs that customarily receive tips.

"These proposed regulations represent a thoughtful and data-driven approach, providing much-needed clarity on the scope of occupations and the definition of 'qualified tips' for the new deduction," Michael K. Mahoney of Ogletree Deakins told *Tax Notes*.

"I'm glad [Treasury and the IRS] released the proposed regs, and earlier than they were due so that everyone in these industries can get started on how to address the tips and how to account for the tips that are received," said Heather Posey of Frost Law.

The deduction for tips under section 224, enacted in the One Big Beautiful Bill Act (P.L. 119-21), would allow single filers who earn up to \$150,000 annually or married couples who earn up to \$300,000, to deduct up to \$25,000 in qualifying tipped income.

A qualified tip must be "received from customers or, in the case of an employee, through a mandatory or voluntary tip-sharing arrangement, such as a tip pool," according to the proposed regs.

A qualified tip must also be a cash tip, which is a tip paid by a cash medium of exchange. The proposed regs identify possible exchanges of cash to include a check, a credit or debit card, a gift card, "tangible or intangible tokens that are readily exchangeable for a fixed amount in cash (such as casino chips)," and any other form of

electronic or mobile payment that is denominated in cash.

Under section 224, a tip is eligible for deduction only if it is given voluntarily, isn't the subject of negotiation, and the amount is determined by the payer. The proposed regs further define what counts as voluntarily given, saying that a qualified tip must be paid without compulsion.

Any mandatory payments, such as service charges and automatic gratuities, which are added to a customer's bill by the vendor or establishment aren't qualified tips, even if they are then distributed to employees, according to the proposed regs.

However, there should be a reconsideration of automatic gratuities counting as qualified tips, Posey said. It's common for restaurants to include automatic gratuities for larger dining parties, so employees who work in a restaurant that uses this practice might not be able to get the full benefit of the deduction, she said.

The proposed regs would exclude certain tips — even if they otherwise meet the criteria — from being deducted, such as those received through illegal activity, prostitution, and pornography.

The proposed regs define the ends of the qualified tip spectrum well, said Daniel B. Boatright of Littler Mendelson PC. The types of payments that would qualify as tips were a bit unclear in the statute itself, but the proposed regs make it clear that it must be cash or a cash equivalent, he said.

### Eligible Jobs and Enforcement

Concerns arose about whether an occupation qualifies as one that "customarily and regularly receives tips" as required by section 224.

In an effort to address comments on eligible jobs, the proposed regs incorporate the preliminary list released by Treasury and the IRS containing 68 job titles that would be eligible for the deduction, divided into eight industry categories: beverage and food service, entertainment and events, hospitality and guest

services, home services, personal services, personal appearance and wellness, recreation and instruction, and transportation and delivery.

Although the jobs list in the proposed regs shows a serious effort to balance the statutory and administrative goals, more guidance could be given to employers to determine whether an employee is in a tipped occupation in which he or she provides services in different areas, Mahoney said.

“Clearer direction on how employers should document and communicate tip eligibility to their workforce would help ensure consistent application and minimize audit risk,” Mahoney said.

Boatright voiced reservations about the difference in definitions between Treasury and the Department of Labor regarding what jobs customarily receive tips.

The Fair Labor Standards Act has long had a settled concept that jobs that “customarily and regularly receive tips” means the tips are received through customer interaction, Boatright said.

But under the proposed regs, the list includes jobs that don’t normally have customer interactions like cooks and dishwashers, which could cause issues, said Boatright.

For example, an employee who works in an occupation that doesn’t ordinarily have customer interaction but still customarily and regularly receives tips for purposes of the qualified tips deduction under the proposed regs may not qualify for participation in a tip pool under the FLSA, Boatright said.

The proposed regs include an effort to combat the potential for abuse, which some tax professionals have suggested, by saying that a tip received by an employee who has an ownership interest in or is directly employed by the payer of the tip doesn’t count as a qualified tip.

However the proposed regs acknowledge that more steps may be needed to stop abuse. “Treasury and the IRS are concerned that taxpayers might misclassify income as tips and request comments on how to address this issue in the final regulations,” they said.

A public hearing on the proposed regs is scheduled for October 23. ■

## Threat of Mass Firings Ups Ante in Shutdown Standoff

by Alexander Rifaat, Cady Stanton, and Benjamin Valdez

The stakes are raised after the Office of Management and Budget instructed federal agencies to slash more staff in the event of a government shutdown.

In an undated memo obtained by *Tax Notes*, the OMB told federal agencies that if Congress fails to reach an agreement on a continuing resolution to fund the government by the September 30 deadline, they should use it as “an opportunity to consider” further reduction-in-force notices.

All federal employees involved in programs, projects, and activities that will have their discretionary spending lapse on October 1, have no other source of funding, and are “not consistent with the President’s priorities” would be subject to the potential wave of mass firings, according to the memo, first reported on by *Politico*.

The OMB said it has received lapse plans from many, but not all, agencies, and reminded agencies that lapse plans shouldn’t include the repurposing of funds and that any appropriations provided to them as part of the One Big Beautiful Bill Act (P.L. 119-21) should be “consistent with OMB-approved spend plans.”

The status of Treasury and IRS lapse plans is unclear, and neither responded to requests for comment by press time.

But previous recent shutdown plans could indicate that furloughs at the IRS will be light.

### The View From Capitol Hill

The memo marks a dramatic attempt by OMB Director Russell Vought to lay the blame for the firings at the feet of Senate Democrats in the ongoing spending battle.

Most of the caucus opposed a Republican-led stopgap bill on the Senate floor September 19 — which would have extended the funding deadline from September 30 to November 21 — because it didn’t address the upcoming expiration of enhanced premium tax credits from the Affordable Care Act.