

Tips and Overtime | How the OBBBA Impacts the Restaurant Industry | Transcript

Chaleise Fleming & Amy Hehman

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Chaleise Fleming:

Hi everyone and welcome to Barnes Dennig's Ask the Experts. I'm Chaleise and today I'm here with Amy and we're going to talk about the One Big Beautiful Bill's impact on the restaurant industry and we're going to focus kind of specifically on the tips and overtime deduction. Thanks for joining me, Amy.

Amy Hehman:

Thanks so much for including me today. I really appreciate it. And I want to just start with a question for you. What is the OBBBA and why is it significant for the restaurant industry, Chaleise?

Chaleise Fleming:

Oh yes. The One Big Beautiful Bill Act, OBBBA for short. It's a tongue twister for sure. This has been a big buzzword on the tax side of things all last year and I expect it will continue to be this year. So pretty much this was legislation passed last year that brought, for the restaurant industry specifically, two new above-the-line deductions for qualified overtime and qualified tips. So in the restaurant industry, you guys often pay a lot of employees overtime and a lot of your employees are tips. So those are two things that are going to really impact your industry.

Amy Hehman:

Yeah. That being said, the OBBBA, it really does change how employers have to calculate overtime when they're earning tips and bonuses and other incentive pay. I just want to understand like how do the new deductions for the tips and the overtime work when it comes to this type of legislation?

Chaleise Fleming:

So with this, what it is is it's an above-the-line deduction on the employee's tax return. So above the line means even if they don't itemize, they can benefit from this deduction.

Chaleise Fleming:

For qualified tips, it has to be tips that are received in an industry that's customarily received tips before January of 2025. They did that so a bunch of new industries don't start paying tips to get the benefit of this deduction. Restaurants are covered because they already have been paying tips. For the qualified overtime, that is the 0.5 of the time and a half that's required by the Federal Labor Standards Act.

And a big part of this, and one thing I've been trying to clarify with a lot of clients, is it doesn't mean that suddenly tips and overtime are exempt from taxes. It's still going to be subject to taxes. It's still subject to social security and Medicare. When it's processed through payroll, the regular withholding's going to apply, but it gives them a deduction that they can now take on their personal return. It is phased out at different income levels. So at about \$150,000, it starts getting phased out if you're single on your tax return and if you're married filing joint, it starts getting phased out at about \$300,000.

Amy Hehman:

Okay. Okay. Good to know. All great information. I mean, it seems like it's so convoluted, right? There's so much here that we have to pay attention to. So yeah, I really appreciate that conversation.

Chaleise Fleming:

All right, Amy, how does the One Big Beautiful Bill change the way overtime is calculated, specifically for tipped employees?

Amy Hehman:

So the OBBBA, it now requires that all non-discretionary pay be taken into consideration with the regular overtime rate. So what that means is mandatory tip pooling, service charges, and certain bonuses now have to be taken into consideration with that calculation. So HR teams need to really ensure that managers understand this, as do employees. They need to make sure that our HR systems and our payroll systems specifically are updated and that individuals really, truly understand how their pay is calculated.

I think that it's really important to point out that tip pooling itself is not new, but what the OBBBA does is it makes that reporting that much more critical. Since tips now influence how the regular rate for overtime is calculated, HR really has to ensure that the tip pools are correct, that they're accurate, that they're reported daily, and that processes are accurate with the new law and up to date.

Chaleise, could you explain just a little bit more about what exactly is included with the overtime rate?

Chaleise Fleming:

Yes. And this has been a misconception that some people have had as well. The qualified overtime is not all of your overtime. The qualified overtime calculation is the 0.5 of your one and a half times overtime rate. So it's really one third of your total overtime pay, not all of it. It's just that additional 0.5 time that you're getting. Sorry, 0.5 rate that you're getting.

Amy Hehman:

Okay. Okay. And just do you happen to have any suggestions or words for wisdom? I mean, it is a lot to actually think through how an employer would go about just making sure that all of this is correct. I mean, the record keeping behind it. Any thoughts for how they can best track to ensure consistency and accuracy as they are looking at their total overtime rate?

Chaleise Fleming:

A very high level double check, and this is not going to be exact if they've had bonus pay or any additional pay during that period, but very high level. If you're calculating your qualified overtime, it should be your total overtime paid by a third to quickly back into what was that 0.5 at the time and a half.

Amy Hehman:

Okay. That makes sense. That makes sense. Okay.

Chaleise Fleming:

And when you're factoring in any non-discretionary bonuses or your tipped wage, you have to kind of look at the whole picture and then come up with your average hourly rate. And then again, it would be the 0.5 of that would be the qualified overtime for the deduction.

Amy Hehman:

Yeah. It's certainly a lot to get your arms around, to understand, and also to put into action, which is the main thing. And then of course then have to turn around and explain it to employees and managers alike. It's a heavy undertaking.

Chaleise Fleming:

This is why we have HR joining us today as well.

Amy Hehman:

Yeah, there's a lot, right?

Chaleise Fleming:

So tying into that from an HR perspective, what challenges do you anticipate with these tracking and payroll changes?

Amy Hehman:

Yeah. I think probably the biggest thing is just that, are the systems updated with the appropriate regulations and with the rules? So are the systems being updated and do restaurants have in place policies and practices that will ensure that the overtime calculations are correct, that the reporting is happening daily?

And I think the biggest thing is just changing the processes around the communications to make sure that not just the managers understand the change, but more importantly, that the employees understand the change. So that's having communication very transparently, making sure that they're showing their employees examples of what this looks like.

And again, being a resource on an ongoing basis if they do have questions. When that trust is established and employees know what to expect, then they'll have fewer questions and they'll be able to mitigate complaints or this feeling of distrust around their pay. Pay is a big thing, so we want to make sure that we get it right.

Chaleise Fleming:

Yeah. And tying into that from a tax perspective, what I've run into a lot already with some of my clients are questions. Employees are having their first payroll and they're saying, "Why are my tips taxed? Why is my overtime still being taxed?" So making sure employees fully understand this deduction and how the calculation is working. If employees do want to update their withholding, because it's not going to happen automatically, they need to fill out a new form W4 to indicate what they think their tip credit's going to be to reduce their withholding through their payroll.

Amy Hehman:

Right. Yep. That's a great point. That's a great point. And I think just, again, if I could just add, just making sure that the reporting is accurate, making sure that just your personnel information is accurate, just like what you said, right? Like the tax forms. I think when employees get that first payroll where they see that change that's occurred, that is an excellent time to go in and have a conversation with their HR team or with their manager and sit down and talk about the change that they are seeing and really what they can expect moving forward in the event that they make future personnel changes.

Chaleise Fleming:

That's great. So do you have any final bits of advice for restaurants?

Amy Hehman:

I think that human resources needs to make sure that they get in front of it, like I mentioned before. So auditing the payroll systems, we want to make sure that they are calculating the overtime rate correctly. Train the managers on scheduling practices and also look to minimize any sort of unwanted overtime costs. Update obviously your policies around your tips, bonuses, and service charges, and communicate clearly with employees and with management so that everybody is on the same page and understands how the pay is calculated.

Chaleise Fleming:

That's great. And I'll add just kind of on the tax side of things, the whole point of this discussion is to show this is going to be a team effort as you guys implement these changes. You need to pull in your HR, your payroll team, your CPA and make sure you're all aware of what this change is and you have a game plan for tracking it. Because at the end of the year, the new form W2 will need to include the qualified tips and the qualified overtime.

Amy Hehman:

Yeah, yeah. And I think that restaurants will be ... I mean, again, they're already operating, like we said, right, on very minimum margins. So it's one mistake could really be very costly. And I just want to say by not doing this, you might encounter things such as back pay, miscalculations, class action exposure, for example, penalties.

So really making sure that you get in front of this and putting these things in place now, along with your accounting teams, as you mentioned, that is going to ensure that the proper documentation is happening, proper audit is happening, and everyone's on the same page with communication upfront and early.

Chaleise Fleming:

Yeah. My concluding thought's the same. Documentation is key and just making sure you have all your records to support these line items that your employees are not going to be taking as deductions.

Amy Hehman:

Yeah.

Chaleise Fleming:

Well, thanks so much, Amy. I love all these insights. And if any of you guys want to have a conversation with us or dig in a little deeper for how this is impacting your restaurant, check us out at barnesdennig.com. Thank you very much.