



Tax Insights
from Compensation,
Benefits, and Employment
Tax Services



Final regulations address qualified tips deduction and information reporting

April 22, 2026

In brief

What happened?

Treasury published final regulations on April 13, 2026, addressing the federal income tax deduction for qualified tips established under the One Big Beautiful Bill Act (Act). Under the Act, employees and payees may temporarily deduct qualified tips for federal income tax purposes for calendar years 2025 through 2028. The final regulations provide additional guidance on the definition of qualified tips and expand the list of occupations that customarily and regularly receive tips.

Why is it relevant?

Employers and payors that remit qualified tips to service providers in certain occupations have ongoing compliance obligations. For each service provider, they must identify and quantify tips paid since January 1, 2025, determine what portion, if any, constitutes qualified tips, assign the appropriate three-digit Treasury Tipped Occupation Code (TTOC), and report qualified tip income on the applicable information return. The final regulations largely retain the proposed regulations' framework for defining qualified tips and identifying the other data points necessary for employers and payors to manage information reporting obligations, while also providing several clarifications and expanding the list of covered occupations.

Actions to consider

Although the Act did not exclude qualified tips from the definition of taxable wages or ordinary income subject to information reporting, it imposes significant reporting obligations on employers and payors that

have a direct impact on payees' ability to claim an individual income tax deduction for qualified tip income. Employers and payors should review their payment streams in light of the revised guidance in the final regulations to facilitate proper identification and quantification of qualified tips for year-end reporting.

Observation: The IRS previously published drafts of the 2026 Forms W-2, 1099-K, 1099-MISC, and 1099-NEC, along with draft instructions. Each draft form includes additional fields and related instructions intended to capture the information taxpayers need to claim deductions for qualified cash tips and overtime. Filers should review these draft forms now to prepare for 2026 reporting requirements.

In detail

Qualified tips

The Act added Section 224 to the Internal Revenue Code, creating a federal income tax deduction for “qualified tips.” Qualified tips are defined as “cash tips” received by employees and self-employed individuals (collectively referred to as “payees”) working in an occupation that customarily and regularly received tips on or before December 31, 2024. The deduction is capped at \$25,000 and phases out for taxpayers with modified adjusted gross income over \$150,000 (\$300,000 for joint filers).

The definition of cash tips includes several criteria:

1. Cash tips must be paid either in cash or through a cash equivalent, such as by check, credit card, debit card, or similar electronic settlement method. Cash tips may include foreign currency, but do not include tangible property such as event tickets, meals, services, or other assets that are not exchangeable for a fixed amount of cash.
2. Cash tips must be received, directly or indirectly, from payors. The final regulations add a definition of “payor” as the ultimate recipient of the services. In most cases, this will be the customer, client, or other service recipient. An entity that merely acts as a conduit for transmitting a tip originally paid by a customer, client, or service recipient to the tip recipient — such as an employer, third-party settlement organization (TPSO), sole proprietorship, or single member LLC through which the recipient operates — is not treated as the payor for these purposes.
3. Tips paid to employees can include amounts received through either mandatory or voluntary tip-sharing arrangements. The guidance reiterates that qualified tips also could be received through a tip pool; however, amounts received by managers or supervisors through a tip-sharing arrangement are not qualified tips.
4. Cash tips must be paid voluntarily and cannot be dictated by the payee, as is the case with automatic gratuities. The regulations define tips as amounts paid by payors for services in excess of the amount agreed to, required, charged, or otherwise reasonably expected as a required payment for the services in an arm’s-length transaction. The preamble to the final regulations discusses when payments constitute tip income versus service charges. This distinction is consistent with longstanding IRS guidance and remains important for federal employment tax and information reporting purposes. Suggested gratuities generally qualify as tips if the customer can reduce the amount to zero. For example, tip selection methods such as a point-of-sale system that allow the customer to move a slider to zero or select “other” and enter zero indicate the payment is voluntary.

Observation: In the years following the COVID pandemic, many restaurants have adopted policies that impose a mandatory gratuity on all parties or parties above a certain size (e.g., six or more guests). This practice could prevent recipients of these standardized gratuities from treating the amounts as deductible tip income. Businesses that have implemented these policies may want to reconsider them in light of the “no tax on tips” provisions.

The final regulations also include anti-abuse provisions. A payee can only claim a deduction for qualified tips that do not represent a recharacterization of wages, payment for services, or other income. Whether a payment has been improperly recharacterized depends on all relevant facts and circumstances. For example, a significant shift in historical tipping or payment practices between the payor and tip recipient (e.g., to lower the cost of services and increase tip income) could indicate recharacterization. In some circumstances, the regulations also impose an irrebuttable presumption of recharacterization.

Observation: The final regulations provide additional clarification on the distinction between amounts paid as tips and amounts paid for access to services. For digital content creators (TTOC 209), amounts retained by a host platform and payments made by customers for access to content are not qualified tips. By contrast, voluntary payments made by customers directly to the content creator in recognition of their services could constitute qualified tips.

Finally, qualified tips do not include tips received in a specific trade or business as defined in Section 199A(d)(2), or as otherwise described by Treasury.

Observation: Certain employees are not required to determine qualified tips based on actual tips received. Employees participating in a Tipped Employee Participation Agreement as part of the Tip Reporting Determination Agreement (TRDA) program, or a Model Gaming Employee Tip Reporting Agreement under the Gaming Industry Tip Compliance Agreement (GITCA) program, can determine qualified tips using the applicable tip rate specified in their agreement, together with amounts reported on Form 4137 (or any successor form).

Expansion of occupations

The proposed regulations contained a list of occupations that customarily and regularly received tips on or before December 31, 2024. As in the proposed regulations, the final regulations organize these occupations into eight TTOC categories:

- 100s – Beverage and Food Service
- 200s – Entertainment and Events
- 300s – Hospitality and Guest Services
- 400s – Home Services
- 500s – Personal Services
- 600s – Personal Appearance and Wellness
- 700s – Recreation and Instruction
- 800s – Transportation and Delivery

The preamble to the final regulations discusses the data sets used to develop the list, as well as comments received on the methodology. The final regulations expand the list of covered occupations across several categories.

For example, “Pet Caretaker” was revised to “Pet *and Show Animal* Caretaker,” thereby encompassing individuals who work with horses. The Personal Services category was expanded to include visual artists and floral designers. In the Transportation and Delivery category, gas pump attendants—specifically individuals who pump gas for customers in New Jersey and Oregon—were added. Eyelash service providers, residential building maintenance workers, building doormen, and gig economy delivery drivers also were highlighted.

Information reporting

For tax years beginning after December 31, 2024, the Act added new information reporting requirements for certain payments of cash tips, generally as follows:

- **Employers (Form W-2):** Employers must report on Form W-2, furnished to the employee and filed with the Social Security Administration, the total amount of cash tips reported by the employee and the employee’s occupation.
- **Miscellaneous payments made in the course of a trade or business (Form 1099-MISC):** A payor must report on Form 1099-MISC the amount of cash tips paid to a non-employee, together with the non-employee's occupation. This information must be included both on the information return filed with the IRS and on the statement furnished to the payee.
- **Payments made for services and direct sales (Form 1099-NEC):** A payor must report on Form 1099-NEC the amount of cash tips paid to a non-employee in connection with services and direct sales, together with the non-employee's occupation. This information must be included both on the information return filed with the IRS and on the statement furnished to the payee.
- **Payment Settlement Entities (PSE):** A PSE must report on Form 1099-K the portion of payment transactions designated as cash tips and the occupation of the recipient. This information must be included on both the information return filed with the IRS and provided to the payee.

Although these reporting requirements apply to tax years beginning after December 31, 2024, the Act permits persons filing information returns or statements for calendar year 2025 to approximate amounts designated as cash tips using any reasonable method if separate accounting is not available.

The IRS also released Notice 2025-62 on November 5, 2025, providing that employers and payors would not be subject to penalties for failing to separately account for any amounts reasonably designated as “qualified tips” or for failing to identify the occupation of the recipient. This relief applied only to information returns and statements filed and furnished for calendar year 2025, and only if the filer otherwise timely filed and furnished complete and correct information returns required under preexisting law, notwithstanding the new provisions of the Act.

Observation: The 2025 Forms 1099-MISC, 1099-K, and 1099-NEC do not provide a mechanism for separately reporting qualified tips. As a result, payors that separately account for 2025 qualified tips will need to do so on an ad hoc basis, using any reasonable manner.

A key limitation remains that individuals can only claim a deduction for qualified tips reported on information returns, including Forms W-2, 1099-NEC, 1099-K, and 1099-MISC, or are reported by the individual on Form 4137.

Next steps

Employers and payors of tip income have been reviewing their payment streams to determine when they are remitting qualified tips to payees in occupations that regularly and customarily receive tips. The limited relief the IRS provided for 2025 reporting will not apply to 2026. Because the amounts reported by an employer or payor on an individual's information return are necessary for the payee to determine any qualified tip amount eligible for an individual income tax deduction, employers and payors should continue refining their analysis of point-of-sale data and information reporting systems to provide accurate reporting.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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