Special Report

Federal OBBBA Round-Up: What Employers Need to Know Now

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July 10, 2025

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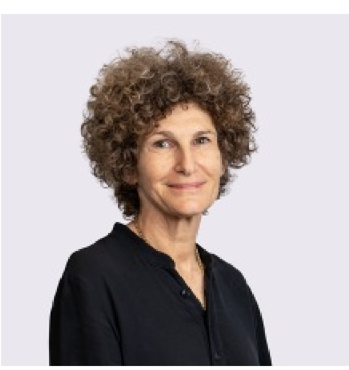

Takeaways

- The federal budget bill, aka the "One Big Beautiful Bill Act," impacts a wide range of workplace matters, including immigration, benefits, and employment tax liabilities.
- The OBBBA includes new, non-waivable fees and stricter requirements that are expected to increase financial and administrative burdens for employers hiring non-citizen workers.
- It also increases dependent care FSAs and employer-provided childcare credits, adds incentives for student loan and adoption assistance, and allows for temporary federal tax deductions that could make overtime and tipped work more attractive, especially in hospitality.
- Employers must update payroll and reporting systems to meet new IRS rules on tips, overtime, and tax credits.

Related links

- H.R. 1 – "One Big Beautiful Bill Act"
- AI Moratorium Removed from Federal Budget Bill
- What Are the Immigration Impacts in Budget Reconciliation Bill H.R. 1?
- Is the One Big Beautiful Bill Act an Employee Benefits Crystal Ball?
- How Will Federal Bills Eliminating Tax on Tips and Overtime Impact Employers?

Article

President Donald Trump signed H.R. 1, "One Big Beautiful Bill Act" (OBBBA), on July 4. The OBBBA affects a wide range of workplace issues, including immigration, benefits, and employment tax liabilities. Below is only a brief summary of the OBBBA's impact on these areas.

Agency Impact

The OBBBA introduces the "Workforce Pell Grant" program, and the Department of Labor (DOL) will likely have an expanded role in overseeing and approving short-term, career-oriented training initiatives. The DOL will be involved in collaborating with state workforce boards and governors to ensure Pell Grants align with in-demand industry sectors and occupations.

Additionally, the DOL will be tasked with enhancing workforce data management, credentialing processes, and conducting labor market analyses to support the effectiveness and accountability of these new workforce development efforts.

Immigration Impact

The OBBBA introduces immigration-related changes that are likely to affect employers

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Related Services

who recruit, employ, and sponsor foreign workers. It outlines new and increased fees on an array of immigration-related applications and processes, many of which cannot be waived or reduced.

Highlights include:

- An increased fee of $550 for Employment Authorization Documents (EADs) requested by asylum applicants, parolees, and individuals with Temporary Protected Status (TPS); an additional $275 fee is applied for renewals/extensions. These fees cannot be waived and will be adjusted annually for inflation.

- New fees on the underlying applications for asylum ($100 fee, adjusted annually with additional $100/year for every year the application is pending), parole ($1,000 fee for most parolees, with limited humanitarian exceptions), and TPS ($500 fee, adjusted annually).

Employers who hire individuals under these categories may encounter higher costs or potential delays as employees work to obtain or renew their work authorization.

Other new or increased fees include, but are not limited to:

- A $24 fee for Form I-94 (Arrival/Departure Record).
- A $250 Visa Integrity Fee for nonimmigrant visa issuance.
- Increased and inflation-adjusted fees for ESTA and Electronic Visa Update System.
- A $1,500 Adjustment of Status for in-court applicants.
- A $1,050 fee for Waivers of Inadmissibility.
- Variable fees of $900–$1,325 for Appeals and Motions depending on the type of appeal or motion.

The OBBBA also significantly increases funding for Customs and Border Patrol (CBP) with a combined $15 billion. The money is to be allocated to hiring and training additional CBP personnel; improving facilities and checkpoints; and implementing advanced surveillance and inspection technologies, including AI and biometric systems for entry and exit screening. Although aimed at reducing unauthorized entry and drug trafficking, an expanded use of AI and biometric systems may increase scrutiny and create delays for legal immigrants, including visa holders and lawful permanent residents, at ports of entry.

Overall, these changes mean the financial and administrative aspects of hiring non-citizen employees will need more attention. Planning for increased fees, understanding new requirements, and anticipating possible delays in the authorization process will be essential for maintaining compliance and a stable workforce. The expansion of funding for state and local participation in federal immigration enforcement (through agreements authorized by Section 287(g) of the Immigration and Nationality Act) could increase worksite enforcement actions, as well. Employers should continue to take preventive measures to ensure their programs are compliant.

Benefits Impact

The OBBBA introduces significant enhancements to employer-provided benefits.

1. Dependent care and other assistance programs

Employee Benefits
Energy and Utilities
Hospitality
Immigration
Restaurants
Wage and Hour

Among the most notable changes for employers is that, effective for tax years beginning after Dec. 31, 2025, the maximum annual exclusion for IRS Section 125 dependent care flexible spending accounts or FSAs has been increased from $5,000 to $7,500 ($3,750 for separate returns filed by married individuals). Additionally, the OBBBA substantially increases the employer-provided childcare credit, raising the maximum annual credit from $150,000 to $500,000, and boosting the percentage of qualifying expenses covered from 25% to 40%. Small businesses benefit from a new, separate credit, and all maximums are indexed for inflation.

The OBBBA also makes permanent the federal income tax exclusion for certain employer payments of student loans and adds an inflation adjustment for tax years beginning after 2026. Additionally, the adoption credit is enhanced to include a refundable portion up to $5,000, as adjusted for inflation. Collectively, these measures encourage businesses to invest more deeply in their workforce while making it easier for employees to manage education, dependent care, and family expenses.

The OBBBA permanently eliminates the exclusion for qualified bicycle commuting reimbursements and moving expenses for most taxpayers. Employers should update benefit policies accordingly.

2. 1099 reporting

Effective for payments made after Dec. 31, 2025, the threshold for reporting payments to certain persons engaged in a trade or business and payments of remuneration for services (Form 1099 MISC or NEC) has been raised from $600 to $2,000, to be indexed for inflation. A conforming change was made to the backup withholding rules. Employers will benefit from reduced reporting burdens for smaller payments, but they must update accounting systems to adapt to the new threshold.

3. Health savings accounts

The OBBBA provides employers flexibility to offer telehealth services pre-deductible to employees with a health savings account (HSA) and a high-deductible health plan (HDHP). This is a permanent change, and retroactively effective for plan years beginning after Dec. 31, 2024.

Starting in 2026, direct primary care arrangements (DPA) with monthly premiums of $150 or less are no longer disqualifying coverage for purposes of HSA/HDHP participation. These arrangements consist solely of primary care services by primary care practitioners under a fixed periodic fee compensation arrangement, subject to per-individual limits. Covered services cannot include procedures that require anesthesia, prescription drugs (other than vaccines), and certain laboratory services. The OBBBA also makes certain DPA fees HSA-reimbursable.

4. Paid leave

The OBBBA brings substantial changes to how employers manage and benefit from paid family and medical leave programs. Central to these reforms is the extension and enhancement of the paid family and medical leave credit. The OBBBA introduces greater flexibility for employers by allowing them to choose between two methods for calculating the credit.

The first option retains the original method, in which employers can claim a credit calculated as a percentage of wages paid to qualifying employees during periods of family and medical leave.

The newly introduced alternative permits employers to base the credit on a percentage of total premiums paid or incurred for insurance policies that provide paid family and medical leave coverage. This approach recognizes and rewards employers' proactive efforts to provide leave coverage, regardless of actual use, and may encourage broader adoption of paid leave benefits.

Additionally, the OBBBA changes the rules for aggregating related employers for purposes of the credit.

Another significant shift is the expanded definition of a qualifying employee. Employers may now treat employees who have been employed for at least six months as qualifying employees (assuming they otherwise meet the definition of qualifying employees).

Other Employment Tax Impacts

The OBBBA also provides federal income tax deductions for a portion of an eligible worker's tips and overtime earnings. Both deductions are temporary and are set to expire after the 2028 tax year. Tips and overtime pay are still subject to Social Security and Medicare taxes (as well as state and local taxes).

1. Deduction for overtime pay

The new tax law creates for eligible workers a temporary deduction from gross income for premium pay for overtime hours worked. The OBBBA caps the deduction at $12,500 (or $25,000, in the case of a joint return) for all employees. For higher earners, the allowable deduction is reduced by $100 for each $1,000 by which the employee's gross income exceeds $150,000 (or $300,000, in the case of a joint return).

The deduction applies only to the premium compensation paid in excess of an employee's regular rate of pay. For example, if an employee's regular rate of pay is $15 per hour, the employee's overtime rate (time and one-half) is $22.50 per hour. Only the $7.50 overtime premium for that hour may be deducted. The deduction is also limited to premium pay that is statutorily required under Section 7 of the Fair Labor Standards Act. (Thus, additional overtime compensation paid pursuant to heightened state-law requirements or negotiated under collective bargaining agreements do not qualify for the deduction.) The overtime deduction does not apply to qualified tips.

Employers are required to separately report on Form W-2 the portion of the employee's pay that is qualified overtime compensation. Additionally, effective for tax years beginning after Dec. 31, 2025, the procedures for withholding are to be modified to take into account this deduction. Finally, there is a transition rule for 2025 that permits employers to approximate a separate accounting of amounts as qualified overtime compensation by any reasonable method specified by the IRS. Employers should be on the lookout for specific IRS guidance.

2. Deduction for tips

The new tax law creates a separate deduction for tipped workers, allowing them to deduct up to $25,000 of qualified tips earned. Like the overtime deduction, the allowable deduction for tipped earnings is reduced by $100 for each $1,000 by which the tipped worker's gross income exceeds $150,000 (or $300,000, in the case of a joint return).

Only tips that are paid voluntarily by the customer or client, not subject to negotiation, may be deducted. Therefore, earnings from mandatory service charges assessed automatically to customers are not deductible. Tips received under tip-sharing arrangements count as qualified tips.

The deduction is available only for tips earned in "traditionally and customarily tipped industries." This most typically means the hospitality industry (restaurants and hotels), but there are other businesses where tips are common (such as barber shops and hair salons). The legislation also extends an employer tax credit for Social Security taxes paid on tips, currently applicable only to food or beverage service employees, to include tips customarily earned by employees providing beauty services such as hair care, nail care, and spa treatments.

To deter abuse of the tip deduction (such as reclassifying workers' regular pay as qualified tips), the treasury secretary is required to publish, within 90 days, a list of occupations that have customarily and regularly received tips on or prior to Dec. 31, 2024.

The deduction also applies to individuals who are not statutory employees but who earn tips in the course of a trade or business. The tip deduction only applies, however, to the extent that the income from that trade or business (including tips) exceeds the full sum of allowable deductions (not counting the tip deduction) allocable to that trade or business.

Businesses will need to separately report tips reported by the employee on Form W-2 and identify the employee's qualifying tip-earning occupation. For non-employees, entities must furnish a statement identifying the portion of payments made to the individual that are designated as cash tips, as well as the individual's qualifying tip-earning occupation. This reporting requirement extends as well to "third-party settlement organizations" such as gig companies. Third-party settlement organizations will be required to report to the federal government the portion of payments made that were "reasonably designated by payors as cash tips," along with the occupation of the payee receiving those tips.

As with overtime, the procedures for withholding are to be modified to account for this deduction. There is also a transition rule for 2025 that permits employers to approximate a separate accounting of amounts designated as cash tips by any reasonable method specified by the IRS. As with overtime, employers should be on the lookout for specific IRS guidance.

3. Impact on employers

The ability to earn overtime wages not subject to tax may make employees more willing to work overtime or take on extra shifts, which could ease chronic staffing shortages in healthcare and other industries. Employers might consider restructuring compensation to provide employees with more take-home pay without incurring higher payroll costs.

One possible strategy is to reduce the regular rate of pay for non-overtime hours and permit more overtime work that is tax-free — a win for employers and employees.

Exempt employees may ask to be reclassified as non-exempt because more of their earnings will be tax-free. Employers should consult with counsel before undertaking drastic changes to their pay practices.

It is anticipated that no-tax-on-tips will materially impact certain industries, such as hospitality. The deduction on tipped earnings could deflate the ongoing efforts of worker organizations that have been advocating at the state and local level to eliminate the use of the tip credit and efforts by some employers to eliminate all tipping at restaurants and use service charges or higher prices instead.

The tax deduction also may help in recruitment, raising the appeal of tipped work in restaurants, for example, and easing the strain of ongoing labor shortages in the industry. In states that permit back-of-the-house workers (such as cooks) to participate in a tip pool (permitted under federal law if no tip credit is taken), the tax deduction may also benefit kitchen workers. But, in other states, it may widen the asserted unfairness between service staff and kitchen staff regarding compensation. Hospitality employers may want to consider a review of their compensation practices as the favorable tax treatment for tips will increase the divide between the earnings of tipped and non-tipped workers.

If you have questions or need assistance, please reach out to the Jackson Lewis attorney with whom you regularly work.