

# DEPARTMENT OF TAXATION

## 2025 Fiscal Impact Statement

1. **Patron** Anne Ferrell H. Tata

3. **Committee** House Finance

4. **Title** Individual Income Tax Deductions for Tips  
and Overtime Compensation

2. **Bill Number** HB 1965

**House of Origin:**

  X   **Introduced**

       **Substitute**

       **Engrossed**

**Second House:**

       **In Committee**

       **Substitute**

       **Enrolled**

### 5. **Summary/Purpose:**

This bill would provide an individual income tax deduction for the amount of cash tips, including tips paid by electronic means, that are included on statements furnished to the taxpayer's employer for federal tax purposes.

This bill would also provide an individual income tax deduction for the amount of any overtime compensation received by an employee who is not exempt from overtime compensation rules pursuant to the federal Fair Labor Standards Act.

This bill would be effective for taxable years beginning on and after January 1, 2026.

### 6. **Budget amendment necessary:** Yes.

Item(s): Page 1, Revenue Estimates  
258 and 260, Department of Taxation

### 7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

#### 7a. **Expenditure Impact:**

| <i><b>Fiscal Year</b></i> | <i><b>Dollars</b></i> | <i><b>Positions</b></i> | <i><b>Fund</b></i> |
|---------------------------|-----------------------|-------------------------|--------------------|
| 2026-27                   | \$108,722             | 1                       | GF                 |
| 2027-28                   | \$108,263             | 1                       | GF                 |
| 2028-29                   | \$110,625             | 1                       | GF                 |
| 2029-30                   | \$112,163             | 1                       | GF                 |
| 2030-31                   | \$114,625             | 1                       | GF                 |

#### 7b. **Revenue Impact:**

| <i><b>Fiscal Year</b></i> | <i><b>Dollars</b></i> | <i><b>Fund</b></i> |
|---------------------------|-----------------------|--------------------|
| 2025-26                   | (\$120.5 million)     | GF                 |
| 2026-27                   | (\$248.4 million)     | GF                 |
| 2027-28                   | (\$263.5 million)     | GF                 |
| 2028-29                   | (\$279.6 million)     | GF                 |
| 2029-30                   | (\$292.6 million)     | GF                 |
| 2030-31                   | (\$314.7 million)     | GF                 |

## **8. Fiscal implications:**

### Administrative Costs

The Department of Taxation (“the Department”) would incur estimated expenditures, as shown on Line 7a, for the overtime compensation deduction provisions of this bill. The costs above would be incurred for purposes of hiring one full-time employee to administer the Department’s responsibilities with respect to the over-time deduction, and additional ongoing operational expenses related to overseeing the deduction.

The Department considers the provisions of this bill creating a tip income deduction as routine, and does not require additional funding.

### Revenue Impact

The provision of this bill creating a tip income deduction would reduce General Fund revenues by \$35.0 million in FY 2026, \$64.7 million in FY 2027, \$66.3 million in FY 2028, \$67.9 million in FY 2029, \$69.5 million in FY 2030, and \$71.1 million in FY 2031. No budget amendment is needed because the revenue impact of this portion of the bill is assumed in the Introduced Executive Budget.

The provision of this bill creating an overtime compensation deduction would have an estimated negative General Fund revenue impact as shown on Line 7b. A budget amendment is needed because the revenue impact of an overtime compensation deduction is not assumed in the Introduced Executive Budget.

## **9. Specific agency or political subdivisions affected:**

Department of Taxation

## **10. Technical amendment necessary: No.**

## **11. Other comments:**

### Cash and Noncash Tips

Tips are optional cash or noncash payments that customers make to employees. Four factors determine whether a payment qualifies as a tip. Generally, all four must apply:

- The customer makes the payment free from compulsion;
- The customer must have the unrestricted right to determine the amount;
- The payment should not be the subject of negotiations or dictated by employer policy; and
- Generally, the customer has the right to determine who receives the payment.

“Cash tips” include tips received directly from customers, electronically paid tips distributed to the employee by their employer, and tips received from other employees under any tip-sharing arrangement. Employees must report all cash tips to their employer.

Tips reported to the employer are included on the employee's Form W-2, Wage and Tax Statement, for reporting on an individual tax return.

“Noncash tips” are goods or services received in any medium other than cash. This would include tickets, passes, or other goods or commodities that a customer gives the employee. Noncash tips are not reported to the employer, but the fair market value of such tips is required to be reported to the Internal Revenue Service as income for tax purposes. Any tips that the employee didn't report to the employer must be reported separately and the employee must pay the employee share of Social Security and Medicare tax owed on such tips.

### Overtime Compensation

Overtime compensation is paid to employees who work more than the standard number of hours in the day or week. The Fair Labor Standards Act (FLSA), 29 U.S.C. § 201 *et seq.* requires employers to pay certain employees who work more than 40 hour per workweek, overtime pay at a rate of time and a half, or 150% of their typical pay rate. Currently, there are several exemptions to the FLSA overtime rules. Virginia's overtime law, *Va. Code* § 40.1-29.3, generally mirrors the federal law.

### Virginia's Individual Income Tax Modifications

#### *Federal Adjusted Gross Income*

Virginia's Individual Income Tax substantially conforms to federal income tax law by using federal adjusted gross income (“FAGI”) as the starting point for computing Virginia income taxes. Virginia law then provides various modifications to FAGI that must be taken into account that figure in determining Virginia taxable income.

#### *Virginia Adjusted Gross Income*

When completing a Virginia individual income tax return, a taxpayer starts with the amount of FAGI reported on his federal return. A taxpayer then calculates Virginia adjusted gross income by making two types of adjustments: (1) “additions” which increase the amount of income taxable by Virginia and (2) “subtractions” which reduce such amount. These adjustments are made only to the extent that they have not already been included or excluded from FAGI.

#### *Virginia Taxable Income*

The taxpayer calculates his Virginia taxable income by making another type of modification referred to as “deductions,” which further reduce the amount of income taxable by Virginia. These modifications are made regardless of federal treatment unless specifically stated otherwise in the provision.

Please find below an illustration of how taxable income is computed for federal and Virginia income tax purposes and how they interrelate:

| Federal Income Tax                                    | Virginia Income Tax                                                                             |
|-------------------------------------------------------|-------------------------------------------------------------------------------------------------|
| +Wages and Other Income                               | = <i>Federal Adjusted Gross Income</i><br>(“FAGI”)                                              |
| +Federal Adjustments                                  | +Virginia Additions<br>(only if not included in FAGI)                                           |
| -Federal Adjustments                                  | -Virginia Subtractions<br>(only if not excluded from FAGI)                                      |
| = <i>Federal Adjusted Gross Income</i><br>(“FAGI”)    | = <i>Virginia Adjusted Gross Income</i><br>(“VAGI”)                                             |
| -Federal Standard Deduction or<br>Itemized Deductions | -Virginia Standard Deduction or<br>Federal Itemized Deductions<br>(depends on federal election) |
| -QBI Deduction                                        | -Deduction for Virginia Exemptions                                                              |
|                                                       | -Virginia Deductions<br>(regardless of federal treatment)                                       |
| = <i>Federal Taxable Income</i>                       | = <i>Virginia Taxable Income</i>                                                                |

Because this bill would establish a new Virginia deduction, the amount allowed under this bill could be taken whether the taxpayer chooses to take the Virginia standard deduction or itemized their deductions.

### Proposal

This bill would provide an individual income tax deduction for the amount of cash tips, including tips paid by electronic means, that are included on statements furnished to the taxpayer’s employer for federal tax purposes.

This bill would also provide an individual income tax deduction for the amount of any overtime compensation received by an employee who is not exempt from overtime compensation rules pursuant to the federal Fair Labor Standards Act.

This bill would be effective for taxable years beginning on and after January 1, 2026.

### Similar Bills

**HB 1562** and **SB 763** would provide an individual income tax deduction for cash tips but would not include an individual income tax deduction for overtime compensation.

cc : Secretary of Finance

Date: 01/18/2025 JLOF  
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