

ARTICLES

Waiter, Extra Tip, No Tax: A Tax and Poverty Law Analysis

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ABSTRACT

“Add a tip?” Maybe you just don’t want to—but tipped workers can’t afford for you not to. Across the country, service workers are twice as likely to live in poverty as their non-tipped counterparts, yet Congress has now chosen to exempt a portion of their tips from income tax. The One Big Beautiful Bill Act (OBBBA), enacted in 2025, establishes a new “No Tax on Tips” deduction of up to \$25,000 for workers in occupations that the Treasury deems “traditionally and customarily” tipped. While the measure mirrors earlier proposals, it expands eligibility far beyond the low-wage workers it was ostensibly designed to help.

This Article examines the distributive and equity implications of OBBBA’s tip deduction and compares it to earlier legislative proposals that sought to eliminate tip taxation. Using a case study of Judy, a single mother earning \$30,000 a year as a waitress in Texas, it models how each proposal would affect take-home pay, refundable tax credits, and eligibility for programs such as SNAP, Section 8, and Medicaid. The analysis finds that although framed as a form of poverty relief, OBBBA’s graduated phase-out—from \$150,000 to \$400,000 for single filers—channels benefits toward middle- and upper-income taxpayers, with negligible gains for the working poor.

The Article makes three contributions to tax and poverty-law scholarship. First, it situates tip taxation within the long historical arc of wage suppression and racial inequality that has shaped tipped work in the United States. Second, it evaluates how eliminating tax on tips interacts with means-tested programs such as the EITC, CTC, SNAP, and Section 8, showing that the policy may inadvertently reduce eligibility for safety-net benefits. Third, it exposes how OBBBA’s design, particularly its exclusion of ITIN filers and its joint-filing requirement, reinforces systemic inequities for immigrant and mixed-status households. Ultimately, while eliminating the tax on tips might seem like a simple fix, this Article argues that it is a superficial solution to a deeply entrenched problem.

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"The IRS is always looking for ways to screw the poor people."

1983 letter from "Pissed Off in Bird, Oregon" to the IRS¹

INTRODUCTION

"Add a tip?"

Studies show that the majority of Americans dread this question, but at the same time feel pressure to tip and maybe even guilt for not tipping.² And those conflicted feelings are not without merit. Many Americans are struggling to make ends meet.³ And tipflation—the growing expectation to tip at least 18 to 20%

1. Joel S. Newman, *Waiter, There's an IRS Agent in My Soup*, 40 TAX NOTES 861, 865 (1988).

2. A majority of Americans are experiencing what is now known as 'tip fatigue.' See, e.g., Jessica Dickler, "*Tip Fatigue*" Is Real. Here's When to Leave 20%, and When It's OK to Leave Less, CNBC (Aug. 18, 2023, 9:38 AM), <https://www.cnn.com/2023/08/18/tip-fatigue-is-real-heres-how-much-people-really-tip-post-pandemic.html> [<https://perma.cc/3WQN-8BPD>]; Alina Machado, *Tired of Tipping? Many Americans Agree It Has 'Gotten out of Control': Survey*, NBC 6 S. FLA., (June 20, 2024, 7:27 PM) <https://www.nbcmiami.com/news/local/tipping-culture-bankrate-survey/3342389/> [<https://perma.cc/M4N5-ME6C>]; Stella Shon, Glen Luke Flanagan & Robin Saks Frankel, *More Places Are Asking for Tips, and It's Tiring Americans Out*, USA TODAY (Sept. 10, 2024, 3:41 PM), <https://www.usatoday.com/money/blueprint/credit-cards/tipping-fatigue-growing-in-america/> [<https://perma.cc/GL6A-AQN7>].

3. See, e.g., Claire Jones, *Janet Yellen Says Many Americans Still Struggling with Inflation*, FIN. TIMES (May 24, 2024), <https://www.ft.com/content/38935f6b-4f61-4001-84a7-226e52d9a184> [<https://perma.cc/8A94-HPQT>]; Matt Egan, *Even Wealthy Americans Are Struggling to Make Ends Meet*, CNN BUS. (June 26, 2024, 2:43 PM), <https://www.cnn.com/2024/06/26/economy/wealthy-economy-inflation/index.html> [<https://perma.cc/C335-T78Y>]; Jessica Dickler, *More Americans Are*

everywhere, from coffee shops to takeout counters, and even on self-serving kiosks or websites like GoFundMe—only adds to those struggles.⁴ But it's not like tipped workers are raking in the riches. Across the country, poverty rates for tipped workers are 2.3 times higher than those of non-tipped workers.⁵ Against this backdrop of widespread economic anxiety and dissatisfaction with tipping norms, the idea of exempting tips from taxation has seemingly gained political traction.

This Article critically examines the newly enacted “No Tax on Tips” provision in the One Big Beautiful Bill Act (OBBBA) together with recent legislative proposals to eliminate the tax on tips, tracing the historical origins of the custom, its systemic inequities, and the socioeconomic consequences for low-wage workers. It is one of the few tax papers to approach this issue from a poverty-law perspective rather than a compliance-focused lens, advancing reforms aimed at promoting equity and economic justice for tipped workers.

* * *

On his first day back in office, President Donald Trump, during one of his inaugural speeches, asked, “Can you remember that little statement about tips?” and added, “I think we won Nevada because of that statement.”⁶ Trump was referring to a campaign promise he made in June 2024 during a rally in Las Vegas to

Struggling Even as Inflation Cools—Here's Why, CNBC (July 9, 2024, 5:19 PM), <https://www.cnbc.com/2024/07/09/why-more-americans-are-struggling-even-as-inflation-cools.html> [<https://perma.cc/C4YS-UUXR>]; Christopher J. Brooks, *Inflation is Cooling, yet Many Americans Say They're Living Paycheck to Paycheck*, CBS NEWS (July 15, 2024, 12:01 AM), <https://www.cbsnews.com/news/americans-living-paycheck-to-paycheck-survey/> [<https://perma.cc/8DNF-HQR3>]; Jeanna Smialek, *America's Inflation Fight Is Ending, but It's Leaving a Legacy*, N.Y. TIMES (Sept. 19, 2024), <https://www.nytimes.com/2024/09/19/business/economy/inflation-interest-rates-effects.html> [<https://perma.cc/FHX9-E7Z5>].

4. *Choosing a Tip Amount*, GOFUNDME (July 17, 2025), <https://support.gofundme.com/hc/en-us/articles/360051144952-Choosing-a-tip-amount> [<https://perma.cc/GF3E-JXD4>]; Aimee Picchi, *How “Tipflation” and “Tip Creep” Are Sparking a Backlash: “I Don't Feel Obligated” to Tip*, CBS NEWS (Jan. 27, 2023, 2:38 PM), <https://www.cbsnews.com/news/tipping-backlash-inflation-who-should-get-tipped/> [<https://perma.cc/NBH2-SNRC>]; Chris Taylor, *Tipped off: American Consumers Grapple with Tip Creep*, REUTERS (July 2, 2024), <https://www.reuters.com/world/us/tipped-off-american-consumers-grapple-with-tip-creep-2024-07-02/> [<https://perma.cc/W4AS-6TMU>]; Tanasia Kenney, *Is ‘Tipflation’ out of Control? Most Say Pressure to Tip Has Gone Too Far, Poll Finds*, MIA. HERALD (Oct. 3, 2024, 4: 41 PM), <https://www.miamiherald.com/news/nation-world/national/article293371534.html> [<https://perma.cc/7DBT-ZA27>]; Cynthia Furlong Reynolds, *Are Americans Reaching a Tipping Point in Tipping?*, SUN TIMES NEWS (Jan. 2, 2025), <https://thesuntimesnews.com/are-americans-reaching-a-tipping-point-in-tipping/> [<https://perma.cc/77WQ-JLBL>].

5. NINA MAST, ECON. POL'Y INST., TIPPING IS A RACIST RELIC AND A MODERN TOOL OF ECONOMIC OPPRESSION IN THE SOUTH 3 (2024).

6. Abel Garcia, *President Trump: “I Think We Won Nevada” with “No Tax on Tips” Campaign Promise*, CHANNEL 13 LAS VEGAS NEWS KTNV (Jan. 22, 2025, 8:32 PM), <https://www.ktnv.com/news/president-trump-i-think-we-won-nevada-with-no-tax-on-tips-campaign-promise> [<https://perma.cc/SM77-25EQ>].

eliminate taxes on tips.⁷ Though admittedly improvised, the policy appeared to have enough appeal in a state like Nevada for then-candidate Kamala Harris to endorse it as well.⁸ These campaign promises inspired a flurry of legislative proposals, each offering different design options to abolish the taxation of tips. Some proposed exempting tips entirely from both income and payroll taxes,⁹ others suggested exemptions for a limited period,¹⁰ while some sought to eliminate income taxes on tips by introducing various types of deductions¹¹ specifically for cash tips.¹² Ultimately, Congress chose the deduction-based model, codifying a “No Tax on Tips” provision in OBBBA, which now allows qualifying workers to deduct up to \$25,000 in annual tip income.¹³

While fields such as economics,¹⁴ labor studies,¹⁵ behavioral science,¹⁶ and

7. Alayna Treene et al., *Trump Proposes Eliminating Taxes on Tips at Las Vegas Campaign Rally*, CNN (June 9, 2024, 10:44 PM), <https://www.cnn.com/2024/06/09/politics/donald-trump-nevada-rally/index.html> [<https://perma.cc/9RT5-93TP>].

8. Andrew Duehren, *No Taxes on Tips? A Trump Idea Gains Ground*, N.Y. TIMES (July 18, 2024), <https://www.nytimes.com/2024/07/18/us/politics/trump-tips-taxes.html> [<https://perma.cc/2JCA-CHHM>]; Aaron Pellish et al., *Harris Endorses Eliminating Taxes on Tips, Touting Policy First Proposed by Trump*, CNN POLITICS (Aug. 12, 2024, 9:28 AM), <https://www.cnn.com/2024/08/12/politics/taxes-on-tips-eliminate-proposal-harris/index.html> [<https://perma.cc/7PDZ-UEMV>].

9. Tax Free Tips Act of 2024, H.R. 8785, 118th Cong. (2024).

10. Tip Tax Termination Act, H.R. 7870, 118th Cong. (2024).

11. No Tax on Tips Act, S. 4621, 118th Cong. (2024); No Tax on Tips Act, H.R. 8941, 118th Cong. (2024); Tipped Income Protection and Support (TIPS) Act, H.R. 9624, 118th Cong. (2024).

12. It should be noted that, in this context, the term “cash” in relation to tips refers to all dollar-denominated tips, whether paid in physical currency or via electronic payments. “Cash tips,” therefore, explicitly exclude any tips provided in-kind.

13. H.R. 1, 119th Cong. § 70201(a) (2025) (enacted).

14. See, e.g., Ofer H. Azar, *The Economics of Tipping*, 34 J. ECON. PERSP. 215 (2020); Ofer H. Azar, *The Implications of Tipping for Economics and Management*, 30 INT’L J. SOC. ECON. 1084 (2003); Ofer H. Azar, *Why Pay Extra? Tipping and the Importance of Social Norms and Feelings in Economic Theory*, 36 J. SOCIO-ECON. 250 (2007); Zvi Schwartz, *The Economics of Tipping: Tips, Profits and the Market’s Demand—Supply Equilibrium*, 3 TOURISM ECON. 265 (1997); Melville Saayman & Andrea Saayman, *Understanding Tipping Behaviour—An Economic Perspective*, 21 TOURISM ECON. 247 (2015); Öm B. Bodvarsson & William A. Gibson, *Economics and Restaurant Gratuities: Determining Tip Rates*, 56 AM. J. ECON. & SOCIO. 187 (1997). There are also some writings about tipping in the field of business. See, e.g., Michael Lynn & Glenn Withiam, *Tipping and Its Alternatives: Business Considerations and Directions for Research*, 22 J. SERVS. MKTG. 328 (2008); MICHAEL LYNN, CENTER FOR HOSPITALITY RESEARCH, *THE BUSINESS CASE FOR (AND AGAINST) RESTAURANT TIPPING*, CORNELL HOSPITALITY REPORT 1 (2016) [<https://perma.cc/HKL2-3RP6>].

15. See, e.g., William E. Even & David A. Macpherson, *The Effect of the Tipped Minimum Wage on Employees in the U.S. Restaurant Industry*, 80 S. ECON. J. 633 (2014); Oz Shy, *Do Tips Increase Workers’ Income?*, 61 MGMT. SCI. 2041 (2015); Ashley Weis, *Tip Jars in Need of Change: The Case for Reforming Employee Tip Regulations in the Fair Labor Standards Act*, 50 U. TOL. L. REV. 575 (2019); Eli R. Wilson, *Tip Work: Examining the Relational Dynamics of Tipping beyond the Service Counter*, 42 SYMBOLIC INTERACTION 669 (2019); Eli R. Wilson & Davyd Setter, *Working Through Tips: Examining Labor Dynamics in Tipped Workplaces*, in POPULATION CHANGE AND PUBLIC POLICY 259 (Billystrom Jivetti & Md. Nazrul Hoque eds., 2020).

16. See, e.g., Ian Ayres et al., *To Insure Prejudice: Racial Disparities in Taxicab Tipping*, 114 YALE L.J. 1613 (2005); Michael Conlin et al., *The Norm of Restaurant Tipping*, 52 J. ECON. BEHAV. & ORG. 297 (2003); Michael Lynn, *Tipping in Restaurants and Around the Globe: An Interdisciplinary Review*, in HANDBOOK OF CONTEMPORARY BEHAVIORAL ECONOMICS 626 (Morris Altman ed., 2006); Michael Lynn, *The Effects of*

ethics¹⁷ have extensively explored tipping, the scholarly tax literature has been sparse. What exists has focused on tax compliance—how to get tipped workers to pay taxes on their tips.¹⁸ Scholarship at the intersection of tip taxation and poverty remains limited.¹⁹ This article seeks to fill that gap by situating the newly enacted tip deduction within the broader policy movement to exempt tips from federal taxation—a trend lawmakers across the political spectrum have embraced as a form of worker relief.²⁰ Although framed as an effort to support low-wage service workers, OBBBA and the proposals that preceded it raise serious equity and efficiency concerns, including significant revenue loss, opportunities for tax avoidance, and distortions in refundable credits and means-tested benefits. To assess these tradeoffs, this Article compares OBBBA’s “No Tax on Tips” provision with

Tipping on Consumers’ Satisfaction with Restaurants, 52 J. CONSUMER AFFS. 746 (2018); Michael Lynn et al., *Consumer Racial Discrimination in Tipping: A Replication and Extension*, 38 J. APPLIED SOC. PSYCH. 1045 (2008); Matt Parrett, *An Analysis of the Determinants of Tipping Behavior: A Laboratory Experiment and Evidence from Restaurant Tipping*, 73 S. ECON. J. 489 (2006).

17. See, e.g., Mark P. Mailer, *The Morality of Tipping*, 7 PUB. AFFS. Q. 231 (1993); Iniobong Udoidem, *Tips in Business Transaction: A Moral Issue*, 6 J. BUS. ETHICS 613 (1987); Daniel Suarez, *Restaurant Tipping: Short-Circuiting the Morality of the Market*, in ECONOMIC DEVELOPMENT, INTEGRATION, AND MORALITY IN ASIA AND THE AMERICAS 307 (Donald C. Wood ed., 2009); Paula Mulinari, *Weapons of the Poor: Tipping and Resistance in Precarious Times*, 40 ECON. & INDUS. DEMOCRACY 434 (2019); Edward N. Gamble et al., *Dishing Up Morality: How Chefs Account for Gratuity*, 191 J. BUS. ETHICS 539 (2024).

18. See, e.g., Yoram Margalioth, *The Case Against Tipping*, 9 U. PA. J. LAB. & EMP. L. 117 (2006) (questioning the treatment of tips under tax and employment laws, while proposing a switch to mandatory service charges or treating tips as regular service payments to reduce discrimination, negative externalities, and tax evasion); Lawrence Zelenak, *Custom and the Rule of Law in the Administration of the Income Tax*, 62 DUKE L. J. 829 (2012) (using tips as an example where the IRS enforces reporting for only a portion of income despite requiring taxpayers to report 100% of tip earnings, which raises concerns about underenforcement and rule-of-law values); John Robertson et al., *Unreported Tip Income: A Taxing Issue*, 76 CPA J. 30 (2006) (examining the issue of unreported tip income in the U.S. restaurant industry, highlighting IRS initiatives like aggregate estimation methods and voluntary compliance programs to address tax evasion, and discussing judicial and legislative responses to the employer’s Federal Insurance Contributions Act (FICA) tax liability for tips); Lesli S. Laffie, *Got Tips? Better Report Them*, 190 J. ACCT. 75 (2000) (discussing the importance of reporting tip income, IRS enforcement measures, and the legal obligations for both employees and employers in the service industry to ensure compliance with income and FICA tax regulations); John E. Anderson & Örn B. Bodvarsson, *Tax Evasion on Gratuities*, 33 PUB. FIN. REV. 466 (2005) (analyzing tax evasion on tips through a model of joint server-employer compliance, examining how factors like tipping rates, sales, tax rates, and IRS penalties influence behavior, and validating the model with empirical data on state-level differences in reported hourly wages); Peter Kipp et al., *Self-Reporting Cash Tip Income for Income Tax Purposes*, 15 J. FORENSIC & INVESTIGATIVE ACCT. (2023) (exploring the underreporting of tip income among college students in the service industry, examining the influence of social norms, peer behavior, and workplace culture on compliance, and suggesting that increased awareness and training may improve tax reporting habits).

19. One notable exception is Yoram Margalioth’s 2010 article, which examines the correlation between tipping and inequality, arguing that tipping is actually welfare-reducing. See Yoram Margalioth, *The Social Norm of Tipping, Its Correlation with Inequality, and Differences in Tax Treatment Across Countries*, 11 THEORETICAL INQUIRIES L. 561 (2010).

20. See, e.g., Nik Popli, *Ending Taxes on Tips Is Controversial Even Though Trump and Harris Both Want It*, TIME, Aug. 2024, <https://time.com/7010478/kamala-harris-donald-trump-taxes-tips/> (noting that both former Vice President Kamala Harris and President Donald Trump have endorsed eliminating federal income taxes on tips).

four key alternatives considered but not enacted—the Tip Tax Termination Act, the Tax Free Tips Act of 2024, the No Tax on Tips Act, and the Tipped Income Protection and Support (TIPS) Act—by modeling their effects on a hypothetical tipped worker, Judy, a single mother earning \$30,000 a year as a waitress in Texas.

The analysis considers the new legislation and proposals' implications for income targeting and poverty alleviation, the protection of social insurance programs, the integrity of means-tested benefits, behavioral incentives, and structural labor reform. The findings are clear. The Tax Free Tips Act and the 2024 version of the Tip Tax Termination Act pose the greatest distributional and administrative risks by excluding tips from income and payroll taxation, undermining Social Security, encouraging income manipulation, and inflating eligibility for need-based programs. The No Tax on Tips Act is more balanced, especially in its 2025 iteration, which adds safeguards such as a \$25,000 deduction cap and a Treasury-published list of traditionally tipped occupations. But the legislation still features an overly generous \$160,000 income cutoff that fails to effectively target relief to low-wage earners. OBBBA mirrors the 2025 No Tax on Tips Act in most respects but introduces a graduated income phase-out of up to \$400,000 and excludes filers using an Individual Taxpayer Identification Number (ITIN) and mixed-status families, raising additional concerns about redistributive impact and exclusion. In contrast, only the TIPS Act meaningfully addresses the underlying inequities of the tipped labor market by repealing the subminimum wage.

This Article ultimately supports a hybrid approach which preserves the TIPS Act's structural reform while refining its tax deduction provision using some of the targeting mechanisms found in the 2025 No Tax on Tips Act. In addition, it advocates for an income limit of \$75,000 on the deduction—the amount that economists Emmanuel Saez and Gabriel Zucman identify as both the average income of the American middle class and the national average.²¹ Properly tailored, such a hybrid could offer real relief to low-income workers while safeguarding public revenues, tax equity, and long-term retirement security.

This Article makes several key contributions to the literature by addressing the critical yet underexplored intersection of tip taxation and poverty. First, it contextualizes the tipping custom within its socio-economic and racial origins, situating tipping within a broader historical narrative that includes its entrenchment during the post-emancipation era. Second, it analyzes how tip taxation interacts with social safety net programs like Section 8 housing and the Supplemental Nutrition Assistance Program (SNAP), showing how eliminating the tax might reduce workers' financial support. This represents a significant addition to both tax and poverty law scholarship. By using the example of a hypothetical single mother, a low-income waitress named Judy, this study ensures its findings are accessible to anyone curious about whether eliminating the taxation of tips is an effective solution for addressing poverty among tipped workers. Third, it assesses OBBBA's enacted "No Tax on Tips" provision, along with recent legislative

21. EMMANUEL SAEZ & GABRIEL ZUCMAN, *THE TRIUMPH OF INJUSTICE* 2–4 (2019).

proposals, by modeling their effects on a hypothetical low-income worker and situating those results within the broader context of industry lobbying, projected revenue loss, and ongoing scholarly discourse about the role of tipping. This debate is more urgent than ever, as tipped workers remain one of the few groups legally excluded from receiving the full minimum wage, instead earning a tipped minimum wage that is significantly lower in many states.²²

This Article proceeds in three parts. Part I traces the racial and economic origins of tipping in the United States, showing how it evolved from a European custom into a wage-suppressing institution in the post-emancipation era. Part II uses a case study—Judy, a low-wage waitress—to illustrate how current tip taxation rules affect take-home pay and access to social benefits. Part III evaluates recent proposals to eliminate tip taxation, analyzing their design, fiscal impact, and equity implications. While these reforms promise relief, most fall short of addressing the deeper labor and policy inequities that keep tipped workers in precarity.

I. HISTORY OF TIPPING

Part I provides a historical and conceptual genealogy of tipping in the United States. Rather than offering a new archival discovery, this section serves as a historical literature review that draws together the work of Kerry Segrave, Saru Jayaraman, Nina Mast, and other scholars and labor historians who have traced the emergence and evolution of tipping. Following a Foucault-inspired genealogical method, this account does not treat tipping as a benign or natural feature of the service economy, but as a historically contingent practice shaped by racial hierarchy, wage suppression, and later, organized industry lobbying. By tracing how tipping moved from European aristocratic custom to a tool of post-emancipation labor control and, ultimately, to a politically reinforced subminimum wage regime, Part I illuminates how present-day debates over tipped income are rooted in structures of exploitation rather than just consumer generosity or cultural tradition.

A. *The Emergence of Tipping as a Practice*

Tipping, though of uncertain origin, evolved from early customs of rewarding exceptional service and gradually became entrenched in various societies. This subsection traces its development from Tudor-era “vails” to its adoption and transformation in the United States. The account that follows summarizes Kerry Segrave’s social history of tipping, which draws on contemporaneous newspaper commentary, etiquette manuals, and archival references to gratuity practices in Europe.²³

1. Early Origins of Tipping

The early history of tipping is difficult to trace, and its precise origins are uncertain.²⁴ Segrave explains that while small tokens of appreciation for service

22. *Minimum Wages for Tipped Employees*, U.S. DEP’T OF LAB. (July 31, 2025), <https://www.dol.gov/agencies/whd/state/minimum-wage/tipped> [<https://perma.cc/T9ZQ-KDAQ>].

23. KERRY SEGRAVE, *TIPPING: AN AMERICAN SOCIAL HISTORY OF GRATUITIES* (1998).

24. *Id.* at 1.

may have existed in various contexts, the clearest documented antecedent to modern tipping is the English custom of “vails.”²⁵

During the Tudor period in England (1485–1603), it became customary for visitors to private homes to give monetary gifts, known as vails, to the host’s servants at the end of their stay in recognition of services performed beyond their usual duties.²⁶ This practice solidified the idea of tipping as a reward for additional effort or service.²⁷ Over time, vails became an expected obligation for every guest who dined at the host’s table or stayed overnight, though the practice eventually grew burdensome for the givers. Segrave reports that even members of the British royalty lamented the steep costs associated with visiting friends.²⁸ A stingy guest risked finding his horse injured or overhearing a servant grumble that next time, he’d have gravy spilled on his trousers.²⁹

When a master attempted to suppress vails in his home, the consequences were immediate and explosive. Segrave recounts the chaos that erupted in 1764 at Ranelagh House in London, when household servants—enraged by attempts to eliminate their customary gratuities—launched a violent rebellion.³⁰ The servants “began by hissing their masters, then they broke all the lamps and outside windows with stones; and afterwards, putting out their flambeaus, pelted the company in a most audacious manner, with brick-bats, etc., whereby several were greatly hurt, so as to render the use of swords necessary.”³¹ This violent backlash underscores the entrenched economic dependence of service workers on gratuities and highlights how resistance to wage suppression was already a volatile issue in the 18th century. The Ranelagh House riot serves as a stark reminder that tipping, even in its earliest forms, was not merely an informal social custom but a battleground for power and economic survival.

Despite the widespread unpopularity of vails, the practice persisted, remaining a point of contention in British private homes well into the early 20th century.³² American visitors were accused of tipping too generously, thereby raising the amounts that servants came to expect.³³ It was not just in Britain; Americans abroad had gained a reputation for excessive tipping throughout Europe.³⁴

25. *Id.*

26. *Id.*

27. *Id.*

28. *Id.* at 2.

29. *Id.*

30. *Id.*

31. *Id.*

32. *Id.* (citing *EARL OF SEFTON BARS TIPS.; Takes Lead to End Gratuity Nuisance at House Parties.*, N.Y. TIMES (Aug. 25, 1907), <https://www.nytimes.com/1907/08/25/archives/earl-of-sefton-bars-tips-takes-lead-to-end-gratuity-nuisance-at.html> [<https://perma.cc/CSL2-BC4C>]).

33. *Id.* at 2–3 (citing *AMERICANS BLAMED FOR TIPPING EVIL; Servants at English Country Houses Spoiled by Too Liberal Gifts. HOST WARNS A VISITOR Asks Wealthy American Not to Disorganize Household Staff by Over-Tipping – Week-End Trips Costly.*, N.Y. TIMES (Apr. 26, 1908), <https://www.nytimes.com/1908/04/26/archives/americans-blamed-for-tipping-evil-servants-at-english-country.html> [<https://perma.cc/9SG2-YPGL>]).

34. *Id.* at 2; Joanne M. May, *Looking for Tips: An Empirical Perspective on Restaurant Tipping*, 20 CORNELL HOTEL & REST. ADMIN. Q. 6, 9 (1980).

Although the practice of tipping servants in private homes began to wane during and after World War I, this was far from the end of tipping. In America, its story was only just beginning.

2. Tipping: An American Debut

Segrave suggests that tipping was virtually nonexistent in the United States before 1840, or even prior to the Civil War.³⁵ It was, arguably, one of England's least popular exports to America. In a 1913 article, *Harper's Magazine* described tipping as “altogether wrong,” tracing its origins to “the largess flung to slaves” and the “trifling gratuity” given to servants at foreign inns.³⁶ The article lamented tipping's evolution, noting that “like graft, it is ‘wholly un-American’ in spirit, and, like graft, it is now characteristically American.”³⁷ According to *Harper's*, tipping was almost unknown before the Civil War but became widespread as Americans traveled abroad and brought the custom home. It concluded with a scathing comparison: “It is as distinctly of European origin as the gipsy-moth or the deadlier brown-tail, and as yet we have not discovered any parasite that will keep it in check.”³⁸

As such, tipping in the United States seems to have originated among the traveling aristocracy, gradually trickling down through the social hierarchy. For many, tipping became a way to showcase their familiarity with European customs and project an air of worldly sophistication.³⁹ The custom of tipping then gained traction and, by 1900, was reportedly commonplace in the private households of the affluent class.⁴⁰ Segrave explains that with the advent of industrial capitalism, wage labor became more common, reducing the prevalence and prominence of domestic servants.⁴¹ Simultaneously, the expansion of industrial society fueled the growth of restaurants, bars, hotels, and mass transportation, creating new roles for workers—such as maids, valets, and waitstaff—who increasingly became the recipients of gratuities.⁴²

Economics professor Ofer H. Azar notes that one explanation for the delayed emergence of tipping in the United States is the absence of a deeply entrenched servant class, as existed in Europe.⁴³ Although the United States may not have had a traditional “servile class,” it relied on the labor of an enslaved population, a

35. SEGRAVE, *supra* note 23, at 6 (citing Harper Staff, *Editor's Easy Chair*, 127 HARPER'S MONTHLY MAG., July 1913, at 310, 312).

36. Harper Staff, *Editor's Easy Chair*, 127 HARPER'S MONTHLY MAG., July 1913, at 310, 312.

37. *Id.*

38. *Id.*

39. Ofer H. Azar, *The History of Tipping—from Sixteenth-Century England to United States in the 1910s*, 33 J. SOCIO-ECON. 745, 754 (Dec. 2004).

40. SEGRAVE, *supra* note 23, at 3 (citing *FEEING IN PRIVATE HOUSES.*, N.Y. TIMES (Jan. 28, 1900), <https://timesmachine.nytimes.com/timesmachine/1900/01/28/101047325.html?pageNumber=8> [<https://perma.cc/8MRZ-DQS4>]; *THE WEEK-END TIP*, N.Y. TIMES (Sep. 1, 1907), <https://www.nytimes.com/1907/09/01/archives/the-weekend-tip.html> [<https://perma.cc/N4T9-8QVU>]).

41. *Id.* at 5.

42. *Id.*

43. Azar, *supra* note 39, at 754.

factor that shaped early tipping practices. Segrave quotes an 1896 issue of *Gunton's Magazine* which notes:

During the last few years, however, the tipping habit has been gradually on the increase among a certain class of laborers. The occupations in which this system is chiefly practiced are domestic servants, coachmen, barbers, waiters at hotels and restaurants, and porters on railway trains. It will be observed that these occupations are nearly all filled by foreigners and negroes who for the most part have been reared under the patronizing and semifeudal influences of paternal or ante-wage conditions. The colored people represent the remnants of menialism resulting from centuries of slavery.⁴⁴

This framing reveals the stigmatization of tipped workers, who were seen as occupying the lowest rungs of the labor hierarchy, and it underscores how tipping reinforced social stratification in a post-slavery, industrializing society.

While tipping in America first emerged among the upper class as a way to imitate European customs, it quickly evolved into a deeply racialized and class-based practice. As tipping expanded beyond elite households and into the service economy, it became a tool to justify low wages—especially for Black workers in the post-Reconstruction era. The next section explores how tipping came to reinforce racial and economic inequities, disproportionately impacting people of color and low-wage workers.

B. Tipping and Social Inequities

Tipping in America has historically reinforced social and racial inequities, emerging as a tool to exploit freed Black workers after emancipation. This subsection examines how tipping has perpetuated wage suppression, poverty, and exploitation for marginalized groups, particularly women and people of color.

1. Racial Roots of America's Tipping Culture

Because slavery confined Black Americans to roles of forced servitude and degradation, practices like tipping emerged within a social hierarchy that equated service work with racial inferiority.⁴⁵ Drawing on extensive newspaper commentary and labor reports from the decades following emancipation, Segrave shows that tipping became associated with social hierarchy and racial subordination. For instance, in 1891, journalist Arthur Gaye observed that tipping was typically reserved for those perceived as socially inferior.⁴⁶ Similarly, Segrave quotes

44. *Economic Effects of Tipping*, 11 GUNTON'S MAG., July 1896, at 13, 14–15.

45. SEGRAVE, *supra* note 23, at 6.

46. SEGRAVE, *supra* note 23, at 9 (quoting Arthur Gaye, *Baksheesh*, 64 MACMILLAN'S MAG., 1891, at 206, 210); *see also* *Tip*, JAMES A.H. MURRAY ET AL., A NEW ENGLISH DICTIONARY ON HISTORICAL PRINCIPLES: FOUNDED MAINLY ON THE MATERIALS COLLECTED BY THE PHILOLOGICAL SOCIETY VOL. 10,

journalist John Speed who wrote in 1902, “I had never known any but negro servants. Negroes take tips, of course; one expects that of them—it is a token of their inferiority.”⁴⁷ This sentiment was echoed in *The Itching Palm* (1916), where William Rufus Scott likened tipping to slavery, arguing that the dynamic between tipper and recipient undermined democratic ideals by reinforcing social hierarchies.⁴⁸

Although many decried tipping as un-American, it became a widespread practice in the decades following emancipation, often functioning as a mechanism for employers to justify paying Black workers lower wages by relying on customer gratuities to supplement income.⁴⁹ While customers may have tipped out of habit or social expectation, employers leveraged this practice to justify suppressing wages, particularly for Black workers who faced limited employment opportunities and systemic discrimination.⁵⁰ A 1903 account by journalist and civic activist James Samuel Stemons, who was working as a restaurant waiter at the time, highlights the racial dynamics of tipping in the early 20th century. Stemons wrote, “The white waiter [. . .] is an accident,” explaining that white men often became waiters temporarily due to personal or financial setbacks.⁵¹

In contrast, he argued, “the negro is a waiter from necessity, for it is usually the zenith of his industrial possibilities.”⁵² Stemons emphasized the racial barriers limiting Black workers’ opportunities, noting that clerical positions and other jobs in industries like factories or railways were typically unavailable to them. As a result, waiting jobs became more competitive for Black individuals, who were almost always paid less than their white counterparts.⁵³ This systemic inequality perpetuated the racial stratification of the tipping system in America.

And if your wages were already lower simply because you were Black, it increased your reliance on tip income. This reliance was particularly evident in occupations like railroad porters, where tipping made up the bulk of their earnings.⁵⁴ Segrave’s account of the Pullman sleeping-car porters illustrates how tipping became embedded in racialized wage relations. Pullman hired almost exclusively Black men as porters and paid them very low base wages, expecting tips to constitute the bulk of their earnings.⁵⁵ As Segrave strikingly puts it, “[a]ll of Pullman’s porters were black.”⁵⁶ He also records that company leadership openly stated a

PT 1, at 60 (1926) (PREDECESSOR TO THE OXFORD ENGLISH DICTIONARY) (“A SMALL PRESENT OF MONEY GIVEN TO AN INFERIOR”).

47. SEGRAVE, *supra* note 23, at 10 (quoting John Gilmer Speed, *Tips and Commissions*, 69 LIPPINCOTT’S MONTHLY MAG., June 1902, at 742, 748).

48. WILLIAM R. SCOTT, *THE ITCHING PALM: A STUDY OF THE HABIT OF TIPPING IN AMERICA* 50–51 (1916); Ayres et al., *supra* note 16, at 1621.

49. See SEGRAVE, *supra* note 23, at 9–24.

50. *Id.* at 11.

51. James Samuel Stemons, *Tipping—The Other Side*, 55 INDEP., Mar. 1903, at 725, 726.

52. *Id.*

53. *Id.*

54. SEGRAVE, *supra* note 23, at 16.

55. *Id.* at 17.

56. *Id.*

preference for Southern Black workers on the theory that they would be more likely to smile and perform cheerful deference to white passengers in ways their Northern counterparts would not.⁵⁷

Contemporary newspapers recognized this structure as exploitative. Segrave notes that the *St. Louis Republic* newspaper condemned Pullman's labor model for underpaying Black porters and then depending on the public to subsidize their wages through tips, arguing that the company had engineered the widespread adoption of tipping by exploiting racial hierarchy.⁵⁸ Furthermore, porters had to pay for their own uniforms, meals, and sleeping quarters while traveling and often faced dehumanizing treatment, including being subjected to racial slurs or addressed as "boy" or "George," a term implying they belonged to George Pullman.⁵⁹

This systemic exploitation, coupled with the pervasive racism of the time, eventually galvanized the porters to organize and demand better treatment, culminating in their formation of the Brotherhood of Sleeping Car Porters in 1925.⁶⁰ One of their first actions was to petition the Interstate Commerce Commission (ICC) to ban tipping, which they condemned as a "hold-over from slavery," according to a *New York Times* report.⁶¹ As Ian Ayres and his co-authors note, the porters' willingness to sacrifice significant tip income to eliminate the practice indicates that their struggle was as much about reclaiming dignity and freedom from enforced servility.⁶²

And while the Brotherhood succeeded in negotiating higher base wages separate from tips, workers in the hospitality industry—such as servers and bartenders—remained wholly dependent on gratuities for their livelihoods, often receiving minimal or no pay directly from their employers.⁶³ For more than a century, restaurant owners justified this system by claiming that tipped employees earned substantial sums through gratuities, absolving businesses of the responsibility to provide fair wages.⁶⁴ This narrative endured despite the stark reality that many tipped workers lived in deep poverty, even with tips factored in.⁶⁵

The Brotherhood's campaign against tipping was part of a larger national push to challenge the exploitative logic behind gratuities. While the porters succeeded in securing better base wages, other tipped professions—particularly in the restaurant and hospitality industries—remained trapped in a system that

57. *Id.*

58. *Id.* at 18 (quoting SCOTT, *supra* note 48, at 111–12).

59. LARRY TYE, *RISING FROM THE RAILS: PULLMAN PORTERS AND THE MAKING OF THE BLACK MIDDLE CLASS* 93–95 (1st ed. 2004).

60. Ayres et al., *supra* note 16, at 1622; Ellen Terrell, *This Month in Business History: Brotherhood of Sleeping Car Porters Union Formed*, LIBR. OF CONG. (LOC), <https://guides.loc.gov/this-month-in-business-history/august/brotherhood-of-sleeping-car-porters> [<https://perma.cc/M4Y5-VAVE>].

61. Ayres et al., *supra* note 16, at 1622; *PORTERS ASSAIL TIPPING; Pullman Brotherhood Calls Practice a "Hold-Over From Slavery," Preventing Higher Wages*, N.Y. TIMES (Nov. 27, 1927), <https://www.nytimes.com/1927/11/27/archives/porters-assail-tipping-pullman-brotherhood-calls-practice-a.html> [<https://perma.cc/6BNU-SHHX>].

62. Ayres et al., *supra* note 16, at 1622–23.

63. SARU JAYARAMAN, *FORKED: A NEW STANDARD FOR AMERICAN DINING* 34 (2016).

64. *Id.*

65. SEGRAVE, *supra* note 23, at 11–12.

justified low pay through tipping. By the early 20th century, labor activists and reformers began pushing for legislative action, arguing that tipping allowed businesses to shift the cost of wages onto customers while keeping workers in poverty.

2. Wages, Welfare, and the Law: A Struggle for Equity

In the early 1900s, labor and consumer advocates mounted a campaign to abolish tipping, arguing that it allowed employers to avoid paying wages and shifted the burden of compensation onto customers.⁶⁶ Several states passed anti-tipping laws, some of which explicitly recognized the system's racist effects.⁶⁷ These laws, however, were short-lived; Segrave attributes their repeal in part to pressure from employers who relied on tipping to keep labor costs low.⁶⁸ Expanding on this dynamic, Nina Mast of the Economic Policy Institute notes that, during this same period, employers seeking to preserve low wages and limit worker organizing formed the National Restaurant Association (NRA).⁶⁹ The restaurant industry stood to gain immensely from a wage system that required it to contribute minimally to employees' paychecks, shifting the financial burden onto the public—a continuation of the Pullman logic outlined above.

And the industry did in fact score a decisive win with the passage of the first minimum wage law in 1938. By the 1930s, with the Great Depression exposing the dire economic conditions of low-wage workers, reformers pushed for a broader federal response.⁷⁰ However, rather than eliminating tipping, industry lobbying efforts scored a decisive victory in the passage of the Fair Labor Standards Act (FLSA) of 1938. The FLSA explicitly allowed employers to count tips toward fulfilling minimum wage obligations, effectively ensuring that tipped workers would not be guaranteed a base wage from their employers—a loophole that would entrench a separate and unequal wage system for tipped employees. Amid a backdrop of judicial resistance, the “depression born” FLSA, regarded as the New Deal's final gasp, introduced a national minimum wage of 25 cents per hour, a 44-hour maximum workweek, and restrictions on child labor for those under 16.⁷¹ After enduring over a year of contentious debate in Congress, the Act

66. *Id.* at 36–38.

67. William J. Barber II, *The Racist History of Tipping*, POLITICO MAG. (July 17, 2019), <https://politi.co/2JCQNMD> [<https://perma.cc/3RXV-RDW3>].

68. SEGRAVE, *supra* note 23, at 38.

69. MAST, *supra* note 5, at 2.

70. See generally Michael E. Parrish, *The Great Depression, The New Deal, and the American Legal Order New Deal Symposium*, 59 WASH. L. REV. 723 (1983) (discussing how the Great Depression revealed the economic struggles of low-wage workers and how the New Deal marked a turning point in federal intervention).

71. Harry S. Kantor, *Two Decades of the Fair Labor Standards Act*, 81 MONTHLY LAB. REV. 1097, 1097–99 (1958). See generally GEORGE E. PAULSEN, A LIVING WAGE FOR THE FORGOTTEN MAN: THE QUEST FOR FAIR LABOR STANDARDS 1933–1941 (June 1996) (tracing the New Deal-era struggle to establish federal wage, hour, and child-labor standards against entrenched constitutional and political opposition).

emerged in a compromised form, ultimately covering industries that collectively employed only about one-fifth of the nation's workforce.⁷²

The FLSA originally left out hotel, restaurant, and other service workers from its protections.⁷³ Mast explains that this was a deliberate strategy by FLSA proponents to secure Southern Democratic support by excluding industries predominantly employing Black Americans.⁷⁴ Southern leaders feared that New Deal labor reforms, such as wage standards and worker protections, would disrupt the racial hierarchy central to their region's economic structure.⁷⁵ As a result, the FLSA specified that the minimum wage could be fulfilled through either wages or tips, meaning tipped workers were not guaranteed a base wage from their employers.⁷⁶

In the decades that followed, rather than eliminating tipping, policymakers formalized and institutionalized it through the tip credit system, further entrenching the economic precarity of tipped labor.

3. The Tip Credit and Modern Wage Suppression

In its 1942 *Williams v. Jacksonville Terminal Co.* decision, the Supreme Court held that wages under the FLSA “are not to be interpreted as limited to money passing from the terminal company to the redcap” and could therefore include tips.⁷⁷ However, it also ruled that employees had an exclusive right to their tips, meaning employers could not require tipped employees to share tips with non-tipped staff.⁷⁸ It wasn't until 1966 that advocates were able to secure a base wage for tipped workers, and even then, it was only 50% of the minimum wage guaranteed to other workers.⁷⁹ This marked the creation of the “subminimum wage” for tipped workers, also referred to as the “tipped minimum wage.”⁸⁰

The 1966 amendments to the FLSA introduced the concept of a “tip credit,”⁸¹ allowing employers to count employees' tips toward up to 50% of the minimum wage they were required to pay.⁸² In other words, employers were required to pay tipped workers a base cash wage and ensure that tips made up the difference to meet

72. Jonathan Grossman, *Fair Labor Standards Act of 1938: Maximum Struggle for a Minimum Wage*, 101 MONTHLY LAB. REV. 22, 22 (1978).

73. MAST, *supra* note 5.

74. *Id.* (citing *From Excluded to Essential: Tracing the Racist Exclusion of Farmworkers, Domestic Workers, and Tipped Workers from the Fair Labor Standards Act Before the Subcomm. on Workforce Prots. of the H. Comm. on Educ. & Lab.*, 117th Cong. (2021) (testimony of Rebecca Dixon, Executive Director, National Employment Law Project)).

75. *Id.* See also STEVEN C. PITTS & SYLVIA ALLEGRETTO, TO WORK WITH DIGNITY: THE UNFINISHED MARCH TOWARD A DECENT MINIMUM WAGE 5 (Aug. 2013).

76. JAYARAMAN, *supra* note 63, at 35.

77. *Williams v. Jacksonville Terminal Co.*, 315 U.S. 386, 407 (1942).

78. *Id.* at 397.

79. Peyton Elder, *The 1977 Amendments to the Federal Minimum Wage Law*, 101 MONTHLY LAB. REV. 9, 10 (1978).

80. PITTS & ALLEGRETTO, *supra* note 75, at 12–13.

81. The “tip credit” refers to the portion of an employee's tips that an employer can apply toward meeting its obligation to pay the full minimum wage.

82. WILLIAM G. WHITTAKER, CONG. RSCH. SERV., THE TIP CREDIT PROVISIONS OF THE FAIR LABOR STANDARDS ACT 3 (Mar. 2006).

the federal minimum wage. If the tips were insufficient to cover the 50% credit, the employer was required to cover the difference. The 1966 amendments defined a tipped employee as anyone who typically earned more than \$20 per month in tips.⁸³ Subsequent amendments to the FLSA adjusted the tipped minimum wage to varying percentages of the regular minimum wage, peaking at 60% in 1980.⁸⁴

In 1996, the FLSA was amended to raise, in steps, the federal minimum wage from \$4.25 to \$5.15.⁸⁵ However, as part of the bipartisan deal that enabled this increase, Congress decoupled the tipped minimum wage from the regular minimum wage.⁸⁶ Under the leadership of Herman Cain, then head of the National Restaurant Association, the restaurant industry agreed to accept a modest increase in the federal minimum wage in exchange for permanently freezing the tipped minimum wage at \$2.13 per hour—the level set in 1991.⁸⁷ This marked a significant departure from the prior practice of tying the tipped minimum wage to a percentage of the regular minimum wage, a practice established with the introduction of the tip credit in 1966.⁸⁸

By locking the tipped minimum wage at a fixed dollar amount, the 1996 amendments ensured that it would no longer rise in tandem with increases to the federal minimum wage. As a result, the gap between the tipped minimum wage and the regular minimum wage has steadily widened.⁸⁹ Under the current federal minimum wage of \$7.25 per hour, employers are required to pay tipped workers a minimum cash wage of \$2.13 per hour (just 29% of the federal minimum) and can claim up to \$5.12 per hour (71%) as a tip tax credit.⁹⁰ If this fixed-dollar approach continues, the tipped minimum wage will shrink as a percentage of the regular minimum wage with each future increase. Accordingly, the 1996 amendments paved the way for a steadily increasing tip credit that primarily benefits the restaurant industry.

Although many states have set minimum wages higher than the federal rate of \$7.25 per hour, several still maintain notably low tipped minimum wages.⁹¹ As Mast points out, the majority of Southern states continue to apply the maximum

83. *Id.*

84. *Id.* at 4–5.

85. MAST, *supra* note 5.

86. *Id.*

87. SYLVIA A ALLEGRETTO & DAVID COOPER, ECON. POL'Y INST., TWENTY-THREE YEARS AND STILL WAITING FOR CHANGE: WHY IT'S TIME TO GIVE TIPPED WORKERS THE REGULAR MINIMUM WAGE 2–4 (Jul. 2014); JAYARAMAN, *supra* note 63, at 35–36. *See also* Mike Elk, *Herman Cain, the Other NRA and the Stagnant Minimum Wage*, IN THESE TIMES (Sept. 26, 2011), <https://inthesetimes.com/article/herman-cain-the-other-nra-and-the-stagnant-minimum-wage> [<https://perma.cc/4X7E-4U2U>] (“In his leadership role Cain transformed the National Restaurant Association from a sleepy little trade association to earning a spot in Forbes Magazine 1997 Survey of Washington’s 25 most powerful pressure groups coming at number 24.”); Tom Philpott, *Herman Cain’s Enduring Lobbying Triumph*, MOTHER JONES (July 30, 2020), <https://www.motherjones.com/politics/2020/07/herman-cains-enduring-lobbying-triumph/> [<https://perma.cc/G9VG-VUA7>].

88. ALLEGRETTO & COOPER, *supra* note 87, at 3–4.

89. DAVID H. BRADLEY, CONG. RSCH. SERV., THE TIP CREDIT PROVISIONS OF THE FAIR LABOR STANDARDS ACT (FLSA): IN BRIEF 2–3 (Mar. 2015).

90. *Id.*

91. MAST, *supra* note 5, at 3.

allowable tip credit.⁹² This means employers are only required to pay around a third of the workers' wage obligations (\$2.13 per hour), with the expectation that employees will make up the remainder through tips.⁹³ Mast also highlights that the South has the largest tipped workforce in the U.S., with over one million workers, 17.3% of whom are Black—the highest proportion of any region.⁹⁴ Given that the region is home to the largest Black population and most Southern states maintain a subminimum wage, this system disproportionately impacts Black workers in the South.⁹⁵ This can be seen as a bleak mirroring of the Pullman tactics that led to the exploitation of Southern Black workers over a century ago.

Mast also emphasizes that tipped workers face significant economic instability, as their wages depend heavily on unpredictable customer generosity, leading to dramatic fluctuations in income from day to day and week to week.⁹⁶ While employers are legally required to ensure that tipped workers' tips cover the gap between the tipped minimum wage and the regular minimum wage for total hours worked each week, this requirement is rarely enforced.⁹⁷ This economic precarity is reflected in poverty rates. Mast reports that tipped workers across the country experience poverty at 2.3 times the rate of non-tipped workers (11.3% vs. 4.9%).⁹⁸ In states with the federal tipped minimum wage of \$2.13 per hour, tipped worker poverty rates soar to 14.8%, compared to 11% in states where the tipped minimum wage has been eliminated.⁹⁹ Low wages and erratic income are compounded by a lack of benefits. Tipped workers are less likely to have access to health care, paid sick leave, or disability insurance, and often rely on public assistance at higher rates than the overall workforce.¹⁰⁰

The economic precarity caused by the subminimum wage system not only keeps many tipped workers in poverty but also creates a workplace dynamic where employees are forced to tolerate exploitative conditions to secure their income. Since tipped workers depend on customer generosity rather than a stable paycheck, they often feel pressured to endure inappropriate behavior, including

92. *Id.* See also *Minimum Wage Tracker*, ECON. POL'Y INST., [https://www.epi.org/minimum-wage-tracker/\[https://perma.cc/HSG2-63T6\]](https://www.epi.org/minimum-wage-tracker/[https://perma.cc/HSG2-63T6]) (last visited Dec. 16, 2024).

93. Mast, *supra* note 5, at 3.

94. *Id.* at 6.

95. *Id.* at 6, 9.

96. *Id.* at 3.

97. *Id.* During a compliance sweep conducted by the U.S. Department of Labor's Wage and Hour Division (WHD) between 2010 and 2012, nearly 83.8% of the approximately 9,000 full-service restaurants investigated were found to have committed some form of violation. These violations included 1,170 instances of tip credit infractions, leading to nearly \$5.5 million in back wages owed to workers. ALLEGRETTO & COOPER, *supra* note 87, at 18.

98. Mast, *supra* note 5, at 3 (relying on the Economic Policy Institute's analysis of U.S. Census Data for Social, Economic and Health Research).

99. *Id.* (citing JUSTIN SCHWEITZER, ENDING THE TIPPED MINIMUM WAGE WILL REDUCE POVERTY AND INEQUALITY 5 (2021) [<https://perma.cc/6UBD-4ZDA>]).

100. *Id.* ALLEGRETTO & COOPER, *supra* note 87, at 15–17; JAYARAMAN, *supra* note 63, at 36–37 (“[R]esearch shows that half of all full-service restaurant workers use public assistance, for a total of \$9.5 billion annually, and that the average Olive Garden, for example, costs the taxpayer nearly \$200,000 annually in public assistance for workers.”).

sexual harassment, to secure higher tips and avoid retaliation. Unsurprisingly, the restaurant industry has the highest rate of sexual harassment claims of any industry in the U.S., with as many as 90% of women reporting some form of sexual harassment.¹⁰¹

This structural vulnerability disproportionately affects women and workers of color, who make up a majority of the tipped workforce. Indeed, Mast highlights that the tipped workforce is nearly two-thirds women and disproportionately composed of women of color.¹⁰² It also includes an overrepresentation of Hispanic, Asian-American and Pacific Islander (AAPI), and foreign-born workers.¹⁰³ She further points out that tipped workers are more likely to be single parents, especially women, further underscoring the economic challenges they face in a system that leaves them reliant on tips to make ends meet.¹⁰⁴ Women, particularly minority women, are often placed in lower-paying positions, such as quick-serve and family-style restaurants, while men dominate management and higher-paying roles like fine dining.¹⁰⁵

The typical frontline restaurant worker is a young woman working under a male manager, highlighting the power imbalances inherent to the industry. However, the harassment extends beyond management and is frequently driven by customers as well. Tipped workers who rely on a subminimum wage experience sexual harassment at far higher rates than their non-tipped counterparts (76% vs. 52%), as their dependence on customer tips forces them to tolerate abusive behavior to earn a living.¹⁰⁶ This dynamic worsened during the pandemic, with women servers subjected to ‘maskual harassment,’ where male customers demanded they remove their masks to judge their appearance before deciding on their tips.¹⁰⁷ For single mothers and other economically vulnerable women, this system reinforces their precarious position, leaving them trapped in a cycle of low wages and exploitation.

II. THE PRE-OBBBA ARCHITECTURE OF TIP TAXATION

Part II of this article examines the pre-OBBBA system of tip taxation, tracing the legal and regulatory developments that governed the treatment of tips before

101. Stefanie K. Johnson & Juan M. Madera, *Sexual Harassment Is Pervasive in the Restaurant Industry. Here's What Needs to Change*, HARV. BUS. REV. (Jan. 18, 2018), <https://hbr.org/2018/01/sexual-harassment-is-pervasive-in-the-restaurant-industry-heres-what-needs-to-change>.

102. MAST, *supra* note 5, at 5.

103. *Id.*

104. *Id.*

105. JAYARAMAN, *supra* note 63, at 33.

106. MAST, *supra* note 5, at 5 (citing CATHARINE A. MACKINNON & LOUISE F. FITZGERALD, *THE TIPPING POINT: HOW THE SUBMINIMUM WAGE KEEPS INCOMES LOW AND HARASSMENT HIGH 2–3* (Mar. 2021)).

107. *See, e.g.,* Debbie Elliott, *Tipped Service Workers Are More Vulnerable Amid Pandemic Harassment Spike: Study*, NPR (Dec. 6, 2020), <https://www.npr.org/sections/coronavirus-live-updates/2020/12/06/943559848/tipped-service-workers-are-more-vulnerable-amid-pandemic-harassment-spike-study> [<https://perma.cc/34AG-UXCT>].

the Act's reforms. It reconstructs the framework that governed income reporting, withholding, and compliance for tipped workers, highlighting the administrative and distributional consequences of that regime. To illustrate its real-world effects, this Part follows a hypothetical low-income waitress, *Judy*, whose experience demonstrates how the pre-OBBBA tax rules shaped take-home pay, eligibility for social programs such as Section 8 housing vouchers and SNAP, and the broader economic precarity of workers in tipped occupations.

A. Legal and Regulatory Development of Tip Taxation

Although the idea of exempting tips from federal taxation may appear new and politically opportunistic—emerging from a chance encounter between Donald Trump and a waitress in Las Vegas—it must be examined within the context of a century of legal and regulatory developments regarding tip taxation. In his piece *Why Nix a Tip Tax Now*, Lawrence A. Zelenak explores in great detail the history behind the taxation of tips.¹⁰⁸ This subsection summarizes Zelenak's historical analysis to set the stage for the tax equity analysis in the next subsection.

1. Foundations of Tip Taxation

“We heard about this when you heard about it,” remarked Sean Kennedy, executive vice president for public affairs at the National Restaurant Association.¹⁰⁹ Echoing this sentiment, Stephen Moore, a Trump economic adviser, stated, “It’s not like a gang of economists sitting around a table came up with that.”¹¹⁰ In fact, some economists who advised the Trump campaign revealed that they only learned of the idea when President-elect Trump announced it publicly.¹¹¹ At a campaign rally in Virginia in June 2024, Trump himself admitted, “I was actually surprised to hear it,” before unveiling his newest campaign pledge: “No taxes on tips!”¹¹² The idea reportedly originated in Las Vegas, home to the Culinary Workers’ Union.¹¹³ It emerged during dinner at his hotel, when a waitress serving his table expressed frustration about having to pay taxes on her tips.¹¹⁴ This improvised proposal, however, should be considered against the backdrop of the protracted legal and regulatory development of the taxation of tips.

108. Lawrence A. Zelenak, *Why Nix a Tip Tax Now?*, 185 TAX NOTES 237 (Oct. 2024).

109. Duehren, *supra* note 8.

110. *Id.*

111. *Id.*

112. *Id.*

113. Hannah Grabenstein, *Killing Taxes on Tips Sounds Good, but Experts Say It Doesn't Solve the Real Problem*, PBS NEWS (Sept. 4, 2024, 5:13 PM), <https://www.pbs.org/newshour/economy/trump-and-harris-say-theyll-kill-taxes-on-tips-how-would-that-work> [<https://perma.cc/GQ3U-XQJJ>]; Jonathan J. Cooper & Adriana Gomez Licon, *Watch: Trump Holds Rally in Las Vegas after Week of Record High Temperatures in Region*, PBS NEWS (June 10, 2024, 12:52 PM), <https://www.pbs.org/newshour/politics/watch-trump-holds-rally-in-las-vegas-after-week-of-record-high-temperatures-in-region> [<https://perma.cc/2SZZ-RG3Y>].

114. Duehren, *supra* note 8.

Although proposals to exempt tips from federal taxation have recently gained prominence, the taxation of tips has deep historical roots dating back to the early 20th century. The Revenue Act of 1913 marked the introduction of the first federal income tax of the 20th century.¹¹⁵ Explicit recognition of tips as taxable income emerged clearly in 1919, when the Treasury Department enumerated tips among taxable compensation in Article 32 of its regulations. This enumeration persists today in Reg. § 1.61-2(a)(1).¹¹⁶

2. Constructing the Modern Tip Tax Framework

Courts initially treated tips as taxable income without detailed reasoning, focusing largely on disputes about the IRS's calculation methods.¹¹⁷ The first substantial legal clarification came in *Roberts v. Commissioner* (1949), where the Ninth Circuit rejected a taxi driver's claim that tips were nontaxable gifts, emphasizing that tips involve consideration for services.¹¹⁸ The Supreme Court confirmed this interpretation in *Commissioner v. Duberstein* (1960), stating that a true gift stems from detached generosity, and specifically noting in a footnote that tips are not gifts.¹¹⁹ Despite this legal clarity, compliance remained low.¹²⁰

By 1981, the IRS estimated that 84% of tip income went unreported.¹²¹ Legislative action began with the 1965 enactment of Internal Revenue Code (IRC) § 6053(a), requiring tipped workers to report their earnings to employers, who would then withhold Federal Insurance Contributions Act (FICA) taxes, though employers were initially exempt from matching contributions.¹²² In 1977, employer FICA obligations were expanded to cover tips up to the minimum wage.¹²³ The key shift came with the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982, which added § 6053(c), mandating that large food and beverage establishments allocate 8% of gross receipts as tips unless employees reported more.¹²⁴ This significantly improved compliance—raising reported tip

115. Revenue Act of 1913, ch. 16, 38 Stat. 114 (1913) (superseded by Revenue Act of 1916); Zelenak, *supra* note 108, at 238.

116. Regulations 45, Relating to the Income Tax and War Profits and Excess Profits Tax Under the Revenue Act of 1918, art. 32 (Apr. 17, 1919); Zelenak, *supra* note 108, at 238–39.

117. Zelenak, *supra* note 108, at 239–40.

118. *Roberts v. Comm'r*, 176 F.2d 221 (9th Cir. 1949); Zelenak, *supra* note 108, at 240.

119. *Comm'r v. Duberstein*, 363 U.S. 278 (1960); Zelenak, *supra* note 108, at 242. See generally Gregory Tapis et al., *Is It a Tip or a Gift? Investigating Duberstein in the Modern Gratuity Era*, 19 ATA J. LEGAL TAX RSCH. 47 (2021) (analyzing the tax distinction between tips and gifts under *Commissioner v. Duberstein* and applying the Court's intent-based framework to modern tipping practices, including extraordinary gratuities).

120. Zelenak, *supra* note 108, at 242–43 (pointing to a 16% compliance rate in 1981).

121. *Id.* See also U.S. GEN. ACCT. OFF., NO. GAO/GGD-86-119, TAX ADMINISTRATION: TIP INCOME REPORTING CAN BE INCREASED 14 (Sept. 1986) [<https://perma.cc/RJ5Y-KJND>].

122. Zelenak, *supra* note 108, at 242; Social Security Amendments of 1965, Pub. L. No. 89-97, § 313, 79 Stat. 286, 382-85 (July 30, 1965) [<https://perma.cc/5Z36-M5MJ>].

123. Social Security Amendments of 1977, S. Rep. No. 95-572, at 5 (1977); Robertson et al., *supra* note 18, at 31.

124. Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 314, 96 Stat. 324, 605 (1982); Zelenak, *supra* note 108, at 243–44.

income from 16% in 1981 to 48% by 2006—but also drew backlash from workers in lower-income areas.¹²⁵

Meanwhile, Congress amended § 3121(q) in 1987 to require full FICA taxation on all tip income.¹²⁶ In response to industry pushback, lawmakers created IRC § 45B, offering a tax credit to employers for their share of FICA taxes on tips above the minimum wage.¹²⁷ Still in place today, this credit—expected to cost \$2.42 billion by 2033—remains a central incentive for industry compliance.¹²⁸ Its popularity even inspired other industries to seek similar benefits, with two bills introduced in 2023 to extend the credit to beauty service establishments.¹²⁹

Taken together, the legal and regulatory developments outlined in Part II.A establish the basic architecture of modern tip taxation: tips are treated as taxable income, must be reported to employers, and are subject to income and payroll tax withholding. Under IRC Section 6053(c), employers are required to allocate at least 8% of gross receipts as tips unless employees report a higher amount, creating a floor for compliance. Employers must also match the employee's share of Social Security and Medicare taxes on reported tips, but in return, they receive a dollar-for-dollar FICA tip credit under Section 45B—a provision widely embraced by the industry.¹³⁰ With this legal framework in place, Part II.B turns to how these rules play out for low-income tipped workers, particularly in relation to safety net eligibility.

B. *The Pre-OBBBA Landscape of Tip Taxation: A Waitress's Story*

To illustrate how the federal tax system operated before the enactment of the OBBBA, consider Judy, a 31-year-old single mother raising her young son, Anwar, who was born in 2020, on her own. Judy works as a waitress at ‘Tip Jar

125. Zelenak, *supra* note 108, at 244; TREAS. INSPECTOR GEN. TAX ADMIN., NO. 2018-30-081, BILLIONS IN TIP-RELATED TAX NONCOMPLIANCE ARE NOT FULLY ADDRESSED AND TIP AGREEMENTS ARE GENERALLY NOT ENFORCED 4 (Sept. 28, 2018) [<https://perma.cc/UPL9-2JRX>]; U.S. GEN. ACCT. OFF., NO. GAO/GGD-86-119, TAX ADMINISTRATION: TIP INCOME REPORTING CAN BE INCREASED 14 (Sept. 1986) [<https://perma.cc/CLB4-A6TK>]; Newman, *supra* note 1, at 863–64.

126. Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 9006, 101 Stat. 1330, 1330-288, -289 (1987).

127. Robertson et al., *supra* note 18, at 31; I.R.C. § 45B. It should be noted that the benefit of the credit is diluted by certain factors. For instance, employers must owe taxes to benefit from it. Additionally, the credit cannot be used to offset employment taxes. It can only be used against income tax. Moreover, it increases taxable income, as no deduction is allowed for the amount used to calculate the credit.

128. *Beware How You Report Tips Post-COVID-19, Tax Experts Say*, NAT'L REST. ASS'N, (Aug. 17, 2022) <https://restaurant.org/education-and-resources/resource-library/beware-how-you-report-tips-post-covid-19-tax-experts-say/> [<https://perma.cc/8BMV-75W2>]; Martin A. Sullivan, *What Happens After You Leave a Tip on the Table?*, 184 TAX NOTES 1211, 1214 (2024); U.S. DEP'T OF THE TREAS., TAX EXPENDITURES FISCAL YEAR 2025 25 (2024) [<https://perma.cc/9V8J-RUAT>].

129. H.R. 45, 118th Cong. (2023); S. 45, 118th Cong. (2023); Sullivan, *supra* note 128, at 1214.

130. Under federal law, employers are required to match the Social Security and Medicare (FICA) taxes their employees owe on tip income. However, to offset this cost, restaurants and other food and beverage establishments receive a special tax break under IRC § 45B. This provision gives employers a dollar-for-dollar credit against their income tax for the amount of FICA taxes they pay on tips that exceed the federal minimum wage.

Tavern,⁷ a bustling mid-range restaurant located in Amarillo, Texas, where the federal tipped minimum wage is \$2.13 per hour.¹³¹

The selection of Judy as the illustrative case for this Article is grounded in demographic realities supported by existing literature. Research consistently shows that tipped workers are predominantly women, especially women of color, who are disproportionately employed in lower-paying casual restaurants.¹³² Tipped workers, especially women, are also more likely to be single parents, mirroring Judy's circumstances.¹³³ Moreover, the Southern U.S., including Texas, has the highest concentration of tipped workers of any region in the country.¹³⁴ Judy's age, 31, is also representative, as it matches the median age of the tipped workforce.¹³⁵ Thus, Judy's scenario effectively captures the experiences of a particularly vulnerable group, offering a representative and meaningful lens for analyzing the impact of tip tax reforms on poverty.

Judy works five shifts a week, earning a base wage of \$2.13 per hour and receiving a little over \$100 in tips per shift (after accounting for tip pool sharing arrangements and reductions for credit card service fees). Judy's gross annual income totals \$30,000, which consists of:

- **Base Wages:** \$2.13/hour × 40 hours/week × 50 weeks (assuming 2 weeks off) = \$4,260/year
- **Tip Income:** \$102.96/shift × 5 shifts/week × 50 weeks (assuming 2 weeks off) = \$25,740/year

This amounts to an annual gross income of \$30,000, which is slightly below the median income of \$32,000 annually for wait staff in the United States, according to the Bureau of Labor Statistics.¹³⁶ The \$30,000 figure is used to simplify the calculations while remaining close enough to the median to represent a substantial share of tipped workers who live in or near economic precarity.

1. Judy's Tax Bill

Judy will owe both payroll taxes and federal income taxes on her gross income from the 'Tip Jar Tavern,' which is composed of her base wages and tip

131. *Minimum Wages for Tipped Employees*, *supra* note 22.

132. See, e.g., MAST, *supra* note 5, at 5; NOURA HASSOUNA ET AL., INST. FOR WOMEN'S POL'Y RSCH., NO. IWPR #521, *WANT TO HELP WOMEN? GET RID OF THE TIPPED MINIMUM WAGE*. 4–5 (2024) [<https://perma.cc/3JL9-LASU>]; ONE FAIR WAGE (OFW), *ONE FAIR WAGE: MYTHS & FACTS* 4 (2023) [<https://perma.cc/S6KM-CUBM>]; ALLEGRETTO & COOPER, *supra* note 87, at 9.

133. MAST, *supra* note 5, at 5; ONE FAIR WAGE (OFW), *supra* note 132, at 4; ALLEGRETTO & COOPER, *supra* note 87, at 9.

134. MAST, *supra* note 5, at 7.

135. Ernie Tedeschi, *The "No Tax on Tips Act": Background on Tipped Workers*, THE BUDGET LAB (June 24, 2024), <https://budgetlab.yale.edu/news/240624/no-tax-tips-act-background-tipped-workers> [<https://perma.cc/DP72-ZZBN>].

136. *Occupational Employment and Wages, May 2023*, U.S. BUREAU OF LAB. STAT., <https://www.bls.gov/oes/current/oes353031.htm> [<https://perma.cc/7TSQ-BDFH>] (last visited Jan. 17, 2025).

income. However, as a resident of Texas—a state that does not tax individual income—Judy will not owe any state income taxes.

a. Payroll Taxes

Judy's tips are subject to payroll taxes, just like her base wages. Both she and her employer must pay 7.65% (6.2% for Social Security and 1.45% for Medicare) on her total income given that employers are required to match these payroll taxes.¹³⁷ Accordingly, Judy's payroll tax liability is: $30,000 \times 7.65\% = \$2,295$. Her employer matches this amount, also contributing \$2,295 toward Social Security and Medicare.

It should be noted that Judy's payroll tax contributions do not directly fund her own future Social Security and Medicare benefits. Instead, under the pay-as-you-go structure of the Social Security system, taxes paid today are used to support benefits for current retirees.¹³⁸ However, Judy's reported earnings still play an important role in determining her own future benefits, as her lifetime earnings record forms the basis for calculating them.¹³⁹ Underreporting tip income may reduce her tax liability in the short term, but it also lowers her recorded earnings, potentially diminishing the retirement and healthcare benefits she would otherwise receive. Reporting more income now could thus lead to greater financial security later in life.

b. Income Taxes

Judy's gross income is \$30,000, which includes her base wages and tip income. We will assume that Judy doesn't qualify for any above-the-line deductions and is not making 401(k) contributions to save as much money as she can for daily expenses, so her Adjusted Gross Income (AGI) remains \$30,000.¹⁴⁰

As a single mother, Judy qualifies as a head of household for tax purposes, which entitles her to a standard deduction of \$21,900 for the tax year 2024.¹⁴¹ After applying the standard deduction, her taxable income is \$8,100.¹⁴² Thus, Judy's

137. See generally I.R.S., 2024 PUBLICATION 15 2 (Dec. 19, 2023), <https://www.irs.gov/pub/irs-prior/p15-2024.pdf> [<https://perma.cc/NT8T-HUBQ>].

138. CTR. ON BUDGET & POL'Y PRIORITIES, POLICY BASICS: UNDERSTANDING THE SOCIAL SECURITY TRUST FUNDS 1 (Jul. 2024) [<https://perma.cc/EML4-P87F>].

139. *Social Security Benefit Amounts*, SOC. SEC. ADMIN., <https://www.ssa.gov/oact/cola/Benefits.html> [<https://perma.cc/NUR4-5CYS>] (last visited Apr. 22, 2025).

140. Restaurant employees, whether part-time or full-time, may qualify to enroll in a 401(k) plan if they meet the IRS's minimum eligibility requirements. To be eligible, the employee must be at least 21 years old and have completed at least one year of service, although some plans may require up to two years of service. See *401(k) Plan Qualification Requirements*, IRS, <https://www.irs.gov/retirement-plans/plan-sponsor/401k-plan-qualification-requirements> [<https://perma.cc/KJ5X-S55N>] (last visited Jan. 19, 2025).

141. *5 Tax Tips for Single Moms*, TURBOTAX, <https://turbotax.intuit.com/tax-tips/family/5-tax-tips-for-single-moms/L8llzJ4EW> [<https://perma.cc/G3RH-VSGL>] (last visited Jan. 19, 2025); *Filing Status*, IRS, <https://www.irs.gov/faqs/filing-requirements-status-dependents/filing-status> [<https://perma.cc/5VSW-9A7S>] (last visited Jan. 19, 2025); *Publication 505 (2024), Tax Withholding and Estimated Tax*, IRS, <https://www.irs.gov/publications/p505> [<https://perma.cc/GXN5-G4QT>] (last visited Jan. 19, 2025).

142. $30,000 - 21,900 = 8,100$.

preliminary federal income tax liability is \$810.¹⁴³ However, Judy's preliminary federal income tax liability is significantly reduced—and ultimately eliminated—by the refundable tax credits for which she qualifies as a single mother with one child.

c. Refundable Tax Credits

Despite her tax liabilities, Judy benefits from refundable credits like the Earned Income Tax Credit (EITC)¹⁴⁴ and the Child Tax Credit (CTC).¹⁴⁵ For a single mother of one earning \$30,000 annually, the EITC and CTC together can offset her income tax liability entirely and potentially provide additional financial support.

In Judy's simplified case, the IRS estimates that she is eligible for an EITC of \$3,046.¹⁴⁶ It should be noted that at her income level (\$30,000 AGI), Judy's EITC would continue to increase with each additional child, reaching its maximum benefit once she has three qualifying children. In 2024, the maximum EITC for taxpayers with three or more qualifying children is \$7,830.¹⁴⁷

Judy also qualifies for the maximum CTC for 2024 which is \$2000 per child.¹⁴⁸ However, it is important to note that only a portion of the CTC is refundable for the 2024 tax year. This refundable portion, known as the Additional Child Tax Credit (ACTC), allows up to \$1,700 per child to be refundable.¹⁴⁹ To determine the refundable portion of the credit, 15% of earned income exceeding \$2,500 is calculated. The refundable amount is the lesser of this calculated figure or the unused portion of the CTC, with a maximum limit of \$1,700 per qualifying child.¹⁵⁰ The calculation yields \$4,125 ($27,500 \times 0.15$), which exceeds the \$1,700 limit; therefore, the refundable portion of the credit will be capped at \$1,700. If

143. Based on the 2024 federal income tax brackets for a head of household, the first \$8,100 falls entirely within the 10% tax bracket, as it is less than \$16,550. Judy's preliminary federal income tax liability is: $8,100 \times 10\% = \$810$. See *Federal Income Tax Rates and Brackets*, IRS, <https://www.irs.gov/filing/federal-income-tax-rates-and-brackets> [<https://perma.cc/9FMV-RPD3>] (last visited Jan. 19, 2025).

144. I.R.C. § 32.

145. I.R.C. § 24.

146. This result was obtained by inputting the information from this example in the IRS's EITC Assistant. See *Use the EITC Assistant*, IRS, <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/use-the-eitc-assistant> [<https://perma.cc/5SMF-QXEE>] (last visited Jan. 19, 2025). It is assumed that no one other than Judy can claim Anwar as a dependent. It is also assumed that Anwar is healthy and lives with his mother for more than half of the year.

147. *Earned Income and Earned Income Tax Credit (EITC) Tables*, IRS, <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/earned-income-and-earned-income-tax-credit-eitc-tables> [<https://perma.cc/E6VR-EQ62>] (last visited Apr. 18, 2025).

148. The Child Tax Credit has an income limit based on a taxpayer's modified adjusted gross income (MAGI). For the tax year 2024, the MAGI phaseout begins at \$200,000 for taxpayers filing as head of household. In this example, Judy's MAGI clearly falls well below the income limit. See *Does My Child/Dependent Qualify for the Child Tax Credit or the Credit for Other Dependents?*, IRS, <https://www.irs.gov/help/ita/does-my-childdependent-qualify-for-the-child-tax-credit-or-the-credit-for-other-dependents> [<https://perma.cc/J54S-KQYS>] (last visited Jan. 19, 2025).

149. *Refundable Tax Credits*, IRS, <https://www.irs.gov/credits-deductions/individuals/refundable-tax-credits> [<https://perma.cc/RCN5-7ZS8>] (last visited Jan. 19, 2025).

150. Rocky Mengle, *2024–2025 Child Tax Credit*, TURBOTAX, <https://turbotax.intuit.com/tax-tips/family/child-tax-credit/L9ZljdLz> [<https://perma.cc/72GZ-W5SL>].

Judy had additional qualifying children, each would similarly qualify for a refundable ACTC capped at \$1,700 per child, substantially increasing her overall refund.

Consequently, the non-refundable portion of the CTC is applied first, reducing Judy's \$810 tax liability by \$300. The remaining \$510 of income tax is then eliminated by the EITC. Because the EITC is fully refundable, the unused portion of the credit—\$2,536—results in a refund. Judy also qualifies for the refundable portion of the CTC—the ACTC—which is capped at \$1,700. In total, Judy receives a federal income tax refund of \$4,236, consisting of \$2,536 from the EITC and \$1,700 from the ACTC.

In summary, Judy does not ultimately owe any federal income tax. Her tentative tax liability is eliminated through the interaction of non-refundable and refundable credits, and she receives a net refund through the EITC and ACTC.¹⁵¹ Judy's situation is hardly unique; many tipped workers similarly do not owe income taxes. In 2022, it was estimated that 37% of tipped workers had incomes low enough to face no federal income tax, even before accounting for tax credits—unlike Judy, who relied on them.¹⁵² By contrast, only 16% of workers in non-tipped occupations were in a similar position.¹⁵³ This highlights the unique financial realities of tipped workers and underscores the importance of refundable credits like the EITC and ACTC in supporting their financial stability.

d. Underreporting of Tips

Like many tipped workers, Judy is likely to underreport her cash tips. A significant portion of cash tips often goes unreported due to lax enforcement and the inherent difficulty in monitoring cash transactions. In 2006, the IRS estimated that \$23 billion—10% of the \$235 billion individual income tax underreporting tax gap—was attributable to unreported tip income by employees.¹⁵⁴ To address these challenges, the IRS began implementing agreements in the early 1990s aimed at encouraging voluntary reporting and compliance among employers and their tipped employees.¹⁵⁵ However, a 2018 TIGTA report revealed that, in Tax Year 2016, approximately 30% of the 6,513 businesses with such agreements still had an estimated \$1.66 billion in unreported tips.¹⁵⁶ The report further noted that employers in tipping industries without such agreements are likely to have even lower compliance rates.¹⁵⁷

Despite these figures, the compliance rate for that same year was estimated at 48%, a significant improvement from the 16% compliance rate reported in

151. It is assumed that Judy does not qualify for other refundable tax credits like the American Opportunity Tax Credit and the Premium Tax Credit.

152. Tedeschi, *supra* note 135.

153. *Id.*

154. TREAS. INSPECTOR GEN. FOR TAX ADMIN., *supra* note 125, at 3–4.

155. See Robertson et al., *supra* note 18, at 31–32; Sullivan, *supra* note 128, at 1218–20.

156. TREAS. INSPECTOR GEN. FOR TAX ADMIN., *supra* note 125, at 8.

157. *Id.* at 11.

1981.¹⁵⁸ Today, the compliance rate is undoubtedly higher due to the widespread use of credit cards and other electronic payment methods, which make tip income easier to track.¹⁵⁹ And for all the uproar the 1982 TEFRA legislation generated, Martin Sullivan believes that the tip allocation rule introduced with Section 6053 has become largely irrelevant.¹⁶⁰

To recap, Section 6053(c) requires employees to pay additional tax if the total tips they report to their employer fall below 8% of the food and beverage revenue.¹⁶¹ Any shortfall is distributed among employees who receive tips directly from customers, often using hours worked as a basis for allocation.¹⁶² This approach can create inequities, as it places a heavier burden on employees who receive lower tips while favoring those with higher tips. Any excess tips allocated to an employee are recorded in Box 8 of their Form W-2, but employees who have kept accurate records can challenge these allocations if they believe them to be incorrect.¹⁶³ This amount would be added to Judy's AGI when calculating her income tax.¹⁶⁴

According to Sullivan, the practice of reporting allocated tips under the eight percent requirement has become increasingly rare on Forms W-2.¹⁶⁵ His results are drawn from IRS data on wage income which indicate that only 81,000 out of 6.1 million tipped workers (1.3%) received W-2s with allocated tips in 2018.¹⁶⁶ In dollar terms, the \$170 million in allocated tips accounted for less than 0.5% of the \$38.3 billion in total reported tips that year.¹⁶⁷ The irrelevance of the allocation rule, coupled with the substantial rise in charged payments, points to a drastic improvement in tip reporting compliance.¹⁶⁸

2. Judy's Non-Tax Benefits

a. Section 8 Housing Choice Voucher Program

In addition to her tax circumstances, Judy may qualify for a Section 8 Housing Choice Voucher, which assists low-income families in securing affordable, safe housing. Eligibility for this program is determined based on total annual gross income and family size. Unlike the IRC, HUD's definition of "annual income" under 24 C.F.R. § 5.609 is a program-specific measure of household

158. *Id.* at 4.

159. See Zelenak, *supra* note 108, at 245. Zelenak further suggests that the current tip compliance rate likely falls within the range of 80 to 90%. *Id.*

160. Sullivan, *supra* note 128, at 1218.

161. I.R.C. § 6053(c).

162. Sullivan, *supra* note 128, at 1216.

163. *Id.*

164. Judy would also have to file Form 4137 to cover her share of Social Security and Medicare taxes on any tips that were not reported to her employer. See *About Form 4137, Social Security and Medicare Tax On Unreported Tip Income*, IRS, <https://www.irs.gov/forms-pubs/about-form-4137> [<https://perma.cc/UW3W-DU7D>] (last visited Jan. 20, 2025).

165. Sullivan, *supra* note 128, at 1218; Zelenak, *supra* note 108, at 245.

166. Sullivan, *supra* note 128, at 1218.

167. *Id.*

168. Zelenak, *supra* note 108, at 245.

resources that broadly includes all amounts received from all sources, subject only to enumerated regulatory exclusions and asset-imputation rules.¹⁶⁹ For purposes of this analysis, Judy's annual income is assumed to be the same under both frameworks.

A household's income is compared to the Area Median Income (AMI) for their region, and federal guidelines typically require that a family's income not exceed 50% of the AMI for their county or metropolitan area.¹⁷⁰ For FY 2024, the AMI for metropolitan areas in Amarillo, Texas is \$87,700.¹⁷¹ In Amarillo, the Department of Housing and Urban Development (HUD) defines the "very low income" threshold for a two-person household at \$35,100.¹⁷² With Judy's gross annual income of \$30,000, she meets this "very low income" standard, making her eligible to apply for a housing voucher. However, federal law also requires Public Housing Agencies (PHA) to target 75% of their vouchers to families whose income does not exceed 30% of the area median income—in Amarillo's case, \$26,310.¹⁷³ Since Judy's income is higher than that, she would not be in the highest-priority group, which could affect her position on the waiting list. However, if Judy had two additional children—bringing her household size to four—her \$30,000 income would fall within the "extremely low income" category, which is capped at \$31,200 for a four-person household in Amarillo.¹⁷⁴

The Section 8 program typically limits a family's share of rent to about 30% of their adjusted monthly income, with the voucher covering the balance, up to HUD's payment standard.¹⁷⁵ Availability, though, is often constrained by funding and local waiting lists, so meeting the income requirement does not guarantee immediate assistance.¹⁷⁶ It should be noted that if tip income was not counted towards Judy's annual income computation, she would qualify directly for the

169. 24 C.F.R. § 5.609 (2025).

170. *Housing Choice Voucher Program Section 8*, U.S. DEP'T HOUS. & URB. DEV. (HUD), https://www.hud.gov/topics/housing_choice_voucher_program_section_8 [<https://perma.cc/QE4C-952F>] (last visited Jan. 21, 2025).

171. *FY 2024 Income Limits Documentation System – Summary for Amarillo, TX HUD Metro FMR Area*, HUD USER, https://www.huduser.gov/portal/datasets/il/il2024/2024summary.odn?inputname=METRO11100M11100*Amarillo%2C+TX+HUD+Metro+FMR+Area&wherefrom=%24wherefrom%24&selection_type=hmfa&year=2024 [<https://perma.cc/77F7-RAN6>] (last visited Apr. 18, 2025).

172. OFF. OF POL'Y DEV. & RSCH. (PD&R), FY24 SECTION 8 INCOME LIMITS 207 (2024) [<https://perma.cc/N6TD-GGAW>].

173. *Housing Choice Voucher Program Section 8*, *supra* note 170.

174. OFF. OF POL'Y DEV. & RSCH. (PD&R), *supra* note 172, at 207.

175. *Housing Choice Voucher Program Section 8*, *supra* note 170.

176. See generally Kaitlyn M. Sims et al., *Barriers to Safe and Secure Housing in the US Section 8 Voucher Programme Post-Dobbs*, 44 CRITICAL SOC. POL'Y 523 (2024); EVA ROSEN, THE VOUCHER PROMISE: "SECTION 8" AND THE FATE OF AN AMERICAN NEIGHBORHOOD (Jul. 2020); Deven Carlson et al., *The Benefits and Costs of the Section 8 Housing Subsidy Program: A Framework and Estimates of First-Year Effects*, 30 J. POL'Y ANALYSIS & MGMT. 233 (2011); Barbra Ann Teater, *A Qualitative Evaluation of the Section 8 Housing Choice Voucher Program: The Recipients' Perspectives*, 10 QUALITATIVE SOC. WORK 503 (2011); Xinhao Wang & David P. Varady, *Using Hot-Spot Analysis to Study the Clustering of Section 8 Housing Voucher Families*, 20 HOUS. STUD. 29 (2005); Amy Crews Cutts & Edgar O. Olsen, *Are Section 8 Housing Subsidies Too High?*, 11 J. HOUS. ECON. 214 (2002).

Section 8 housing vouchers given that the majority (\$25,740) of her annual gross income of \$30,000 is from tips.

However, that is not the current state of our laws. According to Title 24 of the Code of Federal Regulations, Section 5.609 on Annual Income, tips are included in the calculation of annual income for determining Section 8 eligibility.¹⁷⁷ Although this section does not pertain to the Tax Code, a change in the definition of income for tax purposes might prompt a change in the definition of income for HUD purposes, as the definitions of annual and adjusted income used for HUD-administered programs share similarities with rules used by the IRS.¹⁷⁸ However, such an alignment remains entirely speculative.

b. SNAP Food Benefits

Judy may also be eligible for SNAP (formerly the Food Stamp Program) benefits in Texas, which provide financial assistance to low-income households for purchasing food. SNAP eligibility is determined based on household income, assets, and family size.¹⁷⁹ For SNAP purposes, “household income” is defined by regulation as “all income from whatever source,” consisting of both earned and unearned income, minus only the specific income exclusions listed in 7 C.F.R. § 273.9(c), with eligibility assessed using monthly gross and net income standards tied to the federal poverty guidelines.¹⁸⁰ To qualify under the pre-OBBBA system, a household’s income and resources must meet three tests: the gross income test, the net income test, and the assets test.¹⁸¹

The first is the gross income test, which requires a household’s gross monthly income—income before any deductions—to be at or below 130% of the federal poverty line.¹⁸² This poverty level varies depending on family size, with higher thresholds for larger families and lower ones for smaller households. For Fiscal Year 2024, 130% of the poverty line for a two-person household is \$2,137 per month.¹⁸³ For purposes of this analysis, we assume that the same \$30,000 in annual earnings translates into countable SNAP income (before SNAP deductions and exclusions). Since Judy’s gross income is \$30,000 annually, which equals \$2,500 per month, she does not pass the gross income test. It should be noted, however, that if Judy had more than one child, she would pass the gross income test, as the limit for a three-person household is \$2,694 per month. This threshold continues to increase with each additional household member.

177. 24 C.F.R. § 5.609. It should be noted that a 2017 version of this section explicitly included the word “tip” to clarify that tips are counted as part of annual income.

178. *See, e.g.*, U.S. DEP’T OF HOUS. & URB. DEV., NO. 4350.3 REV-1, HUD HANDBOOK 4350.3: OCCUPANCY REQUIREMENTS OF SUBSIDIZED MULTIFAMILY HOUSING PROGRAMS 5–1 (Nov. 2013) [<https://perma.cc/8BKH-WVBF>].

179. CTR. ON BUDGET & POL’Y PRIORITIES, A QUICK GUIDE TO SNAP ELIGIBILITY AND BENEFITS 2–3 (Sep. 2024) [<https://perma.cc/RM2S-9QZ6>].

180. 7 C.F.R. § 273.9 (2025).

181. CTR. ON BUDGET & POL’Y PRIORITIES, *supra* note 179, at 2–3.

182. *Id.*

183. U. S. DEP’T OF AGRIC., SUPPLEMENTAL NUTRITION ASSISTANCE PROGRAM (SNAP) FISCAL YEAR (FY) 2024 INCOME ELIGIBILITY STANDARDS 1 (2023), <https://fns-prod.azureedge.us/sites/default/files/media/file/FY24-Income-Eligibility-Standards.pdf> [<https://perma.cc/R9XT-EHD5>].

The second test is the net income test. The net income test requires a household's income, after allowable deductions are applied, to be at or below the federal poverty line.¹⁸⁴ While the program allows for several deductions, we will simplify by assuming that Judy is only eligible for the standard deduction, the earnings deduction (equal to 20% of earnings), and the shelter deduction.¹⁸⁵ For a two-person household like Judy and her son, the net income must not exceed the poverty line monthly threshold of \$1,644 for Fiscal Year 2024.¹⁸⁶

Judy's annual gross income is \$30,000, which translates to \$2,500 per month. For a two-person household, Judy qualifies for a monthly standard deduction of \$198.¹⁸⁷ Additionally, SNAP provides an earnings deduction of 20% of gross income, which is \$500 in Judy's case ($\$2,500 \times 20\%$). These deductions total \$698 ($\$198 + \500). Subtracting this from her gross income, Judy's preliminary adjusted net income (PANI) is \$1,802 ($\$2,500 - \698). Next, we calculate the shelter deduction. Judy's total monthly shelter expenses (rent and utilities) in Amarillo are assumed to be \$1,000. SNAP allows a shelter deduction equal to total shelter costs minus half of PANI. This calculates to \$99 ($\$1,000 - \$1,802/2$). After applying the shelter deduction, Judy's monthly net income is \$1,703 ($\$1,802 - \99).¹⁸⁸ Since the poverty line monthly threshold for a household of two is \$1,644, Judy exceeds the limit by a little over \$50, meaning she narrowly misses eligibility for SNAP benefits under the net income test.

If we assume that Judy has two children instead, she would be more likely to qualify for SNAP. Her gross income remains \$30,000 per year, or \$2,500 per month. For a three-person household, the standard SNAP deduction is still \$198, and the 20% earnings deduction stays at \$500, bringing total deductions to \$698.¹⁸⁹ Subtracting this from her gross monthly income results in a preliminary adjusted net income (PANI) of \$1,802. Assuming Judy's rent and utilities remain at \$1,000, the shelter deduction—calculated as shelter costs minus half of PANI—equals \$99 ($\$1,000 - \901). After applying this deduction, Judy's monthly net income comes to \$1,703. Because the net income limit for a three-person household in Fiscal Year 2024 is \$2,072, Judy now falls below the threshold and therefore

184. CTR. ON BUDGET & POL'Y PRIORITIES, *supra* note 179, at 2.

185. The other potential deductions are the dependent care deduction, the child support deduction and the medical expense deduction. It should be noted that all SNAP households are eligible for the standard deduction. Among the optional deductions, the shelter deduction is the most commonly used, with a majority of households taking advantage of it. The earnings deduction is also frequently claimed, especially by households with children. In contrast, deductions for dependent care, child support payments, and medical expenses are far less common, with only a small fraction of households qualifying for or utilizing them. *Id.* at 4–6.

186. U. S. DEP'T OF AGRIC., *supra* note 183, at 1.

187. U. S. DEP'T OF AGRIC., SUPPLEMENTAL NUTRITION ASSISTANCE PROGRAM (SNAP) FISCAL YEAR (FY) 2024 MAXIMUM ALLOTMENTS AND DEDUCTIONS 2 (2023), <https://fns-prod.azureedge.us/sites/default/files/media/file/FY24-Maximum-Allotments-and-Deductions.pdf> [<https://perma.cc/JXC4-7QUC>] [hereinafter 2024 MAXIMUM ALLOTMENTS AND DEDUCTIONS].

188. *See, e.g., How to Calculate SNAP Benefits*, MASS.GOV, <https://www.mass.gov/info-details/how-to-calculate-snap-benefits> [<https://perma.cc/P8KS-ZUH3>] (last visited Jan. 22, 2025).

189. 2024 MAXIMUM ALLOTMENTS AND DEDUCTIONS, *supra* note 187, at 2.

passes the net income test.¹⁹⁰ The maximum allotment for a three-person household in Texas is \$766.¹⁹¹

It should be noted that SNAP considers cash income from all sources when determining eligibility, including earned income (calculated before payroll taxes are deducted) and unearned income such as cash assistance, Social Security benefits, unemployment insurance, and child support.¹⁹² As a result, tips are included in the calculation of income for both the gross and net income tests. Once again, if tips were excluded from her gross income calculation, someone like Judy would easily qualify for this program.

The final test, which we won't delve into here, is the assets test. SNAP counts resources that could be used to purchase food, such as amounts in bank accounts, as assets.¹⁹³ Cars may also count, depending on their value.¹⁹⁴ To qualify, a household's total assets must not exceed the program's established threshold.¹⁹⁵ Notably, states can choose to loosen asset limits, and the majority have opted to do so.¹⁹⁶

c. Medicaid

Medicaid is a joint federal and state program that provides health coverage to millions of low-income individuals and families, including children, pregnant women, and parents.¹⁹⁷ Eligibility for Medicaid is determined based on various factors, such as income, household size, and age. Since the passage of the Affordable Care Act, Medicaid eligibility for most individuals has been assessed using Modified Adjusted Gross Income (MAGI), which considers taxable income and tax filing relationships.¹⁹⁸ MAGI is also used to determine eligibility for other programs, such as Children's Health Insurance Program (CHIP) and premium tax credits.¹⁹⁹

190. U. S. DEP'T OF AGRIC., *supra* note 183, at 1.

191. 2024 MAXIMUM ALLOTMENTS AND DEDUCTIONS, *supra* note 187, at 1. If Judy's household grows to include a third child, making it a four-person household, her gross income stays the same. However, her standard deduction increases slightly to \$208. With the earnings deduction unchanged at \$500, her total deductions rise to \$708, yielding a PANI of \$1,792. The shelter deduction remains \$99, based on the same housing costs. This results in a monthly net income of \$1,693. Compared to the FY 2024 net income limit for a four-person household—\$2,500—Judy remains well below the threshold and easily qualifies for benefits. The maximum monthly SNAP allotment for a household of four is \$973, and this benefit level continues to increase with each additional dependent child.

192. 7 U.S.C. § 2014(d); 7 C.F.R. § 273.9(b).

193. CTR. ON BUDGET & POL'Y PRIORITIES, *supra* note 179, at 2.

194. SNAP Eligibility | Food and Nutrition Service, USDA, <https://www.fns.usda.gov/snap/recipient/eligibility> (last visited Jan. 22, 2025).

195. For FY 2024, the maximum asset limit is \$4,250 for households with at least one member aged 60 or older or who is disabled, and \$2,750 for all other households. 2024 MAXIMUM ALLOTMENTS AND DEDUCTIONS, *supra* note 187, at 2.

196. CTR. ON BUDGET & POL'Y PRIORITIES, *supra* note 179, at 2.

197. September 2025 Medicaid & CHIP Enrollment Data Highlights, MEDICAID.GOV, <https://www.medicaid.gov/medicaid/national-medicaid-chip-program-information/medicaid-chip-enrollment-data/september-2025-medicaid-chip-enrollment-data-highlights> (last visited Jan. 26, 2026).

198. Eligibility Policy, MEDICAID.GOV, <https://www.medicaid.gov/medicaid/eligibility-policy/index.html> [<https://perma.cc/L3WC-5JDS>] (last visited Jan. 23, 2025).

199. The Premium Tax Credit (PTC) is a refundable credit that helps eligible individuals and families cover the premiums for their health insurance. See *The Premium Tax Credit—The Basics*, IRS, <https://www.irs.gov/affordable-care-act/individuals-and-families/the-premium-tax-credit-the-basics> [<https://perma.cc/5TBH-A2ME>] (last visited Jan. 23, 2025).

Additionally, MAGI serves as an income limit to phase out certain taxpayers from the CTC. Simply put, MAGI is your AGI with specific adjustments added back.²⁰⁰

For this hypothetical, we assume that Judy is 31 years old and healthy. This aligns with the fact that tipped workers tend to be younger, with the median age of a tipped worker being 31.²⁰¹ In fact, 23% of the tipped workforce falls between the ages of 25 and 34, and one-third are under the age of 25.²⁰² As such, Judy does not qualify for Medicare, which is available only to individuals aged 65 or older, or to those with specific disabilities or medical conditions.²⁰³ While Medicaid is an option for parents and caretakers of minor children, the income eligibility threshold in Texas for a single-parent household of two is \$196 in gross monthly income.²⁰⁴ With a gross monthly income of \$2,500, Judy far exceeds this limit, making her ineligible for Medicaid as a parent or caretaker.

Even if we considered only Judy's gross base wages, which amount to \$355 per month ($\$4,260 \div 12$), she still would not meet the \$196 threshold to qualify for Medicaid in Texas. In fact, even if tips were excluded from her income calculation, Judy would need to have at least five children—making her a household of six—to fall within the Medicaid eligibility limit in Texas, which rises only incrementally with family size.²⁰⁵

If Judy is ineligible for Medicaid, the next question is whether she qualifies for subsidized coverage through the Affordable Care Act Marketplace. The Affordable Care Act Marketplace is a federally regulated insurance exchange where individuals without access to employer-sponsored or public coverage can purchase health plans, with eligibility for income-based subsidies to reduce premiums and cost-sharing.²⁰⁶ Under I.R.C. § 36B, premium tax credits are available to individuals with household incomes between 100% and 400% of the Federal

200. To calculate your MAGI, you start with your AGI and then add back IRA contributions, student loan interest, foreign earned income and housing exclusions, foreign housing deduction or income exclusion, savings bond interest excluded from your income and adoption benefits excluded from your income. See *Definition of Adjusted Gross Income*, IRS, <https://www.irs.gov/e-file-providers/definition-of-adjusted-gross-income> [<https://perma.cc/8F24-A7DU>] (last visited Jan. 23, 2025).

201. Tedeschi, *supra* note 135.

202. *Id.*

203. See generally *Who's Eligible for Medicare?*, U.S. DEP'T OF HEALTH & HUM. SERVS., <https://www.hhs.gov/answers/medicare-and-medicaid/who-is-eligible-for-medicare/index.html> [<https://perma.cc/EWJ5-WMUM>] (last visited Jan. 23, 2025).

204. *Medicaid for Parents and Caretakers*, TEXAS HEALTH & HUM. SERVS., <https://www.hhs.texas.gov/services/health/medicaid-chip/medicaid-chip-programs-services/programs-children-families/medicaid-parents-caretakers> [<https://perma.cc/6UN5-TCL5>] (last visited Jan. 23, 2025) (defining income for the purposes of the guidelines as pre-tax income).

205. *Id.*

206. See generally CMS, *APTC AND CSR BASICS* (2025), <https://www.cms.gov/marketplace/technical-assistance-resources/aptc-csr-basics.pdf> (explaining eligibility for advance premium tax credits and cost-sharing reductions for Marketplace enrollees, including income thresholds, interactions with employer-sponsored and public coverage, and the mechanics of applying subsidies to reduce premiums and out-of-pocket costs).

Poverty Level (FPL), with the credit amount determined on a sliding scale tied to household income as measured by MAGI.²⁰⁷ Judy's MAGI of \$30,000 places her at approximately 147% of the Federal Poverty Level.²⁰⁸ At that income level, she would ordinarily qualify for Marketplace premium subsidies unless she is offered employer-sponsored insurance that meets the ACA's affordability standard under I.R.C. § 4980H.²⁰⁹ In Judy's specific scenario, she likely qualifies for a \$0-premium CSR Silver plan.²¹⁰ However, the plan still carries deductibles, co-payments, and an annual out-of-pocket cap of roughly \$3,000, an amount that may still be prohibitive for a worker with volatile income.²¹¹

For Judy's young son, Anwar, the gross family monthly income must be \$2,266 or less for a family of two to qualify for Children's Medicaid in Texas in 2024.²¹² Since the family's gross monthly income is \$2,500, Anwar does not meet the income eligibility requirements for Children's Medicaid. However, Anwar might still qualify for the CHIP, a health care program designed for children without health insurance whose families earn too much to qualify for Medicaid but cannot afford private insurance. In Texas, the gross monthly income threshold for CHIP is \$3,424 for a family of two in 2024, which is higher than the family's gross monthly income of \$2,500.²¹³ As a result, young Anwar qualifies for CHIP.

If Anwar had a sibling, increasing the household size to three, the Medicaid income limit would rise accordingly, and both children would then qualify for Children's Medicaid, as the threshold for a family of three in Texas in 2024 is \$2,862, which is greater than Judy's gross monthly income of \$2,500.²¹⁴ This threshold continues to increase with each additional child. It is also worth mentioning that if tips were excluded from the family's gross income or MAGI, Anwar would qualify for Children's Medicaid even as an only child, which provides free healthcare. By contrast, CHIP offers healthcare at a reduced cost, with enrollment fees and co-pays varying according to family income.²¹⁵

207. I.R.C. § 36B.

208. The Federal Poverty Level (FPL) for a family of two for the year 2024 is \$20,440. *See Federal Poverty Level (FPL) - Glossary*, HEALTHCARE.GOV, <https://www.healthcare.gov/glossary/federal-poverty-level-fpl> [<https://perma.cc/REM7-8X5L>] (last visited Nov. 6, 2025).

209. Employers with fewer than 50 full-time employees (or full-time equivalents) are not subject to the employer shared-responsibility mandate and therefore are not required under the ACA to offer health coverage. *See* I.R.C. § 4980H.

210. This estimate was generated using the 2024 Health Insurance Marketplace Calculator created by the Kaiser Family Foundation (KFF), based on Judy's household size, income, and Texas residence. The calculation assumes that her son, Anwar, qualifies for CHIP under Texas eligibility thresholds. *2024 Health Insurance Marketplace Calculator*, KFF, <https://www.kff.org/interactive/subsidy-calculator-2024/> [<https://perma.cc/3GCN-ABTU>] (last visited Nov. 6, 2025).

211. *Id.*

212. *Children's Medicaid and CHIP*, TEXAS HEALTH & HUM. SERVS., <https://www.hhs.texas.gov/services/health/medicaid-chip/medicaid-chip-programs-services/programs-children-adults-disabilities/programs-children-families/childrens-medicaid-chip> [<https://perma.cc/5QJR-AUP8>] (last visited Jan. 23, 2025) (defining income for the purposes of the guidelines as pre-tax income).

213. *Id.*

214. *Id.*

215. *Id.*

C. *Tip Jar Tavern's FICA Tip Tax Credit*

It's important to acknowledge that restaurants face a wide array of tax obligations. First, restaurants are responsible for collecting and remitting sales tax, which varies based on the state and local jurisdiction where the business operates.²¹⁶ They also have significant payroll tax responsibilities, including withholding their employees' FICA contributions and matching those contributions.²¹⁷ For 2024, the combined employer and employee contribution rate for Social Security remains at 12.4%, with each party contributing 6.2%. Similarly, the combined rate for Medicare is 2.9%, with both the employer and employee contributing 1.45%.²¹⁸ In addition to FICA, restaurants must also pay state and federal unemployment taxes as part of their payroll obligations.²¹⁹

If the restaurant owns its physical property, it likely owes property taxes as well. Finally, restaurants are subject to federal and state income taxes, which are particularly relevant to this analysis. However, since this example is set in Texas—a state with no income tax—the restaurant is only responsible for federal income tax. Under pre-OBBBA law, IRC Section 45B allowed Tip Jar Tavern to claim a tax credit against its income tax liability (not payroll taxes) for the employer's share of Social Security and Medicare (FICA) taxes paid on Judy's reported tip income that exceeded the federal minimum wage threshold set by Section 45B. Specifically, the credit applied to tips that go beyond the amount needed to bring the employee's hourly wage up to \$5.15 per hour—the federal minimum wage in effect in 1997, which the statute continued to use as a baseline.²²⁰ In essence, if an employee earned more in tips than what's needed to reach that hourly wage floor, the employer received a dollar-for-dollar credit—applied against its business income tax—for the payroll taxes it paid on those “excess” tips. This FICA tip tax credit helped offset the cost of employing tipped workers and encouraged employers to accurately report tip income, since they were partially reimbursed for doing so.

To calculate the FICA tip tax credit Tip Jar Tavern earned for paying its share of Judy's payroll taxes, we must first determine the amount of her tips that exceeded the portion required to bring her hourly wage up to \$5.15 per hour. Judy earned a base wage of \$2.13 per hour, meaning her employer relied on tips to cover the \$3.02 per hour difference needed to meet the threshold set by Section 45B. Assuming Judy works 40 hours per week for 50 weeks per year, the total amount of tips required annually to reach the minimum wage is \$6,040

216. See, e.g., Cal. Rev. & Tax. Code § 6051; N.Y. Tax Law § 1105; Tex. Tax Code § 151.051 (imposing sales tax on retail sales and requiring sellers to collect and remit tax).

217. I.R.C. §§ 3102(a); 3111(a)–(b).

218. I.R.C. § 3111(a)–(b).

219. See I.R.C. §§ 3301 (imposing federal unemployment tax on employers), 3302(a) (providing credit for state unemployment taxes paid).

220. I.R.C. § 45B(b)(1)(B) (2024); *History of Federal Minimum Wage Rates Under the Fair Labor Standards Act, 1938–2009*, U.S. DEP'T OF LAB., <https://www.dol.gov/agencies/whd/minimum-wage/history/chart> [<https://perma.cc/T5CM-YPU5>] (last visited May 6, 2025).

($3.02 \times 40 \times 50$). Judy's total annual tips amount to \$25,740, based on an average of \$102.96 per shift, working 5 shifts per week over the same period.

To calculate the "excess tips" eligible for the FICA tip tax credit, we subtract the required tips from her total tips, resulting in \$19,700 in excess tips (\$25,740 – \$6,040). The employer is eligible for a credit based on the FICA tax rate of 7.65% applied to the excess tips, which equals \$1,507.05 ($\$19,700 \times 7.65\%$). Thus, Tip Jar Tavern can claim a Section 45B FICA tip tax credit of \$1,507.05 for Judy's reported tips. Notably, the employer paid \$2,295 to match Judy's FICA contributions and recouped more than half of that amount in the form of a tax credit.

III. OBBBA AND THE PATHS UNTAKEN

Part III critically examines recent legislative proposals to eliminate tip taxation, as well as OBBBA's enacted "No Tax on Tips" provision, focusing on their structural design and broader implications. Building on Judy's case, it evaluates how each proposal would alter her tax liability, take-home pay, and eligibility for refundable credits and public benefits. The first section reviews key features like full exemptions, cash-tip deductions, and temporary relief measures. The second assesses their likely consequences.

A. Blueprints for Change

This Section traces the evolution of federal proposals to reform the taxation of tip income, culminating in the OBBBA. It begins by examining OBBBA's "No Tax on Tips" deduction and its immediate predecessors, highlighting how successive legislative models—deduction-based, exclusion-based, and hybrid—sought to deliver tax relief to service-sector workers. It then turns to the political economy of these efforts, using the National Restaurant Association's preferred proposal as a lens to reveal which legislative model best serves employer interests within the industry. The analysis sets the stage for this Article's proposed hybrid framework, which aims to correct these structural distortions while preserving targeted relief for low-wage workers.

1. OBBBA's No Tax on Tips

This subsection first outlines the design of the OBBBA tip deduction, detailing its core features. It then examines the deduction's practical effects through the example of Judy.

a. The OBBBA Framework for Tip Taxation

OBBBA's enacted version of the "No Tax on Tips" provision closely mirrors the No Tax on Tips Act of 2025, adopting its core concept and several key structural features. Both versions create a "between-the-lines" deduction—i.e., one available to both itemizers and non-itemizers—to eliminate income tax on up to \$25,000 in qualified tips per taxpayer per year.²²¹ Rather than excluding tips from gross income, OBBBA provides a deduction for cash tips, modeled on the

221. H.R. 1 § 70201(a) (2025) (enacted).

Section 199A passthrough deduction, which reduces taxable income without altering gross income or AGI.²²²

By leaving AGI intact, OBBBA preserves the inclusion of tips for purposes of calculating refundable credits such as the EITC and the CTC. This provides a clear benefit to workers in the phase-in ranges of these credits, allowing them to maximize their refundable amounts. However, for workers in the phaseout range of the EITC, this approach is disadvantageous since the inclusion of tips increases their reported income, potentially reducing or eliminating their credit eligibility. Since the phaseout functions as a de facto tax on income—unlike the phase-in stage, which acts as a negative tax—it effectively taxes the tips even though they are technically exempt.²²³ As reported income rises, the value of the EITC declines. For reference, in tax year 2024, working families with children may be eligible for the EITC if their AGI is below a threshold ranging from \$49,084 to \$66,819, depending on their marital status and number of dependent children.²²⁴ Approximately 24 million workers and families nationwide received the EITC in 2025,²²⁵ while nearly 90% of families with children received the CTC.²²⁶

To prevent abuse, OBBBA limits eligibility to occupations that “traditionally and customarily” receive tips and directs the Treasury Department to issue a definitive list within 90 days of enactment.²²⁷ The Act also expands the employer tip credit under Section 45B to cover beauty service establishments, including barbering, hair care, nail care, and similar services long excluded under prior law.²²⁸ Employees and employers remain subject to payroll taxes on tip income, ensuring continued contributions to Social Security and Medicare and reinforcing the incentive structure for accurate tip reporting.²²⁹

The expanded Section 45B credit, combined with the increased incentive for employers to favor reported tips, may prompt a rise in reported tip income. Employers in the beauty service industry now stand to gain more from full compliance than before, a development that is concerning given these sectors’ high rates of wage theft, underpayment, and informal record-keeping.²³⁰ In such

222. Zelenak, *supra* note 108, at 246; I.R.C. § 199A.

223. I.R.C. § 32; Zelenak, *supra* note 108, at 247–48.

224. *Earned Income and Earned Income Tax Credit (EITC) Tables*, IRS (July 8, 2025), <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/earned-income-and-earned-income-tax-credit-eitc-tables> [<https://perma.cc/U9TC-83XE>].

225. *EITC Reports and Statistics*, IRS (Jan. 22, 2026), <https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/eitc-reports-and-statistics> [<https://perma.cc/K2LJ-QBG6>].

226. *What Is the Child Tax Credit?*, TAX POL’Y CTR. (Aug. 2025), <https://taxpolicycenter.org/briefing-book/what-child-tax-credit> [<https://perma.cc/F3HJ-VULX>].

227. H.R. 1 § 70201(h).

228. H.R. 1 § 70201(e).

229. There is no denying that OBBBA implements substantial changes to SNAP funding and the reporting requirements associated with Medicaid. *See, e.g.*, Suzanne Blake, *SNAP Changes: Trump Bill Adds New Burdens for Millions of Women, Study Says*, NEWSWEEK (July 28, 2025, 12:04 PM), <https://www.newsweek.com/snap-changes-trump-bill-adds-new-burdens-millions-women-study-2105160> [<https://perma.cc/6HHG-6MVC>].

230. *See, e.g.*, Zoë West, Russell Weaver & KC Wagner, ILR Worker Inst., *Unvarnished: Precarity and Poor Working Conditions for Nail Salon Workers in New York State 3* (2022)

contexts, employers may effectively force the hand of employees by inflating reported tips to maximize their own Section 45B credits. If reported tips increase without a corresponding rise in actual pay, workers' reported earnings may grow on paper even as their take-home pay remains unchanged. Because eligibility for non-tax benefits such as Section 8 housing, SNAP, and Medicaid depends on reported income rather than disposable income, such inflation could reduce or eliminate critical assistance, further destabilizing low-wage workers.

There are, however, several key differences between the current law and the No Tax on Tips Act of 2025 that merit discussion. OBBBA's version of the deduction features a graduated phase-out beginning at \$150,000 for single filers (\$300,000 for joint filers), in contrast to the 2025 No Tax on Tips Act, which imposes a hard cutoff at \$160,000—the IRS's 2025 threshold for “highly compensated employees” under IRC § 414(q)(1)(B)(i).²³¹ The OBBBA version includes a graduated, income-based phase-out designed to reduce the deduction for higher-income earners without categorically excluding them. Specifically, the allowable deduction is reduced by \$100 for every \$1,000 of MAGI above the threshold, meaning that the full \$25,000 deduction phases out completely once a taxpayer's income reaches \$400,000 for single filers and \$550,000 for joint filers.²³²

To put these income thresholds in perspective, the median annual income for waiters and waitresses in 2023 was just \$31,940, and even those at the 90th percentile earned only \$60,100.²³³ Against this backdrop, OBBBA's graduated phase-out, beginning at \$150,000 and continuing until \$400,000 for single filers, appears significantly misaligned with the income profile of the very workers the deduction is intended to benefit. It allows earners making more than six times what the top 10% of waitstaff earn to continue claiming partial benefits. This raises serious concerns about the efficiency and equity of the proposed relief.

Despite its intent to support low-income service workers, OBBBA's tip deduction is poorly targeted. According to recent estimates from the Tax Policy Center, only about 3% of all tax units will benefit from the deduction.²³⁴ The bulk

[<https://perma.cc/4WRR-5VNS>] (documenting pervasive wage theft, underpayment, and health-and-safety violations in New York's nail-salon industry, where predominantly immigrant women of color face low wages, misclassification, and weak enforcement); UCLA LAB. CTR., *NAIL FILES: A STUDY OF NAIL SALON WORKERS AND INDUSTRY IN THE UNITED STATES* (2018) [<https://perma.cc/HUC7-YV48>] (providing the first national labor-focused study of nail-salon work; documenting pervasive wage theft, misclassification, low pay, and hazardous conditions among a largely immigrant and female workforce); Sarah Maslin Nir, *The Price of Nice Nails*, N.Y. TIMES (May 7, 2015), <https://www.nytimes.com/2015/05/10/nyregion/at-nail-salons-in-nyc-manicurists-are-underpaid-and-unprotected.html> [<https://perma.cc/SV8J-GLZ6>] (exposing systemic wage theft, unpaid labor, ethnic hierarchies, and abusive conditions across New York nail salons, where mostly immigrant women work grueling hours for illegally low pay).

231. H.R. 1 § 70201(a).

232. Based on author's calculations.

233. *Waiters and Waitresses: Occupational Employment and Wages, May 2023*, U.S. BUREAU OF LAB. STAT. (May 2023), <https://www.bls.gov/oes/2023/may/oes353031.htm> [<https://perma.cc/4GZF-PAAZ>].

234. TAX POL'Y CTR., *PRELIMINARY ESTIMATES OF TAX BENEFITS OF DEDUCTIONS FOR TIPS AND OVERTIME* (July 31, 2025), <https://taxpolicycenter.org/tax-model-analysis/preliminary-estimates-tax-benefits-deductions-tips-and-overtime> [<https://perma.cc/6THB-UK5G>].

of the benefit, when measured as a share of after-tax income, accrues to the middle 60% of taxpayers, rather than the bottom deciles.²³⁵ Tellingly, the Tax Policy Center estimates that just 0.2% of tax units with expanded cash income between \$10,000 and \$20,000 will benefit from the deduction,²³⁶ even though the bottom 10% of waiters and waitresses earned an average of \$18,600 in 2023.²³⁷ Similarly, only 1.5% of tax units earning between \$20,000 and \$30,000 are expected to benefit,²³⁸ despite the fact that the bottom 25% of waiters earned just \$23,770.²³⁹ These figures underscore a critical mismatch between the policy's design and the economic realities of the workers it purports to help.

Additionally, the OBBBA version of the No Tax on Tips requires taxpayers to include a Social Security Number on their tax return to claim the deduction.²⁴⁰ This requirement excludes foreign-born U.S. residents who file using an Individual Taxpayer Identification Number (ITIN), despite the fact that foreign-born workers are disproportionately represented in the tipped workforce.²⁴¹ In 2025, 22% of restaurant and foodservice employees were foreign-born, compared to just 20% of the overall U.S. labor force.²⁴² Moreover, the Center for Migration Studies of New York estimates that approximately one million unauthorized (or undocumented) immigrants are employed in restaurants.²⁴³

Francine Lipman has extensively documented the contributions of Individual Taxpayer Identification Number (ITIN) holders to the U.S. tax system, challenging the common misconception that undocumented immigrants do not pay taxes.²⁴⁴ Her work reveals that ITIN filers contribute billions annually in federal,

235. *Id.*

236. *Id.*

237. *Waiters and Waitresses: Occupational Employment and Wages, May 2023*, *supra* note 233.

238. TAX POL'Y CTR., *supra* note 234.

239. *Waiters and Waitresses: Occupational Employment and Wages, May 2023*, *supra* note 233.

240. H.R. 1 § 70201(a).

241. See Treas. Reg. § 301.6109-1(d)(3) (2025). Immigrants who file for ITINs include undocumented immigrants, student visa holders, trafficking survivors. *Individual Taxpayer Identification Number (ITIN): A Powerful Tool for Immigrant Taxpayers*, NAT'L IMMIGR. L. CTR. (Apr. 1, 2024), <https://www.nilc.org/resources/itinfoq/> [<https://perma.cc/QY6H-ST8H>].

242. NAT'L REST. ASS'N, RESTAURANT EMPLOYEE DEMOGRAPHICS 9 (2025), <https://restaurant.org/getmedia/a3912d4b-9fd5-42f5-989c-fbc8e8929772/nra-data-brief-restaurant-employee-demographics-april-2025.pdf> [<https://perma.cc/BHQ3-9M36>].

243. Kevin Appleby, *The Importance of Immigrant Labor to the US Economy*, THE CTR. FOR MIGRATION STUD. OF N.Y. (CMS) (Sept. 2, 2024), <https://cmsny.org/importance-of-immigrant-labor-to-us-economy/> [<https://perma.cc/4ACJ-SHBW>]. This may help account for the recent surge in ICE enforcement activity in the restaurant industry. See, e.g., Brett Anderson, Tejal Rao & Korsha Wilson, *As Immigration Crackdown Looms, Restaurants Are Racked With Fear*, N.Y. TIMES (Jan. 25, 2025), <https://www.nytimes.com/2025/01/25/dining/trump-immigration-undocumented-workers-restaurants.html> [<https://perma.cc/L29E-9PD7>]; Nathan Bomey, *Restaurants Ask Trump for "Targeted Relief" from Immigration Crackdown*, AXIOS (July 3, 2025), <https://www.axios.com/2025/07/03/trump-immigration-ice-raids-restaurant-workers> [<https://perma.cc/AEA6-7JYF>].

244. See, e.g., Francine Lipman, *Taxing Undocumented Immigrants Redux*, 21 PITT. TAX REV. 153 (2024); Francine Lipman, *The "ILLEGAL" Tax*, 11 CONN. PUB. INT. L.J. 94 (2011) [hereinafter Lipman, *The "ILLEGAL" Tax*]; Francine J. Lipman, *The Undocumented Immigrant Tax: Enriching Americans from Sea to Shining Sea* (Nov. 1, 2008), <https://papers.ssrn.com/abstract=1292960>.

state, and local taxes, despite being excluded from nearly all federal benefits programs including the EITC.²⁴⁵ Many ITIN filers use the tax system as a way to document presence and good-faith compliance with U.S. law, even without legal immigration status.²⁴⁶ By voluntarily participating in the tax system, these individuals establish a record that may later support immigration relief or demonstrate “good moral character” under certain legalization programs.²⁴⁷ Excluding ITIN filers from tax benefits like the proposed tip deduction in OBBBA not only denies relief to a significant segment of the working poor, but also penalizes taxpayers who have complied with the rules available to them in good faith.

Lipman also argues that the denial of tax credits and deductions to undocumented immigrants creates a de facto second-class tax status that undermines equity and compliance incentives.²⁴⁸ Policies that restrict tax benefits based on immigration status can deter filing altogether, increasing the size of the informal cash economy and undercutting both tax enforcement and worker protections.²⁴⁹ In the case of the restaurant, the OBBBA provision risks exacerbating labor segmentation and exploitation. By conditioning eligibility for the tip deduction on the presence of a valid Social Security Number, OBBBA reinforces systemic exclusion within a sector already marked by precarity, racial stratification, and high rates of non-citizen labor. As Lipman’s scholarship illustrates, such exclusions not only harm immigrant workers, but also erode the integrity and fairness of the broader tax system.

A final point worth noting is that OBBBA conditions married taxpayers’ eligibility for the tip deduction on filing jointly. This requirement disproportionately harms mixed-status families. As advocacy groups have noted in other contexts—such as the CTC or the EITC—joint filing requirements exclude otherwise eligible households from crucial tax relief, effectively penalizing marriage and worsening economic insecurity among immigrant communities.²⁵⁰ For example, if Judy—who has been assumed throughout this article to possess a valid Social Security Number—were married to an undocumented immigrant without either a Social Security Number or an ITIN, she would be unable to file jointly and would

245. See, e.g., Francine J Lipman, *Bearing Witness to Economic Injustices of Undocumented Immigrant Families: A New Class of “Undeserving” Poor*, 7 NEV. L.J. 736, 747, 756 (2007); Francine Lipman, *The Taxation of Undocumented Immigrants: Separate, Unequal, and Without Representation*, 9 HARV. LATINO L. REV. 1, 5–6 (2006).

246. Nneka Obiokoye, *Taxation of Undocumented Immigrants: The Uneasy Connection Between Regulating the Undocumented Immigrant and Fostering Illegal Activity*, 2 BUS. ENTREPRENEURSHIP & TAX L. REV. 359, 371 (2018).

247. *Id.*

248. Lipman, *The “ILLEGAL” Tax*, *supra* note 244.

249. *Id.* at 17, 22, 25.

250. Ben D’Avanzo, *The House Reconciliation Bill’s Tax Provisions Will Increase Poverty and Penalize Immigrants*, NAT’L IMMIGR. L. CTR. (June 10, 2025), [https://www.nilc.org/articles/the-house-reconciliation-bills-tax-provisions-will-increase-poverty-and-penalize-immigrants/\[https://perma.cc/3WW4-6KSS\]](https://www.nilc.org/articles/the-house-reconciliation-bills-tax-provisions-will-increase-poverty-and-penalize-immigrants/[https://perma.cc/3WW4-6KSS]); Carl Davis & Sarah Austin, *House Tax Bill Would Create a Parallel, Harsher Tax Code for Immigrant Filers and Their Citizen Family Members*, ITEP (May 22, 2025), [https://itep.org/house-tax-bill-harsher-tax-code-for-immigrant-filers-and-citizen-family-members/\[https://perma.cc/9YYPG-BTGF\]](https://itep.org/house-tax-bill-harsher-tax-code-for-immigrant-filers-and-citizen-family-members/[https://perma.cc/9YYPG-BTGF]).

therefore lose access to the tip deduction entirely. This would result in a lower tax refund, effectively penalizing both Judy and her son Anwar for her spouse's immigration status.

Even setting immigration concerns aside, the tax literature has long recognized that the joint filing system produces both marriage bonuses and marriage penalties, depending on how spouses' earnings are distributed.²⁵¹ Couples with highly unequal earnings typically receive marriage bonuses, while couples with similar or evenly shared incomes tend to incur marriage penalties. Building on this framework, Dorothy A. Brown documents how these marriage-based tax effects are unevenly distributed across racial groups.²⁵² In *The Whiteness of Wealth*, Brown analyzes census data to show that households receiving marriage bonuses—particularly single-earner households—are disproportionately white, while Black households are more likely to fall into dual-earner configurations that experience marriage penalties, even at comparable income levels.²⁵³ OBBBA's requirement that married taxpayers file jointly to qualify for the tip deduction risks compounding these inequities by extending marriage-based tax penalties to workers in precarious, low-wage sectors. This problem is further exacerbated by the fact that filing jointly can significantly reduce the EITC available to dual-earner households.²⁵⁴

b. Judy's Situation under OBBBA

For Judy, the hypothetical low-income waitress introduced in Part II, OBBBA's effects are modest but tangible. Judy's payroll tax liability would remain unchanged. She would still pay \$2,295 on her \$30,000 in gross income, with her employer matching this amount. This protects her future retirement benefits by ensuring all earnings continue to count toward Social Security.

Her gross income remains \$30,000, composed of \$25,740 in tips and \$4,260 in base wages. Because the deduction applies "between the lines," Judy's AGI remains \$30,000 but her taxable income falls to zero after the \$25,000 tip deduction and the standard head-of-household deduction of \$21,900. As a result, Judy owes no federal income tax. Because tips remain included in earned income and AGI calculations, Judy remains fully eligible for both the EITC (\$3,046) and ACTC (\$1,700). With no income tax liability, she receives a total refund of \$4,746. This marks a \$510 increase over the pre-OBBBA system.

Her employer, Tip Jar Tavern, continues to benefit from the section 45B FICA tip tax credit, which offsets the employer's share of payroll taxes on Judy's reported tip income exceeding the minimum wage threshold set by Section 45B. Under OBBBA, food and beverage establishments like the Tip Jar Tavern may

251. See, e.g., Boris I. Bittker, *Federal Income Taxation and the Family*, 27 STAN. L. REV. 1389 (1975) (explaining that joint filing produces marriage bonuses for couples with unequal earnings and marriage penalties for couples with similar earnings).

252. DOROTHY A. BROWN, *THE WHITENESS OF WEALTH: HOW THE TAX SYSTEM IMPOVERISHES BLACK AMERICANS—AND HOW WE CAN FIX IT* 29–63 (2021).

253. *Id.* at 50–57.

254. *Id.* at 52.

continue calculating the credit using the 2007 federal minimum wage of \$5.15 per hour as the baseline.²⁵⁵ This favorable calculation yields a higher “excess” tip amount, allowing Tip Jar Tavern to claim a credit of \$1,507.05 based on Judy’s annual tips of \$25,740.

In contrast, if Judy were a beautician employed at the Tip Jar Salon, the new expansion of section 45B would apply, but with a key difference: the salon must calculate the credit using the current federal minimum wage of \$7.25 per hour. As a result, the “excess” tip amount is smaller, and the employer’s credit drops to \$1,185.74. While this expansion offers new relief to beauty service employers, the discrepancy in the wage floor used creates a structural advantage for food and beverage establishments.

For non-tax public benefits, Judy’s gross income and MAGI remain \$30,000, leaving her eligibility for Section 8 housing vouchers, SNAP, ACA premium tax credits and CHIP unaffected.

2. Deduction Models: Carving Relief While Keeping Tips in Income

Unlike proposals that would exclude tips from income altogether, deduction-based models aim to provide relief by allowing workers to deduct part or all of their tip income while maintaining its inclusion in gross income and AGI. This structure preserves workers’ eligibility for refundable tax credits such as the EITC and CTC and maintains payroll tax contributions—an approach exemplified by the No Tax on Tips Act and later adopted, with modifications, in OBBBA.

a. No Tax on Tips Act

Introduced first in 2024 by Sen. Ted Cruz (R-TX) and Rep. Byron Donalds (R-FL) and reintroduced in 2025 with revisions by Sen. Cruz (R-TX) and Rep. Vern Buchanan (R-FL), the No Tax on Tips Act sought to eliminate income tax on tip income through a deduction model later echoed in OBBBA.

i. Proposal Breakdown

The No Tax on Tips Act, introduced in 2024 and revised in 2025, advanced a deduction-based approach to tip relief that ultimately became the template for OBBBA. Instead of excluding tips from gross income, both versions created a “between-the-lines” deduction for cash tips that any taxpayer could claim whether or not they itemized.²⁵⁶ The deduction reduced taxable income but left both gross income and AGI unchanged.²⁵⁷ Because tips remained in AGI and continued to count as earned income, they still factored into eligibility for the EITC and CTC. This structure preserved EITC access for very low-wage workers in the phase-in

255. H.R. 1 § 70201(e).

256. No Tax on Tips Act, S. 4621, 118th Cong. § 2 (2024); No Tax on Tips Act, H.R. 8941, 118th Cong. § 2 (2024); No Tax on Tips Act, S. 129, 119th Cong. § 2 (as passed by Senate, May 20, 2025); No Tax on Tips Act, H.R. 482, 119th Cong. § 2 (2025).

257. Zelenak, *supra* note 108, at 246.

range, even as it offered less protection to workers whose EITC was already phasing out.

Both versions of the bill also left tips subject to Social Security and Medicare payroll taxes, allowing employees to continue earning creditable wages for future Social Security benefits and allowing employers to continue claiming the Section 45B FICA tip credit. In other words, unlike proposals that would have excluded tips from taxation entirely, the No Tax on Tips framework aimed to provide income tax relief without undermining payroll tax financing or the earnings records used to calculate Social Security benefits.²⁵⁸

The 2024 version did this in the broadest possible way. It allowed taxpayers to deduct essentially the full amount of their reported cash tips, with no dollar cap, no phaseout by income level, and no meaningful occupational limits.²⁵⁹ A waiter in a luxury restaurant in Manhattan earning \$100,000 annually, including \$60,000 in tips, could deduct the entire \$60,000 from taxable income. This unrestricted availability of the deduction raises concerns about equity and potential tax benefits being disproportionately enjoyed by higher-income earners in tipped professions. Because the bill also lacked a restrictive definition of “tips,” it essentially gave industries *carte blanche* to reclassify any portion of compensation as tips, creating opportunities for widespread income reclassification and potential abuse.

The 2025 version attempted to narrow that overbreadth. It capped the deduction at \$25,000 per taxpayer per year, whereas the 2024 version permitted an unlimited deduction for reported cash tips.²⁶⁰ Additionally, the updated legislation expressly excluded highly compensated employees—defined under IRC Section 414(q)(1)(B)(i) as those earning more than \$160,000 (the adjusted threshold for 2025) from the same employer in the previous taxable year—from claiming the deduction.²⁶¹ But a worker earning \$160,000 is by no means poor—especially when economists Emmanuel Saez and Gabriel Zucman have found that the average income of all Americans is \$75,000, and the average income of working-class Americans is just \$18,500.²⁶²

It also introduced an occupational gate: only cash tips received in jobs that “traditionally and customarily” received tips as of December 31, 2023, would qualify, with Treasury instructed to publish a list.²⁶³ Finally, it expanded the Section 45B employer credit to cover beauty-service establishments (such as nail salons, barber shops, and hair and skin care salons) but preserved a structural advantage for restaurants by allowing food and beverage employers to continue

258. *Id.* at 248–49.

259. S. 4621 § 2(a)(1); H.R. 8941 § 2(a)(1).

260. S. 129 § 2(a)(1) (as passed by Senate, May 20, 2025); H.R. 482 § 2(a)(1).

261. S. 129 § 2(a)(1) (as passed by Senate, May 20, 2025); H.R. 482 § 2(a)(1); I.R.C. § 414(q)(1)(B)(i); *COLA Increases for Dollar Limitations on Benefits and Contributions*, IRS, <https://www.irs.gov/retirement-plans/cola-increases-for-dollar-limitations-on-benefits-and-contributions> [https://perma.cc/6DT5-4XF6] (last visited May 31, 2025).

262. SAEZ & ZUCMAN, *supra* note 21, at 1–6.

263. S. 129 § 2(a)(1); H.R. 482 § 2(a)(1).

using the favorable 2007 federal minimum wage (\$5.15) as the benchmark for calculating “excess” tips, while requiring beauty-service employers to apply the current \$7.25 rate.²⁶⁴ These two refinements were ultimately incorporated wholesale into OBBBA.

ii. Judy’s Situation under the No Tax on Tips Act

Under both versions of the No Tax on Tips Act, Judy’s overall tax outcome would remain largely unchanged. Her \$30,000 in gross income—comprising \$25,740 in tips and \$4,260 in base wages—would continue to be subject to Social Security and Medicare taxes, preserving her future retirement benefits and her employer’s matching contribution of \$2,295. Because the deduction applies “between the lines,” her AGI remains \$30,000 in both cases.

The 2024 version would have allowed Judy to deduct her full \$25,740 in tip income. When combined with the \$21,900 standard deduction for head-of-household filers, this deduction reduces her taxable income to zero and eliminates her federal income tax liability. The 2025 revision introduced a \$25,000 annual cap and an exclusion for “highly compensated employees”, but Judy’s income falls well below these thresholds, yielding the same result: zero taxable income.²⁶⁵ In both cases, because tips remain included in earned income and AGI, Judy remains fully eligible for the EITC (\$3,046) and the refundable portion of the CTC (\$1,700). With no income tax liability to offset, she receives the full amount of both refundable credits, resulting in a total refund of \$4,746—an increase of \$510 over the pre-OBBBA system.

As to the employer-side effects, both versions preserve the Section 45B FICA tip credit for food and beverage establishments, allowing Tip Jar Tavern to claim a \$1,507.05 credit based on Judy’s reported tips.

In both versions, Judy’s gross income and MAGI remain \$30,000, leaving her eligibility for Section 8 housing, SNAP, Medicaid, ACA premium tax credits and CHIP unaffected.

b. Tipped Income Protection and Support (TIPS) Act

First introduced by Rep. Steven Horsford (D-NV) on September 17, 2024, the Tipped Income Protection and Support (TIPS) Act sought to reform both tip taxation and wage practices. Like the No Tax on Tips Act, the bill would have offered a tax deduction for cash tips but distinguished itself by including additional wage protections. The bill was reintroduced in the 119th Congress but did not advance.

i. Proposal Breakdown

The TIPS Act followed a similar “between-the-line” structure for the deduction as the No Tax on Tips Act and OBBBA. It would have allowed taxpayers to deduct qualified cash tips without reducing AGI, meaning the deduction would

264. S. 129 § 3; H.R. 482 § 3.

265. The HCE Threshold for tax year 2024 is \$155,000. *COLA Increases for Dollar Limitations on Benefits and Contributions*, *supra* note 261.

have only affected taxable income.²⁶⁶ The deduction was designed to be available to both itemizers and non-itemizers, functioning outside of the limitations imposed on miscellaneous itemized deductions.²⁶⁷ However, the TIPS Act differed significantly from the No Tax on Tips Act by placing income and occupational restrictions on the deduction.

Although the 2025 iteration of the No Tax on Tips Act introduced a cut-off at \$160,000 for single filers, the TIPS Act proposed a lower income threshold, more closely aligning relief with low- and moderate-income workers. Specifically, it would have disallowed the deduction for individuals with AGI exceeding \$112,500.²⁶⁸ Although this represents an improvement over the No Tax on Tips Act and OBBBA, it remains questionable whether individuals earning six-figure incomes truly require this form of tax relief or whether the associated revenue loss can be justified.

Additionally, the TIPS Act defined “qualified tips” as those received on the job from unrelated parties by employees working in traditionally tipped occupations, including cosmetology, hospitality, food and beverage service, parking, and custodial services.²⁶⁹ While this constituted a positive step toward curbing income reclassification, the Act offered only an illustrative list. An exhaustive list would have been preferable to more effectively prevent reclassification and potential abuse.

A major feature of the proposal was its amendment to the FLSA to eliminate the separate federal minimum wage for tipped employees, commonly known as ‘tip credit’.²⁷⁰ Under the TIPS Act, tipped workers would have been required to receive the full federal minimum wage in cash, with tips retained by the employee. This provision was intended to strengthen wage security for tipped workers and contrasted sharply with other proposals that left the tipped minimum wage intact.²⁷¹ By requiring employers to pay the full federal minimum wage, the TIPS Act sought to protect workers from wage suppression and to counter

266. Tipped Income Protection and Support (TIPS) Act, H.R. 9624, 118th Cong. § 3 (2024); Tipped Income Protection and Support (TIPS) Act, H.R. 1314, 119th Cong. § 3 (2025).

267. H.R. 9624 § 3; H.R. 1314 § 3.

268. H.R. 9624 § 3; H.R. 1314 § 3.

269. H.R. 9624 § 3; H.R. 1314 § 3 (“For purposes of this section, the term ‘qualified tips’ means a tip received by an individual —

(1) from an unrelated party,

(2) who does not have an ownership stake in the business which employs them in the job in for which such individual is receiving a tip, and

(3) in the course of such individual’s employment in an occupation which traditionally and customarily received tips, including —

(A) cosmetology,

(B) hospitality,

(C) food and beverage service,

(D) parking attendants, and

(E) custodial service.”).

270. H.R. 9624 § 2; H.R. 1314 § 2.

271. *Tipped Income Protection and Support (TIPS) Act*, CONGRESSMAN STEVEN HORSFORD (Mar. 10, 2025), <http://horsford.house.gov/issues/tipped-income-protection-and-support-tips-act>.

potential employer incentives under other proposals to shift compensation to tips, thereby transferring the compensation burden to customers while benefiting from the section 45B FICA tip tax credit.

Since the TIPS Act would have retained tips as earned income and left AGI unchanged, tips would have continued to be included in the calculation of refundable tax credits such as the EITC and CTC. This structure would have provided similar advantages to workers in the phase-in ranges of these credits, allowing them to maximize their refundable amounts, but it also would have posed disadvantages for workers in the phase-out range, where higher reported income can reduce or eliminate credit eligibility. Moreover, both employers and employees would have continued paying Social Security and Medicare taxes on tip income. However, the future of the section 45B FICA tip tax credit would have become uncertain.

ii. Judy's Situation under the TIPS Act

Under the TIPS Act, Judy's base wage increases from \$2.13 to \$7.25/hour, raising her gross income to \$40,240.²⁷² Judy would then pay \$3,078.36 in payroll taxes ($\$40,240 \times 0.0765$), with her employer matching the same amount. While this increase represents a higher immediate tax burden, both Judy and her employer would be contributing more to Social Security and Medicare. These increased contributions would improve Judy's future retirement benefits, as her higher earnings would be credited to her Social Security record, potentially leading to larger monthly payments once she retires.

Despite this increase in her payroll taxes, she would be eligible for a deduction for her tip income. This deduction follows the same "between-the-line" structure as in the No Tax on Tips Act and OBBBA, affecting taxable income but not AGI. With \$25,740 in qualified tip deductions, Judy's taxable income would be reduced to \$14,500 ($\$40,240 - \$25,740$). After applying the \$21,900 head-of-household standard deduction, her taxable income would be zero, eliminating her federal tax liability.

However, the higher income pushes Judy into the phase-out range of the EITC, reducing her credit from \$3,046 to \$1,416.²⁷³ She still qualifies for the full \$1,700 refundable CTC, bringing her total refund to \$3,116—a \$1,120 decrease from the pre-OBBBA system.

The future of the Section 45B FICA tip tax credit under the TIPS Act presents two possible scenarios. If tips no longer qualify as "excess" over the minimum wage, Tip Jar Tavern would lose access to the section 45B credit. Alternatively, if all tips are considered "excess" under Section 45B, since they are now paid in

272. Under the TIPS Act, Judy's employer would be required to pay her a base wage of \$7.25 per hour instead of the current \$2.13. This would increase her base wage from \$4,260 to \$14,500 ($\$7.25/\text{hour} \times 40 \text{ hours/week} \times 50 \text{ weeks}$). Consequently, her gross income would rise from \$30,000 to \$40,240.

273. This result was obtained by inputting the information from this example in the IRS's EITC Assistant. See *Use the EITC Assistant*, *supra* note 146.

addition to the full minimum wage, Tip Jar Tavern would qualify for a higher deduction. The employer could claim a credit of \$1,969.11, based on Judy's total tip income of \$25,740 multiplied by the FICA tax rate of 7.65%. This additional tax relief could help offset some of the increased payroll and wage costs under the new system.

This Article posits that the second scenario is the likelier outcome, as it aligns with the rationale behind Section 45B, which is to provide employers with an incentive to continue reporting tip income and paying payroll taxes on it. Furthermore, there is little doubt that the restaurant industry, which has been highly protective of Section 45B, would not relinquish this favored provision without a prolonged judicial fight to defend its applicability under the new wage framework.

Finally, Judy's increased income disqualifies her from Section 8 and SNAP,²⁷⁴ as well as Children's Medicaid for her son Anwar. Anwar would still qualify for CHIP, but the family would lose access to deeper means-tested benefits. With respect to ACA coverage, Judy's MAGI would rise to \$40,240 once her base wage increases to the full federal minimum wage, placing her at approximately 197% of the Federal Poverty Level rather than 147%.²⁷⁵ At this higher income level, she would still qualify for Marketplace subsidies, but the value of her premium tax credit would decline—from fully covering a \$0-premium silver plan to covering roughly 87% of the premium—leaving her responsible for about \$63 per month.²⁷⁶

3. Exclusion Models: Removing Tips from the Tax Base

Unlike deduction models, which preserve tips within gross income to maintain eligibility for credits and payroll taxes, exclusion models treat tips as wholly exempt from income and, in some cases, payroll taxes. The Tip Tax Termination Act and Tax Free Tips Act exemplify this approach, offering immediate relief but raising serious concerns about equity, compliance, and long-term worker security.

a. Tip Tax Termination Act

Introduced by Rep. Don Bacon (R-NE) in April 2024, the Tip Tax Termination Act (H.R. 8299) sought to exempt up to \$20,000 in annual tips from both income and payroll taxes for a five-year period. The proposal was reintroduced in the 119th Congress as H.R. 558 with significant revisions but ultimately failed to advance.

i. Proposal Breakdown

The proposal aims to exempt tips from both income and payroll taxes for a five-year period. The bill states that, “[g]ross income shall not include so much of the eligible tips received by an individual during the taxable year as does not

274. For Section 8 housing assistance and SNAP, Judy's increased gross income would exceed the cutoffs for both Section 8's "very low income" threshold and SNAP's gross and net income tests for a two-person household, effectively disqualifying her from these programs unless her household size grew.

275. *Federal Poverty Level (FPL) - Glossary*, *supra* note 208.

276. *2024 Health Insurance Marketplace Calculator*, *supra* note 210.

exceed \$20,000,” with eligible tips defined as “amounts received while performing services which constitute employment in a position which generally relies on tips as part of wages, including cosmetology, hospitality, and food service.”²⁷⁷

Although the measure is intended to support lower-income workers, it is not well-targeted. The exclusion is applied consistently across all income levels, which means higher-income taxpayers can also take advantage of it.²⁷⁸ For example, a worker with \$100,000 in tips would still be eligible to exclude \$20,000 from taxation. There is no phaseout for the exemption. Additionally, the threshold is based solely on tip income rather than AGI.²⁷⁹ Consequently, a taxpayer with an AGI of \$150,000 from non-tip income could still exclude the full \$20,000 in tips from taxable income. The bill also raises concerns about potential misuse, as it could encourage industries to restructure their pricing models by lowering base fees and relying more on tips to provide tax-free compensation.²⁸⁰ Without a more clearly defined list of eligible occupations or restrictions tied to pre-existing industry practices, the risk of income reclassification remains high.²⁸¹

To address the impact of the exemption on tax credits, the bill specifies that excluded tips must still be factored in when determining eligibility for the EITC and CTC.²⁸² While this allows lower-income workers in the EITC phase-in range to maximize their credits, it has the opposite effect on those in the phaseout range.

The proposal exempts tips up to the \$20,000 limit from both employee and employer contributions to Social Security and Medicare payroll taxes. While this provides an immediate financial benefit to workers by reducing their payroll tax obligations, it also eliminates the employer tax credit under section 45B, which offsets payroll taxes on tipped income.²⁸³ More importantly, removing tips from payroll tax calculations could result in reduced Social Security benefits for workers in retirement.

To address the impact on the Social Security trust funds, the bill includes a provision titled “Trust Funds Held Harmless,” which mandates transfers from the general fund to cover lost revenue.²⁸⁴ However, while this protects the trust funds, it does not safeguard tipped employees, as their tips would no longer contribute to retirement benefit calculations, nor would their employers continue to benefit from the Section 45B subsidy.²⁸⁵

The Tip Tax Termination Act was reintroduced in the 119th Congress as H.R. 558, a new iteration that made several notable departures from its 2024 predecessor but ultimately did not progress. Most significantly, the new version dropped

277. Tip Tax Termination Act, H.R. 7870, 118th Cong. § 2 (2024).

278. Zelenak, *supra* note 108, at 246–47.

279. *Id.*

280. *Id.* at 16.

281. *Id.*

282. H.R. 7870 § 2.

283. *Id.* at 18–19.

284. H.R. 7870 § 2(b)(1)(B); Zelenak, *supra* note 108, at 249.

285. Zelenak, *supra* note 108, at 248–49.

the payroll tax exemption entirely, preserving only the exclusion of up to \$20,000 in tip income from federal income taxes.²⁸⁶ It also eliminated the “Trust Funds Held Harmless” provision, which had been included to offset the lost payroll tax revenue to Social Security and Medicare.²⁸⁷ At the same time, it retained the provision ensuring that excluded tip income is still counted for purposes of the EITC and CTC.²⁸⁸ Notably, several features remained unchanged: the proposal still lacked an income cap or phaseout and continued to rely on an open-ended occupational definition vulnerable to abuse.

ii. Judy’s Situation under the Tip Tax Termination Act

Under the 2024 version, Judy’s payroll tax liability would drop from \$2,295 to \$765, giving her immediate relief but reducing the amount of income credited toward Judy’s Social Security benefits. Over time, this could lower her future retirement benefits unless the proposal’s provision to compensate the Social Security trust funds with general fund transfers adequately addresses this shortfall. Excluding \$20,000 in tips would eliminate her federal income tax liability and increase her refund from \$4,236 to approximately \$4,746 (due to the full refundability of the EITC and CTC amounts she remains eligible for).²⁸⁹ Her employer would lose the full \$1,507 FICA tip tax credit, which could lead to downward pressure on wages.²⁹⁰

Despite the exclusion of tip income from taxes, Judy’s gross income would still count as \$30,000 for Section 8 and SNAP eligibility, but her MAGI would fall to \$10,000, making her son eligible for Children’s Medicaid rather than CHIP.²⁹¹ Her MAGI would be only about 49% of the Federal Poverty Level for a household of two.²⁹² Because Texas has not expanded Medicaid, adults at this income level do not qualify for Medicaid unless they meet narrow categorical

286. Tip Tax Termination Act, H.R. 558, 119th Cong. § 2(a) (2025).

287. *Id.*

288. *Id.*

289. Judy’s taxable income under the pre-OBBBA system is \$8,100 after applying the standard deduction. However, if \$20,000 of her tips were excluded from taxable income, her gross income would decrease to \$10,000 (\$4,260 base wages + \$5,740 in taxable tips). After the \$21,900 head-of-household standard deduction, Judy’s taxable income would be reduced to zero, eliminating her federal income tax liability entirely. Since she would no longer have any tax liability, the entire \$3,046 EITC would be added to her refund, along with the \$1,700 ACTC, resulting in a total refund of \$4,746 (\$3,046 + \$1,700).

290. With a total annual tip income of \$25,740, only \$5,740 would remain taxable after the \$20,000 exemption. However, Judy needs \$6,040 in tips annually to meet the threshold set by Section 45B, meaning the remaining taxable tips do not exceed this threshold. As a result, there are no ‘excess tips’ eligible for the Section 45B credit, and the employer would lose the full \$1,507.05 credit it currently receives.

291. If \$20,000 of Judy’s \$25,740 in tip income is excluded from gross income under the Act, her MAGI would drop from \$30,000 to \$10,000 which equates to \$833/month. In Texas, a single parent must have gross monthly income below \$196 to qualify for Medicaid as a parent, so Judy would still be ineligible even under the reduced income. But her son Anwar would now qualify for Children’s Medicaid, which has a higher income cap of \$2,345/month for a household of two.

292. *Federal Poverty Level (FPL) - Glossary, supra* note 208.

criteria (such as pregnancy or disability).²⁹³ At the same time, under I.R.C. § 36B, individuals below 100% of FPL are not eligible for Marketplace premium tax credits. As a result, Judy would not qualify for subsidized ACA Marketplace coverage.²⁹⁴

By contrast, the 2025 version excludes tips only from income taxes, not payroll taxes. Judy would still receive the increased refund of \$4,746, but her payroll tax payments—and retirement benefit calculations—would remain unchanged. Her employer would continue to claim the full Section 45B credit. Like the 2024 version, this proposal would likely make Anwar eligible for Medicaid. However, Judy would no longer qualify for subsidized ACA Marketplace coverage.

b. Tax Free Tips Act of 2024

Introduced by Rep. Thomas Massie (R-KY) in June 2024, the Tax Free Tips Act (H.R. 8785) seeks to exempt tips from both income and payroll taxes by classifying them as tax-exempt gifts. Interestingly, it was not reintroduced in the 119th Congress.

i. Proposal Breakdown

The bill states that “tips shall be treated as property transferred by gift,” defining tips as “any gratuity provided to a salaried employee by a customer or client of the employer’s business.”²⁹⁵ Accordingly, the proposal places tips entirely outside the scope of taxable income under IRC Section 102.²⁹⁶

Unlike the Tip Tax Termination Act, which limits exemptions to \$20,000 in tips and restricts eligibility to traditionally tipped occupations such as food service or hospitality, this bill adopts a far broader definition of tips. It imposes no restrictions based on occupation, income level, or amount, granting industries where tipping is not customary significant flexibility to reclassify portions of compensation as tax-free tips. Furthermore, this reclassification could have unintended consequences in traditionally tipped industries, such as wage suppression. Employers might reduce base wages and shift a larger share of compensation to tips, expecting employees to rely on gratuities to cover the shortfall.

Moreover, this approach affects refundable tax credits such as the EITC and CTC. Since tips would no longer count as earned income, workers in the phase-in range of these credits could lose out on crucial financial support. These workers would report lower earned income, resulting in smaller credits. On the other hand,

293. See, e.g., Ann Kelleth, *Texas Is One of Just 10 States That Did Not Expand Medicaid under the Affordable Care Act—but What Do We Know About the Impact?*, TEX. A&M HEALTH (June 27, 2024), <https://vitalrecord.tamu.edu/texas-is-one-of-just-10-states-that-did-not-expand-medicaid-under-the-affordable-care-act-but-little-is-known-about-the-impact/> [https://perma.cc/9QYP-AKNH].

294. I.R.C. § 36B(c).

295. Tax Free Tips Act of 2024, H.R. 8785, 118th Cong. § 2 (2024).

296. I.R.C. § 102 (“Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance.”).

workers in the phaseout range may benefit from reporting lower income, preserving or increasing their credit amounts.

The bill also exempts tips from payroll taxes, eliminating both employee and employer contributions to Social Security and Medicare.²⁹⁷ While this offers immediate financial relief, it risks undermining employees' long-term financial security. Under the current system, a worker's future Social Security benefits are calculated based on their lifetime earnings that are subject to payroll taxes. If tip income is excluded from this calculation, workers like Judy could see a significant reduction in their Average Indexed Monthly Earnings (AIME), resulting in lower retirement benefits.²⁹⁸ Although Social Security taxes paid today fund benefits for current retirees—not the contributor's own future benefits—the level of future benefits depends on the amount of earnings that are reported and taxed over a worker's lifetime.

Additionally, employers would lose access to the Section 45B FICA tip tax credit, which helps offset payroll taxes on tips. In contrast, the Tip Tax Termination Act attempted to mitigate this issue by including a provision for general fund transfers to the Social Security trust funds, but the Tax Free Tips Act offers no such safeguard, exacerbating the risk to workers' future financial stability.

ii. Judy's Situation under the Tax Free Tips Act

Under this proposal, Judy's payroll tax liability would fall dramatically from \$2,295 to just \$326, since all \$25,740 of her tips would be exempt—leaving only her \$4,260 base wage subject to Social Security and Medicare taxes.²⁹⁹ Her employer's matching obligation would decrease by the same amount. While this provides immediate relief, it would severely reduce her credited earnings, potentially shrinking her future retirement benefits.

Her federal income tax liability would be eliminated, and her taxable income would drop to zero.³⁰⁰ However, because refundable tax credits like the EITC and ACTC are calculated based on reported earned income, Judy's credits would plummet: her EITC would fall from \$3,046 to \$1,454,³⁰¹ and her ACTC would drop from \$1,700 to just \$264,³⁰² cutting her total refund by more than half from \$4,236 to \$1,718.

297. H.R. 8785 § 2.

298. See generally *Social Security Benefit Amounts*, *supra* note 139.

299. $4,260 \times 7.65\% = \$325.89$.

300. If the Tax Free Tips Act were enacted, Judy's gross income for tax purposes would consist solely of her base wages of \$4,260, as her tips would be fully excluded. After applying the \$21,900 head-of-household standard deduction, her taxable income would be zero. This would eliminate her \$810 federal tax liability and reduce her income tax burden to nothing.

301. This result was obtained by inputting the information from this example in the IRS's EITC Assistant. See *Use the EITC Assistant*, *supra* note 146.

302. The ACTC is calculated as 15% of earned income exceeding \$2,500. With her base wages of \$4,260, Judy would qualify for an ACTC of \$264 ($(4,260 - 2,500) \times 0.15$).

Her employer would lose the entire \$1,507 Section 45B tax credit, removing a key incentive for reporting tip income.³⁰³ Without a replacement for the FICA tip tax credit, employers like Tip Jar Tavern may be incentivized to shift more compensation toward tips and reduce base wages to maximize the tax exemption. This could lead to wage suppression, particularly in traditionally tipped industries, as workers become increasingly dependent on customer gratuities to sustain their earnings.

For means-tested benefits, Judy's gross income would likely still be treated as \$30,000 under Section 8 and SNAP eligibility rules, absent regulatory changes. But for Medicaid and CHIP, her MAGI would fall to \$4,260 annually—well below the \$2,345/month threshold for Children's Medicaid in Texas. As a result, Anwar would newly qualify for full Medicaid coverage, offering more generous benefits than CHIP. At the same time, Judy would stop qualifying for subsidized ACA Marketplace coverage.³⁰⁴

Tables 1 and 2 summarize the comparative effects of the major tip-tax reform proposals discussed above. Table 1 summarizes each proposal's effects on Judy's tax and pay structure, including federal income and payroll tax treatment, refundable credits, base wages, as well as the employer-side § 45B implications and reclassification risks. Table 2 summarizes how the same proposals interact with means-tested safety-net programs, showing their effects on eligibility and benefit levels beyond the tax system. The tables synthesize results already developed in Parts II and III, allowing for side-by-side comparison of how deduction-based, exclusion-based, and hybrid approaches differ in their consequences. Read together, they make clear how design choices that appear modest at the tax level can generate sharply divergent outcomes for low-income workers once interactions with refundable credits and social programs are taken into account.

4. The National Restaurant Association's Preferred Proposal

The National Restaurant Association's (NRA) sharply divergent reactions to the No Tax on Tips Act of 2025 and the Tipped Income Protection and Support (TIPS) Act offer a revealing window into the power dynamics underlying tip tax reform.³⁰⁵ While both bills aim to reduce or eliminate income tax on tips, the NRA's embrace of one and rejection of the other underscores that the stakes are more than just tax policy, but also the preservation of a wage system designed to protect employer margins at the expense of labor equity.

303. Given that tips are excluded from payroll taxes under the Tax Free Tips Act, the employer would no longer have any taxable tips to claim under section 45B, resulting in the complete loss of the credit.

304. This is because her MAGI would fall to around 21% of the FPL. *Federal Poverty Level (FPL) - Glossary*, *supra* note 208.

305. No public statements from the National Restaurant Association were found regarding the Tip Tax Termination Act, the Tax Free Tips Act, or the 2024 version of the No Tax on Tips Act (S. 4621/H.R. 8941).

TABLE 1: COMPARATIVE TAX EFFECTS OF TIP TAX MEASURES

Measure	Effect on Payroll Taxation of Tips	Effect on Income Taxation of Tips	Effect on EITC/ CTC	Effect on Wage Floor (Base Wage)	Risk of Reclassification	Effect on Section 45B Credit
OBGBA	No change	Deductible up to \$25K ; phases out gradually starting at \$150K AGI (\$300K joint)	Retained	No change (subminimum wage remains)	Low	Expanded to include beauty service establishments but retains 2007 wage benchmark
No Tax on Tips Act (2025)	No change	Deductible up to \$25K (phases out at \$160K)	Retained	No change (subminimum wage remains)	Low	Expanded (now includes beauty service establishments)
No Tax on Tips Act (2024)	No change	Deductible (lowers taxable income)	Retained	No change (subminimum wage remains)	High	Preserved
TIPS Act	No change	Deductible (phases out at \$112.5K)	Retained but Judy's EITC reduced due to higher earnings	Base wage raised to \$7.25/hr (subminimum wage eliminated)	Moderate	May be litigated
Tip Tax Termination Act (2025)	No change	Exempt up to \$20K	Retained	No change (subminimum wage remains)	High	Preserved
Tip Tax Termination Act (2024)	Exempt up to \$20K	Exempt up to \$20K	Retained	No change (subminimum wage remains)	High	Reduced
Tax Free Tips Act	Fully exempt	Fully exempt (tips treated as gifts)	Reduced	No change (subminimum wage remains)	Very High	Eliminated

TABLE 2: COMPARATIVE EFFECTS ON NON-TAX BENEFITS

Measure	Effect on Section 8 Housing Eligibility	Effect on SNAP Eligibility	Effect on Medicaid Eligibility and ACA Marketplace Coverage (Judy)	Effect on Medicaid Eligibility (Anwar)
OBGBA	No definitional change—tips still counted as income under HUD rules (24 C.F.R. § 5.609); lower funding may constrain voucher access	No definitional change; reduced funding may lower benefits	Still not eligible for Medicaid (Texas income threshold unchanged) No change in ACA coverage	No improvement (only eligible for CHIP); new rules may reduce retroactive coverage
No Tax on Tips Act (2025)	No direct change	No direct change	Still not eligible for Medicaid No change in ACA coverage	No improvement (only eligible for CHIP)
No Tax on Tips Act (2024)	No direct change	No direct change	Still not eligible for Medicaid No change in ACA coverage	No improvement (only eligible for CHIP)
TIPS Act	Reduced eligibility (no longer considered “very low income”)	Reduced eligibility	Still not eligible for Medicaid No change in ACA coverage	No improvement (only eligible for CHIP)
Tip Tax Termination Act (2025)	No direct change	No direct change	Still not eligible for Medicaid Loss of ACA coverage	Anwar gains eligibility
Tip Tax Termination Act (2024)	No direct change	No direct change	Still not eligible for Medicaid Loss of ACA coverage	Anwar gains eligibility
Tax Free Tips Act	No direct change	No direct change	Still not eligible for Medicaid Loss of ACA coverage	Anwar gains eligibility

In a statement supporting the 2025 No Tax on Tips Act, the NRA praised the proposal as “sensible legislation” that would “put cash back in the pocket of a significant number of workers” and “help restaurant operators recruit industry workforce.”³⁰⁶ Framing the bill as both fiscally responsible and beneficial to workers, the NRA positioned itself as a champion of pragmatic tax reform. Notably, the bill preserves the tip credit and locks in favorable treatment for restaurant employers under Section 45B by maintaining the outdated 2007 minimum wage benchmark. As discussed earlier in this Part, this provision gives food and beverage establishments a significantly higher tax credit than other tipped industries—a structural advantage that appears custom-built for the NRA’s membership.

By contrast, the NRA’s response to the TIPS Act was blistering. While the bill also offers tip tax relief, it does so alongside a repeal of the subminimum wage for tipped workers, requiring employers to pay tipped workers the full federal minimum wage. The NRA denounced this as a “lose-lose-lose proposal,” warning it would “damage [servers’] earning potential and take money from them,” force operators to “cut hours and jobs,” and “increase menu prices.”³⁰⁷ Though couched in concern for workers, the statement reflects a core industry fear: that eliminating the tip credit would redistribute labor costs from customers back to employers.

These responses are consistent with the historical role the NRA has played in shaping the American tipping system—first detailed in Part I. As previously explained, in the 1990s, under Herman Cain’s leadership, the National Restaurant Association successfully lobbied to freeze the tipped minimum wage at \$2.13 per hour and to institutionalize the tip credit in the FLSA. What emerges in the 2025 legislative landscape is not a shift in philosophy but a continuation of the same strategy: support federal tax relief for tipped workers, but only on the condition that employers retain the ability to pay subminimum wages and claim generous payroll tax credits on tip income subsidized by customers.

In short, the 2025 iteration of the No Tax on Tips Act is the NRA’s preferred proposal not because it helps workers—though it may—but because it helps employers most. By contrast, the TIPS Act challenges the very architecture of the tipping system the NRA has spent decades defending. The difference in support is as much about who pays as it is about who benefits. Unsurprisingly, the NRA embraced the passage of OBBBA with open arms.³⁰⁸

306. *National Restaurant Association Statement on the Introduction of the No Tax on Tips Act of 2025*, NAT’L REST. ASS’N (Jan. 16, 2025), <https://restaurant.org/research-and-media/media/press-releases/national-restaurant-association-statement-on-the-introduction-of-the-no-tax-on-tips-act-of-2025/> [<https://perma.cc/SUY2-QGBB>].

307. *National Restaurant Association Statement on the Introduction of the TIPS Act*, NAT’L REST. ASS’N (Sept. 17, 2024), <https://restaurant.org/research-and-media/media/press-releases/national-restaurant-association-statement-on-the-introduction-of-the-tips-act/> [<https://perma.cc/2VY3-UURD>].

308. *One Big, Beautiful Bill Tax Policies Will Fuel the Restaurant Industry and U.S. Economy*, NAT’L REST. ASS’N (July 3, 2025), <https://www.restaurant.org/research-and-media/media/press-releases/tax-policies-in-the-one-big-beautiful-bill-will-fuel-the-restaurant-industry-and-us-economy/> [<https://perma.cc/7LCF-9X2Y>].

5. An Ideal Hybrid: This Article's Proposal

Building on the strengths and correcting the shortcomings of the proposals examined, this article advances a hybrid framework that centers both labor justice and low-income targeting. Like the TIPS Act and the No Tax on Tips Act, the hybrid proposal adopts a between-the-line deduction structure that allows taxpayers to claim the deduction without itemizing. Ideally, widely used tax software platforms such as TurboTax and TaxSlayer will offer a simple way to claim this deduction. This structure has the added benefit of retaining tips within gross income, thereby preserving eligibility for refundable tax credits and means-tested benefits, while also subjecting tips to payroll taxation to protect long-term Social Security entitlements.

To better target relief, the hybrid framework replaces the TIPS Act's \$112,500 AGI threshold with a more modest cap of \$75,000. This figure reflects the amount that economists Emmanuel Saez and Gabriel Zucman identify as both the average income of the American middle class and the national average.³⁰⁹ It ensures the deduction is focused on low- and middle-income workers, avoids windfalls to higher earners, and helps contain the policy's fiscal cost. From a distributional perspective, the cap comfortably encompasses the vast majority of tipped workers: according to the Bureau of Labor Statistics, the median annual income for waiters and waitresses in 2023 was just \$31,940, while even those at the 90th percentile earned only \$60,100.³¹⁰

A \$75,000 cutoff thus benefits nearly all tipped workers while excluding a narrow band of high earners whose compensation already exceeds typical industry standards. This approach strikes a balance between equity and revenue constraints, directing relief to those most likely to experience income insecurity. In contrast to OBBBA's expansive phase-out—which allows earners making up to \$400,000 to claim partial benefits—the hybrid proposal adopts a clear and modest income ceiling that better reflects the earning realities of the tipped workforce.

The proposal also incorporates the more enforceable occupational safeguards found in the 2025 No Tax on Tips Act by directing the Treasury to issue a definitive list of “traditionally and customarily” tipped occupations. To discourage strategic reclassification, the occupational list should remain fixed over time—ensuring that new professions cannot game the system by gradually restructuring compensation to qualify for future inclusion. It also retains the \$25,000 annual cap on deductible tip income to prevent excessive losses to the tax base.

To address the exclusion of foreign-born workers and reinforce principles of tax equity, the hybrid proposal permits eligible taxpayers to claim the deduction using either a Social Security Number or an Individual Taxpayer Identification Number (ITIN). This inclusion recognizes the vital contributions of ITIN filers to the restaurant and service industries and avoids creating a second-class taxpayer status.

309. SAEZ & ZUCMAN, *supra* note 21, 2–4.

310. *Waiters and Waitresses: Occupational Employment and Wages*, *supra* note 233.

Finally, to avoid penalizing vulnerable households, the hybrid framework does not condition the deduction on filing jointly. This design choice ensures that mixed-status families and low-income dual-earner households are not excluded from tax relief due to their marital or immigration status. In doing so, the hybrid proposal affirms that targeted relief should not come at the cost of equity, access, or administrative fairness.

Taken together, these elements offer a fiscally responsible, equitable, and administratively viable alternative—one that affirms the dignity of low-wage work while protecting the integrity of the tax system from exploitation by higher earners and employers alike.

B. Beyond the Slogan: Unpacking the Effects of the Proposals

While the legislative measures analyzed in Part III.A promise tax relief for tipped workers, their broader implications warrant closer scrutiny. This subsection examines the systemic effects of these reforms. These considerations reveal how narrowly targeted tax relief can carry far-reaching implications for labor markets, revenue systems, and distributive equity.

1. Revenue Loss

The revenue impact of OBBBA's tip tax deduction is substantial. According to the Joint Committee on Taxation (JCT), the "No Tax on Tips" provision is projected to cost approximately \$31–32 billion between 2025 and its scheduled expiration in 2028.³¹¹ If Congress were to make the deduction permanent rather than allowing it to sunset, the JCT's figures imply a static ten-year revenue loss of roughly \$80–90 billion, assuming comparable annual costs across the budget window.³¹²

These estimates exclude the additional fiscal impact of the Section 45B expansion. As noted in Part II, Treasury estimates that Section 45B will cost \$1.7 billion in 2025, rising to \$2.42 billion by 2033; however, those projections reflect the credit as in effect under prior law and therefore do not include the revenue loss from the expansion to beauty-service establishments enacted under OBBBA.³¹³ Although no official projections exist for the cost of extending Section 45B to new industries, the fiscal burden would likely increase substantially as more sectors become eligible for the subsidy. Moreover, as the JCT notes in its revenue effects, the expanded Section 45B credit does not sunset in 2028, resulting in a continuing revenue loss for

311. JOINT COMM. ON TAX'N, 119TH CONG., ESTIMATED REVENUE EFFECTS RELATIVE TO THE PRESENT LAW BASELINE OF THE TAX PROVISIONS IN "TITLE VII – FINANCE" OF THE SUBSTITUTE LEGISLATION AS PASSED BY THE SENATE TO PROVIDE FOR RECONCILIATION OF THE FISCAL YEAR 2025 BUDGET, JCX-35-25, at 2 (2025) [<https://perma.cc/XDX4-EBZC>].

312. This extrapolation is based on the JCT's annual averages and is not an official JCT projection. *See also What's In the One Big Beautiful Bill Act?*, COMM. FOR A RESPONSIBLE FED. BUDGET (July 22, 2025), <https://www.crfb.org/blogs/whats-one-big-beautiful-bill-act> [<https://perma.cc/MV2H-YAS3>].

313. U.S. DEP'T OF THE TREAS., *supra* note 128, at 9.

a tax incentive that could encourage employers in informal or cash-based industries to reclassify ordinary income as tips.³¹⁴

These revenue-loss estimates matter because, in the aggregate, OBBBA is projected to significantly erode federal revenues. According to JCT estimates, the law is expected to reduce federal revenues by about \$4.5 trillion.³¹⁵ These effects are partially offset by about \$1.4 trillion in spending cuts, mainly from reforms to Medicaid, SNAP, and federal student loan programs.³¹⁶ Furthermore, OBBBA will significantly worsen the U.S. fiscal outlook. The law is projected to raise public debt by \$19 trillion over 30 years (and up to \$32 trillion if temporary provisions are made permanent), while pushing debt toward 176% of GDP (or 191% in the permanent scenario).³¹⁷

Although marketed as relief for service workers and the middle class, OBBBA's "No Tax on Tips" deduction illustrates a stark mismatch between rhetoric and reality.³¹⁸ As outlined earlier, only about 3% of all tax units stand to benefit from the provision, which means the vast majority of low-income workers, including most tipped employees, will see no meaningful tax relief.³¹⁹ Yet this narrowly targeted deduction carries an outsized fiscal cost. In this light, the tip deduction's symbolic appeal as "worker relief" masks its distributive asymmetry: a policy framed as helping low-wage workers contributes to a fiscal framework that deepens inequality by eroding the very social safety nets on which those workers rely.

2. Distributional and Administrative Implications

A final concern that has been noted is that the tip tax deduction may encourage employers and workers to restructure compensation to maximize tip-based income, rather than wages.³²⁰ Because only tips—not wages—qualify for the deduction, firms in sectors that do not currently rely on tipping may begin shifting compensation toward gratuities, effectively extending the restaurant tipping

314. JOINT COMM. ON TAX'N, *supra* note 311, at 9.

315. *Id.* at 7.

316. Andrew Lautz, *What Does the One Big Beautiful Bill Cost?*, BIPARTISAN POL'Y CTR. (July 23, 2025), <https://bipartisanpolicy.org/explainer/what-does-the-one-big-beautiful-bill-cost/> [<https://perma.cc/ZJ3A-ZKAJ>].

317. *The 30-Year Cost of OBBBA*, COMM. FOR A RESPONSIBLE FED. BUDGET (July 15, 2025), <https://www.crfb.org/blogs/30-year-cost-obbba> [<https://perma.cc/RZ5B-EZW8>].

318. See, e.g., Johnny Rubin, *No Tax on Tips: \$1,300 Tax Cut for Waitresses, Not Billionaires*, U.S. H. COMM. ON WAYS & MEANS (Aug. 11, 2025), <https://waysandmeans.house.gov/2025/08/11/no-tax-on-tips-1300-tax-cut-for-waitresses-not-billionaires/> [<https://perma.cc/VN2K-XE6K>] (press release from the House Committee on Ways and Means framing the "No Tax on Tips" deduction as a \$1,300 tax cut for service workers and emphasizing it as targeted relief for working Americans).

319. TAX POL'Y CTR., *supra* note 234.

320. Zelenak, *supra* note 108, at 247; Alex Muresianu, *Frustrated with Tipping? No Tax on Tips Could Make It Worse*, TAX FOUND. (July 23, 2024), <https://taxfoundation.org/blog/tipping-trump-tax-on-tips/> [<https://perma.cc/AC2Q-CP86>]; Ian Berlin & William G. Gale, *No Tax on Tips: An Answer in Search of a Question*, BROOKINGS (Sept. 17, 2024), <https://www.brookings.edu/articles/no-tax-on-tips-an-answer-in-search-of-a-question/> [<https://perma.cc/D7LU-ZRPB>].

model into new industries. In this way, the deduction risks reallocating compensation from employer-funded wages to customer-funded tips, without meaningfully improving take-home pay for low-wage tipped workers who already owe minimal income tax.

This shift could inadvertently harm rather than help tipped workers. Most tipped employees already owe little or no federal income tax, so the proposals offer minimal benefit.³²¹ Worse, they could undermine efforts to raise the tipped minimum wage. Service workers at lower-end establishments, where tips are modest, would suffer the most, as would “back of the house” staff—such as dishwashers—who receive small tip shares.³²² These workers may lose opportunities for higher wages without gaining significant financial relief. Tax exemptions for tips may distort labor pricing by reducing employer pressure to raise base wages, effectively shifting the responsibility for worker compensation from the payroll to the tax code.

The potential for gaming is addressed in part by Treasury’s requirement to publish a definitive list of occupations traditionally receiving tips, which offers some clarity and helps curb gaming.³²³ But the OBBBA deduction’s generous graduated phase-out—extending eligibility to taxpayers with MAGIs up to \$400,000—raises concerns about which industries will ultimately benefit from the provision. To illustrate the distributional reach of the deduction beyond low-wage service workers, consider the simplified example of Brody Masters, a self-employed podcast host and digital content creator in Texas, a category expressly included on Treasury’s list of “occupations that customarily and regularly received tips.”³²⁴

Brody earns \$150,000 in gross receipts annually, of which \$25,000 consists of qualified tips from livestreams and subscription platforms. He incurs \$50,000 in ordinary and necessary business expenses for editing services, studio rental, software, and production support, leaving \$100,000 in net business income. As a single filer, Brody claims the standard deduction of \$14,600, which reduces taxable income to \$85,400 before the tip deduction.³²⁵ Because § 224(c) permits self-employed individuals to deduct qualified tips only to the extent that gross business income (\$150,000 in the present example) exceeds allocable business deductions (\$50,000), Brody may deduct the full \$25,000.³²⁶ The deduction reduces taxable income resulting in a new taxable income of \$60,400. Brody’s federal income-tax liability

321. Howard Gleckman, *Untipped: Why Trump’s Tax Cut Promise Would Hurt Many Service Workers*, TAX POL’Y CTR. (June 17, 2024), <https://taxpolicycenter.org/taxvox/untipped-why-trumps-tax-cut-promise-would-hurt-many-service-workers> [<https://perma.cc/JCW7-NTLX>].

322. *Id.*

323. H.R. 1, 119th Cong. § 70201(h) (2025) (enacted).

324. This would fall under TTOC occupation 209 “Digital Content Creators.” I.R.S., Occupations That Customarily and Regularly Received Tips; Definition of Qualified Tips, 90 Fed. Reg. 45340, 45358 (Sept. 22, 2025) (to be codified at 26 C.F.R. pt. 1).

325. All dollar figures for tax brackets and standard deductions are stated in 2024 terms for simplicity and to maintain comparability across hypothetical examples. Inflation adjustments for 2025 and later years would modestly alter the numerical values but not the distributional analysis. *Federal Income Tax Rates and Brackets*, *supra* note 143.

326. I.R.C. § 224(c).

therefore falls from approximately \$13,841 under the pre-OBBA system to \$8,341, producing a tax savings of about \$5,500 solely by removing \$25,000 of tip income from the taxable base while still treating it as earned income for payroll-tax and credit eligibility purposes.³²⁷

Although Brody and Judy both work in occupations that “customarily and regularly receive tips,” the distributional stakes of the deduction differ sharply. For Judy, the deduction eliminates a modest \$810 federal income-tax liability and slightly increases her refund, but it does not alter her underlying economic vulnerability: her hourly wage remains below the minimum, her employer continues to rely on customer gratuities to meet wage obligations, and her long-term earnings remain constrained. By contrast, Brody earns a six-figure income in an occupation not tied to the subminimum wage and already insulated from the economic precarity historically associated with tipped labor. Yet Brody receives a tax benefit nearly seven times larger than Judy’s, despite experiencing none of the structural risks the deduction is purported to address. To be sure, Brody is not representative of the typical tipped worker; the example instead illustrates the breadth of the deduction’s reach and the possibility that higher-earning taxpayers in newly recognized “tipped” occupations may reap substantial benefits. The provision thus extends disproportionately larger benefits to higher-income taxpayers who are not reliant on tips to achieve a living wage, while providing relatively modest relief to the low-wage service workers invoked rhetorically to justify the policy.

Additionally, the proposed IRS regulations under § 224 raise application concerns. The regulations specify that “qualified tips” do not include those received in the course of a trade or business that is a Specified Service Trade or Business (SSTB) as defined in § 199A(d)(2).³²⁸ That limitation encompasses services performed in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, and any trade or business whose principal asset is the reputation or skill of its workers.³²⁹

Reconciling this SSTB exclusion with Treasury’s tipped-occupation categories for entertainment workers (TTOC 205–209) creates ambiguity for both taxpayers and the IRS.³³⁰ Treasury’s list classifies singers, musicians, dancers, and even digital content creators as “traditionally tipped,” yet IRC § 224(d)(2)(B) simultaneously disqualifies tips earned in SSTBs such as the performing arts.³³¹ The result is that the same activity—say, a wedding singer or a magician—may yield qualified tips if the performer is employed by a non-SSTB venue (such as a resort or banquet hall) but disqualified tips if self-employed or performing

327. At this income level, the entire \$25,000 slice falls in the 22% bracket for a single filer in 2024. That means the tax savings are simply the bracket rate times the amount removed from taxable income: $\$25,000 \times 22\% = \$5,500$.

328. I.R.S., *supra* note 324, at 45342–43 (proposed § 1.224-2(d)(2)(B)).

329. *Id.*

330. *Id.* at 45350.

331. I.R.C. § 224(d)(2)(B).

through a production company whose revenue depends on the performer's individual skill.³³² This dual regime blurs the line between the worker's occupation and the employer's business classification, inviting case-by-case disputes over SSTB status. For the IRS, administering this distinction will be onerous: agents must evaluate not only the occupation but the nature of the payer's business, a fact-intensive inquiry that risks inconsistent enforcement across similarly situated performers and creators.

The proposed regulations also risk generating inequities among tipped workers that extend beyond the SSTB versus non-SSTB divide. In particular, they create uneven access to the deduction across wage structures and employment classifications. First, because eligibility for the deduction is not conditioned on earning the subminimum wage under the FLSA, higher-earning employees in traditionally tipped occupations, such as hotel concierges, can benefit alongside low-wage servers who depend on tips to reach the minimum wage.³³³ This extends the deduction's benefits to employees who are not subject to the economic vulnerabilities of subminimum-wage employment.

The proposed regulations further complicate the application of the deduction by introducing distinct eligibility rules for employees and self-employed individuals. While both groups can, in theory, receive "qualified tips," self-employed workers face an additional trade-or-business limitation under IRC § 224(c): they may deduct qualified tips only to the extent their gross business income exceeds other allocable deductions.³³⁴ This prevents the deduction from creating or increasing a business loss and substantially limits its value for small self-employed service providers with thin margins. As a result, workers performing similar customer-facing labor may experience different tax outcomes. A bartender employed by a restaurant can generally deduct all qualified tips, while a self-employed Uber driver may be able to deduct only a fraction of theirs. This asymmetry undermines the deduction's stated purpose of providing worker relief, introduces uneven compliance burdens, and risks fueling further worker-classification disputes in sectors already marked by high levels of misclassification and contested status, particularly gig work.³³⁵ In short, the divergence between Treasury's inclusive occupational framework and the regulations' narrower,

332. I.R.S., *supra* note 324, at 45355–56.

333. The proposed regulations for the tax deduction establish distinct criteria, focusing on whether tips are received voluntarily, are not subject to negotiation, and are determined by the payor. Furthermore, eligibility for the deduction depends on the occupation being listed as one that customarily and regularly receives tips. Therefore, an employee's eligibility for this tax deduction is separate from their employer's wage practices under the FLSA, as the tax rules do not consider the employee's hourly wage in determining deductibility. See I.R.S., *supra* note 324, at 45354.

334. I.R.C. § 224(c); I.R.S., *supra* note 324, at 45356.

335. See generally Shu-Yi Oei & Diane Ring, *Can Sharing Be Taxed?*, 93 WASH. U. L. REV. 989 (2016) (arguing that the sharing economy magnifies classification ambiguity and compliance challenges because platforms leverage regulatory uncertainty and gig workers operate as microbusinesses with limited reporting infrastructure).

employer-centric definition of “qualified tips” may make the new deduction difficult to apply consistently across the modern service economy.

The deduction therefore functions less as an anti-poverty measure than as a broad tax preference layered onto an already unequal wage structure—one that may increase administrative friction, intensify classification disputes, and shift compensation further toward customer-funded gratuities. In short, the provision delivers modest gains at the bottom while potentially extending generous benefits at the top, leaving the foundational inequities of tipped work intact.

3. Reconsidering Tipping

As previously explained, this article supports the TIPS Act for its more targeted and measured approach to making tips tax deductible but more importantly, for its abolition of the “tip credit” and its requirement that employers pay the full federal minimum wage to tipped workers.³³⁶ This, in turn, raises a broader normative question: should we do away with tipping altogether?

Empirical research casts doubt on the long-held assumption that tipping significantly improves service quality. A 2017 study by Michael Lynn, a leading expert on tipping behavior, surveyed several hundred U.S. restaurant servers and found only weak associations between average tip size and workers’ service orientation, intended job tenure, or occupational tenure.³³⁷ These findings suggest that tipping may not be an effective tool for attracting or retaining high-quality service staff.³³⁸ Similarly, Ofer H. Azar, another prominent scholar in the field, challenges the efficiency rationale for tipping.³³⁹ Despite the sizable volume of tips in the U.S. restaurant industry, Azar finds little evidence that tip amounts are meaningfully responsive to service quality. This disconnect—what he terms the “tipping–service puzzle”—highlights the mismatch between customers’ consistently high ratings of service and the minimal variation in tips based on performance.³⁴⁰ Recent experimental research complicates the idea that tipping reflects service quality.³⁴¹ Factors like perceived fairness and familiarity with tipping

336. See discussion *supra* Section III.A.e.

337. Michael Lynn, *Does Tipping Help to Attract and Retain Better Service Workers?*, 20 J. FOODSERVICE BUS. RSCH. 82 (2017).

338. *Id.*; See also Michael Lynn, *Restaurant Tipping and Service Quality: A Tenuous Relationship*, 42 CORNELL HOTEL & REST. ADMIN. Q. 14 (2001). But see Peter M. Kerr & Bruce R. Domazlicky, *Tipping and Service Quality: Results from a Large Database*, 16 APPLIED ECON. LETTERS 1505 (2009) (showing that while many factors influencing tipping behavior are beyond a delivery driver’s control, such as customer demographics or order preparation time, the efficiency of delivery time is a significant determinant of tip size); Lynn, *supra* note 16 (using customer satisfaction data from Joe’s Crab Shack and finding that online ratings were consistently higher under tipping systems than under no-tipping, service-inclusive pricing, suggesting consumers may prefer tipping-based models).

339. Ofer H. Azar, *Incentives and Service Quality in the Restaurant Industry: The Tipping–Service Puzzle*, 41 APPLIED ECON. 1917 (2009).

340. *Id.* at 1917.

341. Jason Tang et al., *The Effect of the Minimum Server Wage on Restaurant Guest Tipping Behavior*, 25 J. FOODSERVICE BUS. RSCH. 1 (2022).

norms influence how customers tip in response to good service.³⁴² These effects are especially pronounced when minimum server wages vary, suggesting that the link between service quality and tip size is far from straightforward.³⁴³ Collectively, these studies suggest that while tipping may hold symbolic or psychological value for patrons, its actual impact on service quality is tenuous at best.

Empirical studies examining the well-being of tipped workers consistently show that eliminating or reducing the tip credit—thereby requiring employers to pay the full minimum wage—improves earnings but has mixed effects on employment. Some research finds that reducing the tip credit leads to higher weekly wages for tipped workers, though it may cause slight declines in employment in full-service restaurants, particularly in less competitive markets.³⁴⁴ These gains for workers often come at the cost of higher prices for consumers.³⁴⁵ Notably, a recent study using two decades of state-level data suggests that modest increases in the tipped minimum wage yield significant gains in worker income with minimal or statistically insignificant impacts on employment.³⁴⁶ Moreover, a comparative study of tipping in Europe found that service workers in countries like Germany and Sweden tend to fare better under local tipping norms than their counterparts in France or Spain.³⁴⁷ This is largely because Germany and Sweden have relatively high minimum wages, allowing gratuities to serve as a meaningful supplement rather than a substitute for base pay.³⁴⁸

Beyond wages, critical ethnographic accounts expose the deeper structural harms of tipping: it informalizes labor relations, exacerbates precarity, and reinforces asymmetric power dynamics between workers, customers, and employers.³⁴⁹ Tipped workers report diminished agency, chronic income volatility, and barriers to workplace organizing, as the tip-based compensation model positions customers as

342. *Id.* at 8–11.

343. *Id.* at 7–9, 16–18, 23–24.

344. WILLIAM E. EVEN & DAVID A. MACPHERSON, INST. FOR THE STUDY OF LAB., *THE EFFECT OF TIP CREDITS ON EARNINGS AND EMPLOYMENT IN THE U.S. RESTAURANT INDUSTRY* (2012), <https://papers.ssrn.com/abstract=2196757> [<https://perma.cc/Q3KF-GP3Y>]; Oz Shy, *Tips versus Higher Wages: Data, Theory, and Simulations* (Feb. 6, 2019), <https://papers.ssrn.com/abstract=3127117> [<https://perma.cc/P2V6-ABE2>].

345. Shy, *supra* note 344.

346. Sylvia Allegretto & Carl Nadler, *Tipped Wage Effects on Earnings and Employment in Full-Service Restaurants*, 54 *INDUS. RELS.* 622 (2015).

347. Stefan Gössling et al., *Restaurant Tipping in Europe: A Comparative Assessment*, 24 *CURRENT ISSUES TOURISM* 811 (2021).

348. *Id.* at 820.

349. Jacqueline Ross & John Welsh, *Service Labor, Freedom, and the Technique of Tipping*, 49 *CRITICAL SOCIO.* 725 (2023) (drawing on critical ethnography of restaurant labor to show that tipping substitutes informal, customer-controlled remuneration for wages, intensifying precarity and placing workers in asymmetric relations of dependence vis-à-vis customers, employers, and coworkers); Jacqueline Ross & John Welsh, *Understanding the ‘Tipped Minimum Wage’: Critical Directions for US Policy Research*, 20 *SOC. POL’Y & SOC’Y* 192 (2021) (arguing that tipping is a legally sanctioned technique of labor control that informalizes the wage relation, entrenches worker precarity, and internalizes asymmetric relations of subordination among workers, customers, and employers).

de facto supervisors.³⁵⁰ These findings challenge the notion that tipping empowers workers, revealing instead how it entrenches inequality and undermines long-term labor protections.³⁵¹

Taken together, the empirical and ethnographic evidence makes a compelling case for rethinking tipping as a cornerstone of worker compensation. While tipping may offer some perceived benefits to consumers and allow employers to externalize labor costs, it fails to deliver consistent gains in service quality and often harms the very workers it purports to reward. The TIPS Act's elimination of the tip credit represents an important step toward dismantling a system that perpetuates wage insecurity and power imbalances. By shifting the responsibility for fair pay back to employers and affirming the dignity of service work through a guaranteed wage floor, the Act lays the groundwork for a more equitable and sustainable labor model.

CONCLUSION

In conclusion, while exempting tips from income taxation may appear appealing, the legislative proposals advanced, particularly OBBBA's enacted version, pose serious equity concerns. OBBBA's high income thresholds, exclusion of ITIN filers, and joint-filing requirements risk disproportionately benefiting higher earners while leaving behind many low-wage and immigrant workers. Moreover, its expansive scope stands in contrast to the TIPS Act, which, despite its flaws, represents the most equitable framework by preserving access to refundable credits, sustaining Social Security contributions, and abolishing the subminimum wage. To fulfill its anti-poverty promise, however, the TIPS Act should incorporate key guardrails from the 2025 No Tax on Tips Act—namely, a \$25,000 cap, occupational specificity, and an income limit of \$75,000 to ensure the deduction remains focused on those most in need. Empirical evidence further weakens the rationale for tipping as a wage structure, showing little connection to service quality and highlighting its role in perpetuating precarity and inequity. A refined TIPS Act, grounded in both fiscal responsibility and distributional equity, offers a rare opportunity to restore dignity to low-wage work and integrity to the tax code.

350. Hanna Goldberg, *Divided Wages and Divided Workers: Tips and the Two-Employer Problem*, in 35 *ETHNOGRAPHERS OF WORK* 9 (Rick Delbridge et al. eds., 2023), <https://doi.org/10.1108/S0277-283320230000035002>; Wilson & Setter, *supra* note 15.

351. Taylor Laemmli, *Workers and Their Foes: Customer Scapegoats in the Service Triad*, 9 *SOCIUS* 1 (2023).