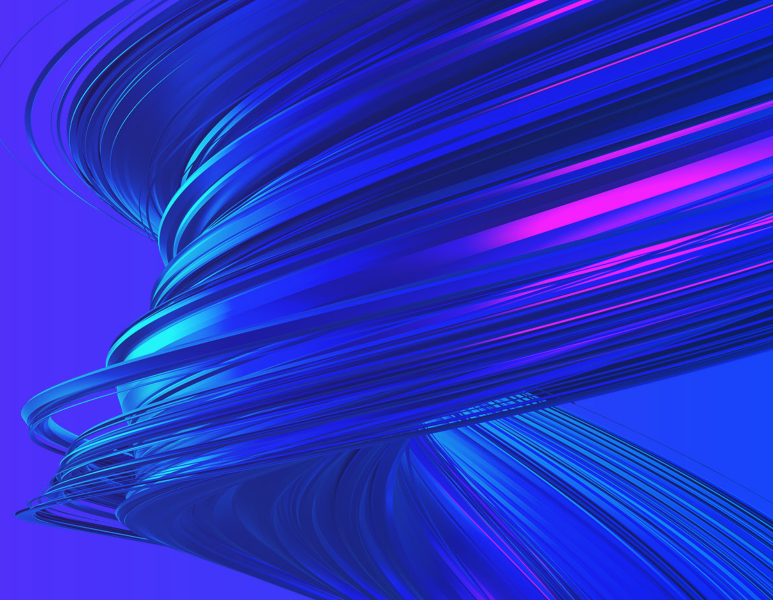

Payroll Insights

Employment tax news to guide you now and for the future

August 2025

John's *fresh take:* One Big Beautiful Bill Act's impact on payroll taxes

As we move into the second half of the year, July brought several important federal and state payroll tax developments that employers should begin actively planning for, especially with year-end fast approaching. Prior editions of *Payroll Insights* and most news sources have been tracking and discussing the One Big Beautiful Bill Act (OBBBA) since its introduction in the US House of Representatives in May 2025. The passage of the OBBBA on July 4, 2025 marked a major legislative milestone, introducing a series of tax reforms that will impact payroll operations in both the short and long term. While the OBBBA dictates the statute, the Department of Treasury and Internal Revenue Service (IRS) are tasked with executing the changes, including determining how to report, for example, affected overtime wages on Form W-2. FAQs need to be released to guide employers and payroll vendors in effectuating these changes. A timeline for releasing complete guidance has not been announced. Now is the time for companies to act, including proactive discussions with payroll providers, HRIS vendors, and tax advisers to ensure systems are ready to be updated, compliance processes are in motion, and implementation planning is in place well ahead of the fall and year-end busy seasons.

Our Washington National Tax group is continuously updating its analysis of the OBBBA at [KPMG reports: Tax subtitle for "One Big Beautiful Bill Act."]

Federal updates

One Big Beautiful Bill Act key reminders

New federal tax deductions for overtime and tips

- Introduces federal income tax deductions for tip and overtime income aimed at increasing take-home pay for hourly and tipped workers
- **Tip income deduction:** Up to $25,000 in qualified tips annually for employees in eligible tip-based occupations; the IRS must provide a list of eligible occupations by October 2, 2025
- **Overtime deduction:** Up to $12,500 ($25,000 for joint filers) per year, applying only to the premium portion of FLSA-defined overtime pay (i.e., the 0.5 times of the 1.5 times pay)
- The deduction is phased out for those with a MAGI over $150,000 ($300,000 for MFJ) in 2025 to be indexed for inflation in future years.
- Effective for tax years 2025 through 2028.

The IRS is expected to provide guidance and potentially transitional relief for both taxpayers and employers subject to new reporting requirements.

Health savings account expansions

- High-deductible health plans with health savings account (HSA) compatibility may continue to cover telehealth services before the deductible is met.
- Starting in 2026, HSA funds may be used to pay up to $150 per month for individuals or $300 per month for families enrolled in direct primary care arrangements.

- Beginning in 2026, individuals enrolled in ACA bronze and catastrophic plans may contribute to HSAs.

Increased dependent care FSA contribution limits

- The dependent care flexible spending account limit will be raised for the first time since 1986.
- The new limit will be $7,500 annually starting in 2026.

Permanent enactment of 2017 Tax Cuts and Jobs Act provisions

Certain provisions of the 2017 Tax Cuts and Jobs Act (TCJA) that were set to expire on December 31, 2025 are permanently changing the tax code, including:

- Student loan benefit under Section 127 for tax-free employer contributions
- Business credit under Section 45S for providing FMLA leave
- Elimination of tax-free qualified bicycle commuting reimbursement and employer deduction under Section 274
- Elimination of tax-free qualified moving expense reimbursements under Section 132(g), other than for military orders.

2017 TCJA provisions now going into effect

- The TCJA added Section 274(o), which eliminates the deduction for meals provided for the convenience of the employer and at employer-operated eating facilities beginning after December 31, 2025.
- The OBBBA added two limited exceptions, but otherwise Section 274(o) will largely go into effect as enacted in 2017.
- Companies are considering including the value of meals in employees' income and taking the full deduction or excluding the amounts from employees' income and forgoing the deduction.

IRS releases draft version of annual FUTA tax return form

The IRS released a draft of the 2025 Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return. The draft introduces a new checkbox that enables aggregate filers to indicate their status as a certified professional employer organization, Section 3504 agent, or other authorized third-party administrator.

Part 4, Lines 15b through 15e, of the draft Form 940 now allows employers to provide direct deposit information for the refund of any FUTA tax overpayments. The current administration has directed the phaseout of most paper payments to taxpayers, and earlier versions of the form lacked a section for a taxpayer to provide banking details.

The final page of the draft also includes updated guidance on electronic payment methods. Employers are reminded that FUTA tax deposits may be paid via the Electronic Federal Tax Payment System, IRS Direct Pay, or through their IRS business tax account. These updates reflect the IRS's ongoing efforts to modernize payroll tax administration and streamline employer compliance.

Employers and payroll providers are encouraged to review the draft Form 940 and prepare for potential changes prior to the release of the final version.

2025 Form 940

Report finds delays in IRS taxpayer advocate case handling

A new report, released on June 11, by the Treasury Inspector General for Tax Administration (TIGTA) has found that the IRS Taxpayer Advocate Service (TAS) experienced significant delays in responding to taxpayer assistance requests during FY 2023.

According to TIGTA's findings, the TAS failed to make timely contact with taxpayers or their representatives in 63 percent of the 163 closed cases reviewed. The TAS is required to initiate contact within 10 business days of receiving a request, but the report found that both initial and follow-up outreach frequently exceeded this timeframe.

On average, taxpayers in affected cases experienced delays of 146 days while waiting for their concerns to be addressed. TIGTA attributed these issues to a combination of rising case volumes, reliance on outdated case management systems, and onboarding of new case advocates.

In response, the TAS acknowledged the challenges and stated it will implement a new customer relationship management system later this summer. The new system is expected to improve case tracking and response timelines. TIGTA has recommended that the TAS adopt more realistic and attainable response benchmarks to improve taxpayer service delivery.

State payroll updates

Connecticut establishes credit for successfully challenging NY's convenience of employer rule

On July 8, Connecticut passed Senate Bill 1558. The bill offers a 60 percent refundable tax credit for Connecticut residents who successfully appeal New York taxes imposed on telecommuters' wages earned for services performed while working remotely from home in Connecticut. Similar to legislation passed in 2023 by New Jersey, the bill and credit are intended to encourage Connecticut residents to challenge New York's "convenience of the employer" tax rule and recapture state revenue.

Georgia revised withholding method and tax rate

Effective July 1, 2025, Georgia has reduced the income tax withholding rate from 5.39 percent to 5.19 percent. Although the state's tax rate change is retroactive to January 1, employers are instructed to begin applying the new withholding rate as of July 1. Any underwithholding or overwithholding related to the first half of the year should generally be reconciled by employees when they file their 2025 state income tax returns.

Illinois announces 2025 tax amnesty program

The Illinois Department of Revenue has announced that the 2025 Illinois Tax Amnesty Program will run from October 1 through November 17, 2025. During this limited window, eligible taxpayers will be able to pay certain outstanding tax liabilities with penalties and interest waived. The program applies to outstanding returns and tax liabilities for periods ended after June 30, 2018 and before July 1, 2024. To qualify for relief, taxpayers must pay the full amount of eligible taxes due within the amnesty period.

Louisiana enacts Earned Wage Access Law, effective August 1

Effective August 1, 2025, Louisiana joined a growing number of states in regulating earned wage access (EWA) services with the enactment of the Louisiana Earned Wage Access Services Act. The legislation establishes guidelines and restrictions on companies providing EWA facilitation services that enable employees and independent contractors to receive early access to wages that have been earned but not yet paid by their employer.

EWA providers are permitted to generate revenue through optional fees, but the law introduces strict consumer protection requirements and limits on provider practices. For example, providers must disclose any fees that may be charged to consumers, and there must be at least one free option offered. The bill will limit the methods EWA providers may use for recouping their fees charged to consumers and will also limit the ways they market their services. EWA providers are prohibited from charging late fees, cancellation fees, deferral fees, and interest for failure to repay outstanding amounts owed to the provider.

Louisiana is the fifth state in 2025 to enact legislation regulating EWA services, following Maryland, Utah, Arkansas, and Indiana.

Ohio moves to flat income tax under new budget legislation

Ohio is set to end its graduated income tax system and adopt a flat tax rate of 2.75 percent under a new two-year budget bill (HB 96) signed by Governor Mike DeWine.

The new law phases out Ohio's current three-bracket system over the 2026–27 biennium. For tax year 2025, the top rate will be reduced from 3.5 percent to 3.125 percent, followed by the implementation of the flat 2.75 percent rate beginning in 2026. Individuals with income below $26,050 will continue to be exempt from paying the state income tax.

Ohio used nine tax brackets as recently as 2015, and this legislation marks a significant shift in the state's tax structure.

Employers with Ohio-based employees should monitor developments and prepare for withholding updates in line with the phased implementation of the new tax rates.

House Bill 96 Documents | 136th General Assembly | Ohio Legislature

Rhode Island increases temporary disability insurance taxable wage base and benefits

Effective January 1, 2026, Rhode Island will significantly increase the taxable wage base for its Temporary Disability Insurance (TDI) program under House Bill 6066, which was signed by Governor McKee on June 26, 2025.

The minimum wage base for TDI contributions will increase from $38,000 in 2025 to $100,000 in 2026. Previously, the taxable wage base in a given calendar year was the greater of $38,000 or a calculated amount based on the maximum weekly benefit in effect on September 30 of the prior year. That amount was preliminarily estimated at $89,200 for the 2025 calendar year.

District of Columbia delays tipped minimum wage increase to October 1

The District of Columbia has delayed its scheduled July 1 tipped minimum wage increase under emergency legislation signed by Mayor Muriel Bowser on June 30, 2025.

As per the revised timeline, the tipped minimum wage will now increase from $10.00 to $12.00 per hour effective October 1, 2025, rather than midyear on July 1 as originally planned. This delay does not affect the city's standard (nontipped) minimum wage, which increased from $17.50 to $17.95 on July 1.

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