Payroll Insights

Employment tax news to guide you now and for the future

December 2025

John's *Fresh Take:*
OBBBA tip and overtime credits take center stage during year-end webcast

On November 20, 2025, KPMG and Bloomberg Tax and Accounting teams presented a webcast on year-end payroll tax considerations. Approximately 30 percent of the presentation focused on tip and overtime credits from the One Big Beautiful Bill Act (OBBBA), and the remaining time focused on typical recommendations for a smooth compliance season (see my *fresh take* in the November edition of *Payroll Insights*).

In the webcast materials, we outline the rules provided in the OBBBA around what qualifying compensation is and how to report it. You may have guessed (correctly) that about 70 percent of the questions from participants were about the OBBBA, and the remaining questions were about the other topics of the webcast. Many of the questions about the OBBBA related to how to calculate qualified tip and overtime compensation, the employers' requirements to report to employees and the IRS, and how we are seeing businesses handle the requirements and uncertainty.

Days before airing the year-end webcast, the IRS issued Notice 2025-62, providing relief from information reporting penalties for failure to report qualified tip and overtime compensation to employees. So, the answer to most of the OBBBA questions is that, like the IRS, we recommend providing a statement or reporting in box 14 of Form W-2 the most accurate qualified tip and overtime compensation possible to facilitate the employee's credit claim.

The day after the webcast aired, the IRS issued Notice 2025-69, providing guidance to employees or self-employed workers on using what is provided by the employer to calculate and claim the credits on their personal income tax returns. As described in more detail below, the transition relief provided to employees includes scenarios where the qualified compensation is not separately stated in a statement or on Form W-2 or 1099. Notice 2025-69 may relieve some of the anxiety many employers are experiencing in making sure that their employees have sufficient information to claim the credits. Had it been released two days earlier, it's likely that 90 percent of the questions following the webcast would have been about the OBBBA, instead of 70 percent. Watch the webcast on demand here.

Federal updates

Guidance for individuals affected by the OBBBA

Notice 2025-69, released by the IRS on November 21, 2025, is one of the first to provide critical information for workers seeking to claim a credit for qualified overtime or tip compensation on their 2025 personal income tax returns. The notice includes the general rules for eligibility and provides examples applying the provisions of the OBBBA.

This guidance requires the employee to make a "reasonable effort" to determine their eligibility for tip and overtime credits. For purposes of calculating qualifying compensation, Notice 2025-69 mostly releases the employee (although not a self-employed individual) from the burden of verifying that the information provided by the employer that calculates the qualifying tip or qualifying overtime is accurate.

Qualified tip compensation
Notice 2025-69 acknowledges that employers and employees (and self-employed individuals) may not have sufficient time in 2025 to determine if their services should qualify as part of an industry that is eligible for the credit or to calculate what may be eligible as a qualified tip. It notes that employers may choose to provide information on an employee's occupation or other relevant information to employees using box 14 of Form W-2, in which case employees may rely on that information.

Also, specific to 2025, employees may rely on amounts reported as Social Security tips in box 7 of Form W-2 and total tips reported to the employer on Form 4070, *Employee's Report of Tips to Employer*, for purposes of calculating their tip credit, or if the employer voluntarily reports total cash tips in box 14 of the 2025 Form W-2, the employee can rely on box 14 for total qualified tips.

Qualified overtime compensation
The following example from the IRS news release IR-2025-114, illustrates the interaction between employer reporting to the employee of qualified overtime compensation:

- Andrew's payroll statement shows a total "overtime" amount of $15,000, which is the total amount Andrew was paid for working overtime (the FLSA overtime premium combined with the portion of his regular wages). Andrew may include the $5,000 FLSA overtime premium, computed by dividing $15,000 by three in determining the amount of qualified overtime compensation for 2025.

Note that this example allows the employee to assume that the employer's statement of overtime compensation is compliant with FLSA rules, and it does not address any differences in straight time and regular rate of pay premiums. This example does not put the onus on the employee to confirm that the FLSA rules are followed.

However, in another example, the employer pays overtime compensation at two times the regular rate of pay, which is 50 percent more than FLSA rules. The employee is responsible for knowing that the employer pays overtime in excess of FLSA rules and for accounting for it accordingly in their personal income tax return calculation of the credit.

Notice 2025-69 confirms that any premiums in excess of the overtime premiums required by the FLSA should not be eligible for the overtime credit, citing differences in state law or collective bargaining agreements from the FLSA.

Please see the KPMG TaxNewsFlash for additional discussion of Notice 2025-69.

IRS releases 2026 draft publications 15 and 15-T: Key updates for employers

The IRS issued 2026 drafts of Publication 15 (Circular E), *Employer's Tax Guide*, and Publication 15-T, *Federal Income Tax Withholding Methods*, highlighting several important updates:

- The Social Security tax wage base increases to $184,500.
- The OBBBA payroll tax provisions are reflected in the draft publications.
  - The information reporting threshold for certain payments, notably Form 1099-NEC reporting of nonemployee compensation, increases from $600 to $2,000 in a calendar year. The threshold also increases to $2,000 for wage reporting on Form W-2, *Wage and Tax Statement*, if no federal income, Social Security, or Medicare tax was withheld.
  - Tip and Overtime Deductions: Employees may deduct up to $25,000 in qualified tips and up to $12,500 ($25,000 for joint filers) in qualified overtime compensation from taxable income for federal purposes. Employers must file information returns with the SSA or IRS, as applicable, and furnish statements to tip recipients showing cash tips received and the Treasury Tipped Occupation Code of the recipient. However, the IRS will provide transition relief to employers and payors for tax year 2025 requirements.
  - Moving Expense Reimbursements: The exclusion from wages for moving expense reimbursements is permanently eliminated, except for active-duty military and certain intelligence community employees.
  - Employer Contributions to Trump Accounts: Beginning July 4, 2026, employers may contribute up to $2,500 annually to Trump accounts for employees under 18, subject to Social Security and Medicare taxes but not federal income tax withholding. The employer contribution must be made through a separate written plan of the employer for the exclusive benefit of its employees to provide contributions to the Trump accounts of such employees or dependents of such employees.
- Electronic Payments and Refunds: Employment tax refunds will now be issued by direct deposit, and electronic payment of balances due is encouraged per Executive Order 14247.
- Electronic Transcripts: Employers can now access employment tax return transcripts electronically via their IRS business tax account.
- 2026 Form W-4, *Employee's Withholding Certificate,* and Form W-4P, *Withholding Certificate for Periodic Pension or Annuity Payments*: Both forms have been revised to accommodate new federal income tax deductions and now feature a checkbox for claiming exemption from withholding.

IRS announces 2026 retirement plan contribution limits

The IRS issued Notice 2025-67, detailing cost-of-living adjustments for 2026 that raise contribution limits and income thresholds for retirement plans and IRAs. Key changes include:

- Defined benefit plan annual benefit limit: increased to $290,000 (from $280,000)
- Defined contribution plan limit: increased to $72,000 (from $70,000)
- Elective deferral limit for 401(k) and similar plans: increased to $24,500 (from $23,500)
- IRA contribution limit: increased to $7,500 (from $7,000).

The notice also updates catch-up contribution limits, income phaseout ranges for IRA deductibility and Roth IRA contributions, and other retirement-related thresholds. These adjustments, required by the tax code to reflect inflation, take effect for the 2026 tax year.

State updates

California updates for 2026

California posted 2026 rules for unemployment insurance, employment training tax, and state disability insurance. There will be no change to using Schedule F+, the highest rate table, to compute employer tax rates. There will also be no change to the 0.1 percent employment training tax rate. The state disability insurance tax rate will increase to 1.3 percent, with no limit on subject wages.

Colorado updates withholding formula and employee certificate for 2026

Colorado revised its withholding formula and Form DR 0004, *Employee Withholding Certificate*, for 2026 in response to federal tax changes under the OBBBA, according to the state revenue department.

Key changes include increased standard withholding allowances if an employee does not submit Form DR 0004.

- Most filing statuses: $5,500 (up from $5,000)
- Married filing jointly or qualified surviving spouse: $11,000 (up from $10,000)

The instructions clarify that employees must use Form DR 0004 to account for federal deductions, as there may be limits and required addbacks.

The 2026 version of Form DR 0004 adds two new lines to its worksheet:

- An estimate of qualified overtime compensation (from the federal Form W-4 deductions worksheet)
- State taxes included in the state and local tax deduction (also from the federal Form W-4 deductions worksheet)

Existing employees do not need to update their Form DR 0004 for 2026.

Colorado has previously chosen to continue taxing overtime pay for state purposes, despite federal changes, under legislation that was signed in May 2025.

Additionally, starting with hours worked in 2025, long-term care employers (such as nursing homes and home care agencies) must report hours worked by direct care workers by January 31, 2026. This reporting supports a new $1,200 tax credit for direct care workers who work at least 720 hours in 2025. Employers must submit an Excel spreadsheet with each worker's name, Social Security number or ITIN, and hours worked via Colorado's Revenue Online portal.

Florida sets 2026 interest rate for tax payments

The Florida Department of Revenue announced that the interest rate for tax underpayments, late payments, and overpayments will be 11 percent from January 1 through June 30, 2026. This rate applies to multiple taxes and fees, including sales and use tax, corporate income tax, and motor fuel taxes.

Iowa releases updated income tax withholding tables for 2026

The Iowa Department of Revenue issued revised income tax withholding formulas and tables for 2026, reflecting inflation adjustments and changes in individual income tax liability under the OBBBA. Iowa law generally conforms to federal tax changes, and the new tables accommodate reduced individual tax liability beginning in 2026.

Kentucky announces updated tax interest rates for 2026

The Kentucky Department of Revenue released the annual tax interest rates effective January 1, 2026, following the statutory review required by state law. In accordance with Kentucky Revised Statutes 131.183, interest will be applied to unpaid tax liabilities at an annual rate of 9 percent, while interest on tax overpayments will be credited at an annual rate of 5 percent. These rates are applicable to all taxes administered by the Commonwealth of Kentucky and will be effective for transactions occurring during the 2026 calendar year.

Maine's 2026 employer unemployment tax rate schedule remains at lowest level

The Maine Department of Labor announced that the 2026 employer unemployment tax rate schedule will remain at Schedule A, the lowest level permitted under state law. Unemployment taxes will continue to be assessed on the first $12,000 of wages paid to each employee, with the average tax per employee set at $267.60 for the year, an increase of $14.40. Actual tax rates will vary by employer based on individual experience ratings.

Maine issues guidance on federal tax law changes

Due to the recent enactment of the OBBBA and its impact on Maine's practice of conforming to federal tax law, Maine Revenue Services has issued guidance on the administration of 2025 state income tax returns. The commissioner has recommended temporary administrative adjustments under the new Maine Act (P.L. 2025 c. 336, effective September 24, 2025).

Maine generally conforms to federal tax law as of December 31, 2024, but the OBBBA introduced retroactive changes for 2025 that have not yet been incorporated into state law. Under the Maine Act, the Governor may direct the State Tax Assessor to make equitable, temporary adjustments to minimize complexity and maintain legislative intent. Taxpayers may file returns using current instructions or request an extension and wait for legislative action. If future legislation differs from current guidance, taxpayers will not be penalized for underpayments or incorrect refunds resulting from these timing issues but may be required to file amended returns.

Additional legislative action is expected to address OBBBA provisions for tax years 2026 and beyond.

New York State and Yonkers withholding tax tables updated for 2026

The New York Department of Taxation and Finance released revised New York State and Yonkers withholding tax tables and methods for 2026, effective January 1 through December 31. The updated schedules reflect recently enacted tax rate reductions. Employers must use these new tables and methods to calculate Yonkers resident personal income tax withholding starting January 1, 2026.

New York City also released its publication of withholding tax tables and methods, but there were no changes to the 2025 publication.

Oklahoma simplifies income tax withholding tables and lowers top rate for 2026

Oklahoma has updated its state income tax withholding tables for 2026, as announced by the Oklahoma Tax Commission in Packet OW-2. The new tables reflect a reduction in the top withholding rate, which now caps at 4.5 percent, down from 4.75 percent in prior years. Additionally, the structure has been simplified to just four tax brackets, including the zero bracket, replacing the previous six- bracket system. These adjustments stem from House Bill 2764, which also establishes a trigger mechanism for further rate reductions if certain state revenue thresholds are achieved.

Oregon statewide transit tax rate increase for 2026

The Oregon Legislature amended ORS 320.550 to increase the Statewide Transit Tax rate from 0.1 percent to 0.2 percent of employee wages, effective January 1, 2026. The tax applies to wages of Oregon residents and nonresidents performing services in Oregon, regardless of regular income tax withholding status. Employers are responsible for withholding, reporting, and remitting the tax, which is separate from Lane or TriMet transit payroll taxes. The increased rate will sunset after 2027, reverting to 0.1 percent in 2028 and beyond.

South Carolina updates withholding formula for 2026

South Carolina's Department of Revenue released the state's 2026 withholding formula. The highest tax rate in the formula has been reduced to 6 percent (down from 6.2 percent). The annual value of a state allowance has increased to $5,000 (up from $4,860), and the maximum standard deduction is now $7,500 (up from $7,300).

The updated 2026 Form SC W-4, *Employee's Withholding Allowance Certificate*, is not yet available.

Vermont announces tax interest rates for 2026

The Vermont Department of Taxes released the annual interest rates applicable to tax underpayments and overpayments for the 2026 calendar year. Effective January 1, 2026, the interest rate will be set at 7.75 percent, representing a decrease from the 8.5 percent rate in effect for 2025. The rate applies to any tax deficiency or excess payment for income, withholding, sales and use, meals and rooms, and other state taxes administered by the department.

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