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Payroll Insights

Employment tax news to guide you now and for the future

July 2025

John's fresh take : The One Big Beautiful Bill Act

As someone who has spent most of my career navigating the ever-changing terrain of employment tax, I've seen few instances where one bill produces more than just incremental reform. The **One Big Beautiful Bill Act (OBBBA)** is one of those times! The changes to tax law indicate an effort by the federal government to take a new approach in how they address payroll taxes, fringe benefits, and employer obligations. A key desired outcome of the OBBBA is to impose a more uniform baseline for calculating taxable compensation. As a tax professional, I welcome simplification, but I also know that any changes require action from payroll tax professionals to be able to comply. Changes in HRIS and payroll compliance systems, benefit planning, and payroll operations may all be affected. We always recommend that payroll tax professionals act proactively to comply with new rules or filing requirements resulting from the OBBBA. Otherwise, the employer risks falling out of step with both compliance and competitive total rewards strategy.

Federal updates

The OBBBA was signed into law on July 4, 2025. The OBBBA is a sweeping legislative package with the goal of modernizing and simplifying the US tax code. It introduces a number of significant reforms with wide-ranging implications for individuals, employers, and tax professionals. Here is a brief overview of some of the key provisions of the OBBBA.

No tax on overtime

The OBBBA provides for certain individuals to claim an above-the-line deduction equal to qualified overtime compensation received during the tax year. Qualified overtime compensation is overtime compensation paid in excess of the regular rate of pay in compliance with Section 7 of the FLSA. Qualified overtime compensation does not include any qualified tips or amounts received by highly compensated employees.

The OBBBA limits the exemption to $12,500 per individual, phased out for income above $150,000. To take an individual deduction (thereby reversing the initial inclusion on a Form 1040 filing), the qualified overtime must be reported separately by the employer on Form W-2, effective for tax years 2025 through 2028. The exception does not apply to Social Security or Medicare taxes. There may be states or local taxing authorities that do not adopt or conform to the federal exclusion. Employers should update pay code tax profiles to account for the change in Form W-2 reporting.

No tax on tips

The OBBBA eliminates federal income tax on certain gratuities received by service workers (tips) for tax years 2025 through 2028, with a maximum exemption of $25,000 per individual, phased out for income above $150,000. The exemption does not apply to Social Security or Medicare taxes. Like the exemption from tax on overtime wages, state and local taxing jurisdictions may not adopt or conform to the federal treatment.

The OBBBA requires employers to separately report the qualified tips on Form W-2. The Department of the Treasury must provide a list of qualifying occupations before an employer can determine which tips are qualified and implement the provision.

Expansion of Section 127 education assistance: Permanent relief and inflation adjustment

Prior to 2017, Section 127 of the Internal Revenue Code (IRC) allowed employers to provide up to $5,250 per year in tax-free educational assistance to employees through a qualified educational assistance program. The 2017 Tax Cuts and Jobs Act (TCJA) temporarily expanded this provision to include employer payments toward an employee's qualified education loans made through December 31, 2025. The payments can be made directly to the employee or to the lender. This temporary expansion was extended by the Taxpayer Certainty and Disaster Tax Relief Act of 2020.

The OBBBA makes the exclusion from wages for employer payments toward qualified student loan debt a permanent feature of Section 127. Beginning in 2027, the $5,250 annual exclusion limit will be indexed for inflation, increasing the long-term value of the benefit for both employers and employees.

For payroll and benefits professionals, this change represents a potential long-term tool for talent attraction and retention.

Elimination of the exclusion for qualified moving expense reimbursement

The OBBBA permanently repeals the qualified moving expense exclusion, effectively striking Section 132(g) from the Code.

Prior to the enactment of the TCJA of 2017, qualified moving expense reimbursements were excludable from the employee's gross income and wages for federal employment tax purposes, provided certain criteria were met.

The TCJA temporarily suspended this exclusion for tax years 2018 through 2025 (except for active duty members of the Armed Forces).

Permanently eliminating the benefit may have immediate and long-term implications for employers' mobility programs, payroll tax compliance, and total compensation strategy.

Extension and enhancement of paid Family and Medical Leave Act credit

The TCJA created a temporary business credit under Section 45S to encourage employers to provide paid family and medical leave to employees. The credit ranges from 12.5 percent to 25 percent of wages paid during the leave, up to 12 weeks for qualifying employees. The OBBBA makes this credit permanent and expands its scope. Employers can choose to claim the credit either on wages paid during leave or on premiums paid for insurance policies that provide paid leave benefits. The OBBBA also introduces an aggregation rule, treating all members of a controlled group under Sections 414(b) and (c) as a single employer and requiring that each member maintain a written paid Family and Medical Leave Act (FMLA) policy that meets the credit's requirements.

Additionally, the OBBBA clarifies that paid leave required under state or local law counts toward meeting eligibility for the credit, but such mandated leave cannot be included when calculating the credit amount. The definition of a qualifying employee is broadened; employers can elect to treat employees as eligible after six months of service (instead of one year), and employees need to be customarily employed at least 20 hours per week. These changes will take effect for tax years beginning after December 31, 2025.

Employee Retention Credit revisions

The OBBBA amends Section 3134 to limit payment of qualifying Employee Retention Credit (ERC) claims for the quarters ending September 30, 2021, and December 31, 2021, to those that were filed on or before January 31, 2024. The amended Section also extends the statute of limitations for IRS assessments for these quarters from April 15, 2027, to six years following the date of the claim.

Note that the OBBBA does not amend the timing for claiming the credit or extend the statute of limitations for IRS assessments for the quarters ending June 30, 2020, through June 30, 2021.

Health savings accounts

The final bill contains limited health savings account (HSA) provisions, including the following:

- Continued telehealth coverage under HSAs – The provision retroactively codifies a safe harbor effective for plan years beginning after December 31, 2024, ensuring that high deductible health plans (HDHPs) can cover telehealth services before the deductible is met without affecting a participant's HSA eligibility.

- HSA reimbursement for direct primary care – Effective for months beginning after December 31, 2025, HSA owners will be allowed to spend up to $150 per month for individuals, and $300 per month for a family, to pay for direct primary care practice memberships.
- Allowance of bronze and silver HSA-compatible plans – HSA eligibility is expanded to include bronze and catastrophic plans. Effective for months beginning after December 31, 2025, HSAs will be deemed compatible with bronze-level coverage and catastrophic coverage available under the Affordable Care Act, even if the annual out-of-pocket spending limits exceed the limits permitted for HSA-compatible HDHPs.

Elimination of qualified bicycle commuting reimbursement

The OBBBA repeals Section 132(f)(1)(D), which provided for qualified bicycle commuting reimbursements to be excluded from taxable wages. While this fringe benefit was already suspended under the 2017 TCJA, OBBBA removes it entirely from the IRC.

For more details and discussion of the OBBBA, please visit the KPMG Washington National Tax group's dedicated website: KPMG reports: Tax subtitle for "One Big Beautiful Bill."

Employer-provided executive security considerations

Many employers have historically provided personal security to employees who are on assignment or traveling for business in certain foreign locations. In the current political landscape, new locations, or even domestic events, may join the conventional list, creating a greater need for employer awareness of the rules for inclusion in taxable wages.

Instances of security may include a bodyguard, or a secured vehicle or plane for personal safety and not for business purposes. The IRC considers the value of this benefit to be personal and includable in taxable wages unless the benefits are pursuant to a qualified security program (see Section 132(a)(3) and applicable Regulations). The program should be based on a "bona-fide business-oriented security concern" and include 24-hour protection, or as recommended by an independent security study.

Use of a secure vehicle or private airplane as part of the program and for personal purposes may require imputed wages. However, the calculation of the value of the personal use prescribed by the Regulations may be favorable to the typical valuation of personal use of a company-provided vehicle.

Employers should confirm that their existing security program is compliant with the tax rules. Employers providing these benefits to employees that do not have a security program should prioritize compliance to avoid assessments of tax, penalties, and interest.

Metropolitan Learning Institute sues IRS over ERC refunds: A cautionary tale for businesses using professional employer organizations

In a case drawing the attention of employment tax professionals and professional employer organization (PEO) clients alike, Metropolitan Learning Institute (MLI) sued the US government, seeking a refund of taxes for the ERC claimed under a PEO.

A PEO is a third-party provider that is the employer of record for employees performing services for the PEO's client. Unlike the typical employers who hire employees and file payroll tax returns under their own Employer Identification Numbers (EINs), a PEO client's payroll taxes are reported under the PEO's EIN for most employment taxes. All the PEO's clients are reported on payroll tax returns in aggregate. The IRS issues any applicable refunds, including those related to the ERC, to the PEO. If all or part of a refund of tax is directly attributable to the PEO's client, the PEO is responsible for distributing the refund to the client.

This structure can complicate accountability and refund tracking. In some cases, PEOs have delayed disbursing refunds to client companies, or the IRS has offset refunds against unrelated liabilities owed by the PEO. This is the case in *Metropolitan Learning Institute, Inc. v. United States of America* (2025). MLI attempted to claim an ERC under its own EIN, but the applicable wages were paid and reported by its PEO. MLI asserts that it has the right to the credit because the credit was generated by its own business. On June 6, 2025, the federal government responded to MLI's complaint with mostly general statements about claiming credits and a request for more time for discovery.

Metropolitan Learning Institute v. United States could set an important precedent for both ERC claims and PEO clients' rights and responsibilities for working directly with the IRS for payroll tax purposes.

Updates to federal rates/publications

Foreign per diem rates

The US State Department updated per diem rates for more than 440 non-US locations, effective June 1, 2025. Per diem rates globally can be found at US Department of State | Home Page.

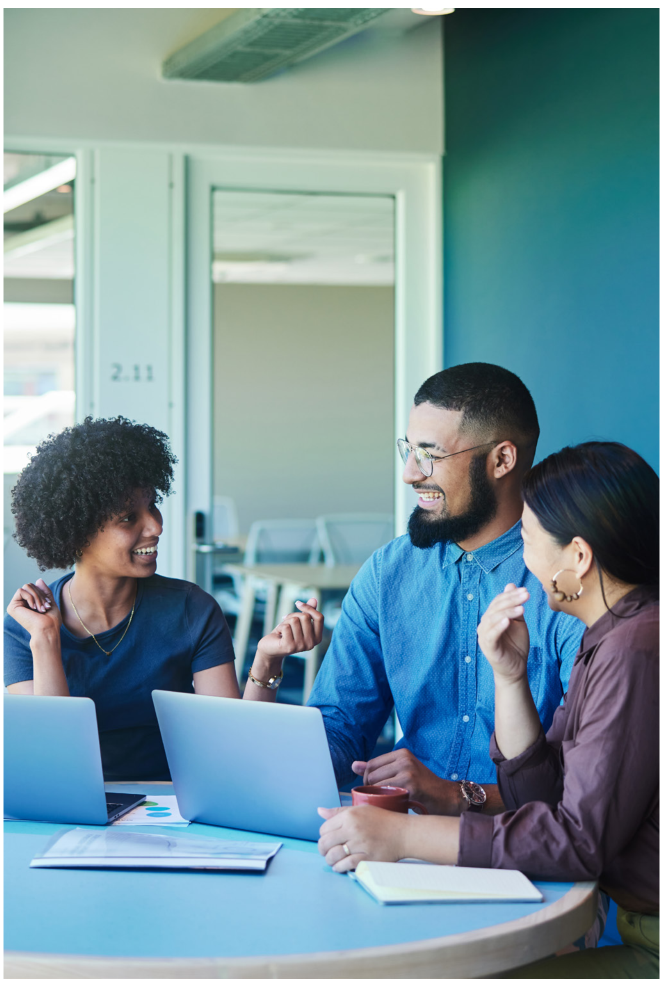
Employers should update their systems to account for the changes.

Federal interest rates

On June 5, 2025, the IRS issued Revenue Ruling 2025-11 to provide the tax overpayment and underpayment interest rates for July 1–September 30, 2025. The rates can be found at Revenue Ruling 2025-11, Determination of Rate of Interest.

Form 941, Schedule B instructions

The IRS released the June 2025 updates to Schedule B, *Report of Tax Liability for Semiweekly Schedule Depositors*, which accompanies Form 941, *Employer's Quarterly Federal Tax Return*, if applicable. There are no significant changes from the 2024 version.



State updates

Alabama enacts 30-day de minimis threshold

On May 14, 2025, Alabama House Bill 379 was enacted, implementing a de minimis exception to Alabama income tax withholding for certain services. Under the bill, compensation paid to a nonresident individual for work performed in Alabama is exempt from Alabama income tax withholding if the individual meets all the following four criteria:

1. The compensation was for employment duties performed in Alabama 30 or fewer days in the calendar year.
2. The individual performed employment duties in more than one state during the calendar year.
3. The compensation is not for duties as a professional athlete, professional entertainer, or public figure.
4. The nonresident individual's state of residence:
   a. Provides a substantially similar exclusion; or
   b. Does not impose an individual income tax; or
   c. The individual's income is exempt from taxation by this state under the US Constitution or federal statute.

If these criteria are met, the employer is not required to withhold or remit Alabama income tax from compensation paid to the employee. However, if the number of days worked in Alabama exceeds the 30-day threshold, the employer must withhold and remit Alabama tax for every day worked in the calendar year, retroactive to the first day worked.

Furthermore, nonresidents performing disaster or emergency-related work on a temporary basis, in response to a declaration by the president of the United States or the governor of Alabama, are exempt from state and local income tax withholding during such declared emergency.

Payroll professionals should prepare to adjust their withholding practices, accordingly, ensuring compliance with the new regulations.

Alabama expiration of overtime wage exemption

On June 4, 2025, the Alabama Department of Revenue confirmed that the exemption of overtime wages from state income tax expires June 30, 2025. This rule is separate from any federal initiatives.

Iowa implements changes to the state's unemployment insurance tax system

Iowa Senate File 607 (SF 607), signed by Governor Kim Reynolds on June 5, 2025, implements changes to the state's unemployment insurance (UI) tax system. The bill introduces a surcharge for employers with high average benefit ratios, modifies the definition of "taxable wages," and adjusts the calculation of UI contribution rates.

Key provisions include:

- **Taxable wage calculation:** The bill modifies the calculation of taxable wages by reducing the percentage of the statewide average weekly wage used from 66.66 percent to 33.33 percent, affecting the maximum weekly benefit amounts. The 2025 wage base for Iowa unemployment taxes is $39,500. Under the bill, the estimated wage base will be $19,800.
- **Reserve ratio adjustments:** The computation of the current reserve ratio will now be based on the preceding year, rather than the previous five calendar quarters, and removes certain requirements related to the reserve ratio.
- **Contribution rate table changes:** Adjustments to the contribution rate table will be made, potentially altering employer contribution rates.
- **Employer savings:** Any savings to an employer resulting from these provisions should be used for either employee salaries and benefits, or as an alternative to unemployment benefits during seasonal unemployment. Iowa has not yet released guidance for complying with this rule.

These changes are designed to align UI premiums with benefits paid out of the fund, aiming to balance the system and ensure its sustainability.

New York pays off federal trust fund loan

Pursuant to the Fiscal Year 2026 Enacted Budget published in May 2025, Governor Kathy Hochul announced that New York State paid off almost $7 billion in debt to the federal Unemployment Insurance Trust Fund. In paying off the loan, New York employers are relieved of a 1.2 percent Federal Unemployment Tax Act (FUTA) credit reduction. For an employee who exceeds the New York wage base of $12,800, the credit reduction would have cost the employer an additional $153. The weekly benefit for unemployed workers will increase from $504 to $869 in October.

The debt payoff and increased benefits are expected to be partially funded by an annual increase in the wage base. In recent years, the wage base has increased by about $200–$300 per year. After 2026, the wage base will be adjusted to 16 percent of the state average annual wage.

Oregon aims to enhance transparency in employee pay statements

Oregon Senate Bill 906, introduced in the 2025 legislative session, aims to enhance transparency in employee pay statements. The bill mandates that employers provide itemized wage statements that clearly outline the amount and purpose of each deduction in plain language. This initiative seeks to address concerns raised by workers about the complexity of current pay statements and to ensure that employees can easily understand their earnings and deductions.

Additionally, the bill allows for the electronic delivery of these statements, if employees consent to receive them in this format and have the means to access, print, or store the information. Employers must also furnish a written explanation of pay details at the time of hire and within 14 days of an employee's request.

For payroll professionals, SB 906 necessitates updates to payroll systems and processes to accommodate the new requirements. Employers will need to ensure that pay statements are clear, accurate, and accessible to all employees, including those who prefer traditional paper statements. Compliance with these provisions will be crucial to avoid potential legal issues and to foster trust and transparency in the employer-employee relationship.

Vermont updates UI and wage-hour laws under SB 117

On May 28, 2025, Governor Phil Scott signed Senate Bill 117 into law, introducing significant changes to Vermont's UI and wage and hour regulations. These amendments aim to modernize the state's labor laws, enhance worker protections, and align with evolving economic conditions.

Unemployment insurance

SB 117 refines how Vermont determines its annual unemployment tax rate schedule. Going forward, the calculation will include the cost of any state-funded extended unemployment benefits, which had previously been excluded.

SB 117 also clarifies reporting obligations for successor employers. If a business is acquired and later divided into multiple corporate entities, one designated entity may file a single quarterly wage report on behalf of all the successor operations. The report must account for all employees under the successor business structure.

In addition, SB 117 extends the timeline for launching Vermont's new UI technology system, pushing the implementation deadline from July 1, 2025, to July 1, 2026. The new system is expected to streamline UI administration and enable the reinstatement of the short-time compensation program, which expired in 2020 and allowed employers to reduce work hours instead of resorting to layoffs.

The law also introduces practical improvements for employers by allowing electronic delivery of UI notices, communications, and determinations from the Vermont Department of Labor.

Wage and hour law adjustments

The bill amends the state's wage recovery provision to clarify how penalties are distributed. When an employer is found to have willfully withheld wages, they are liable for up to double the unpaid amount. SB 117 clarifies that only the additional penalty, above the owed wages, is split between the employee and the state, with half going to the employee and the remainder used to cover enforcement costs.

SB 117 also formally repeals outdated language that allowed the Department of Labor to propose subminimum wages for workers with disabilities, even though Vermont has prohibited subminimum wages for workers with disabilities since 2002.

These changes reflect Vermont's ongoing efforts to modernize its labor laws and improve administrative efficiency.

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