

# NAJJAR EMPLOYMENT LAW GROUP, PC

- A Labor, Employment and Benefits Boutique Law Firm -

## **One Big Beautiful Bill Act: What HR Professionals Need to Know**

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On July 4, 2025, the One Big Beautiful Bill Act (OBBBA) (P.L. 119-21) — a sweeping omnibus reform package — was signed into law by President Donald Trump. The OBBBA was a key part of the Trump Administration’s core policy agenda and includes expansive policy and regulatory changes impacting nearly every sector of the American economy. The final version is approximately 870 pages and contains hundreds of provisions that impact a diverse range of policies and government initiatives. While much of the media coverage has focused on the phasing out of clean energy provisions – such as the EV tax credit and cuts to Medicaid spending, the bill introduces significant employment law and employee benefits reforms that will impact employers across industries. For our clients and friends, this newsletter summarizes the most significant provisions of the OBBBA for Human Resource professionals, which require attention for compliance as well as opportunities for attracting and retaining talent through benefit program enhancements.

### **Bicycle Commuting Credit:**

As evidence of the far-reaching effects of the OBBBA, the bill permanently eliminated the exclusion from Gross Income of reimbursements paid by the employer for expenses to purchase, repair or store a bike regularly used to travel to work. Prior to 2018, employees could exclude up to \$20 a month as a fringe benefit. The Bicycle Commuting credit was temporarily eliminated from 2018-2025 by the Tax Cuts and Job Act. OBBBA permanently eliminates the Bicycle Commuting Credit.

### **No Tax on Tips:**

The OBBBA introduced a federal income tax deduction for qualified tips (up to \$25,000).<sup>1</sup> The provisions are found in newly created I.R.C. Section 224.<sup>2</sup> These provisions apply to taxable years beginning after December 31, 2024, and are set to sunset after December 31, 2028. I.R.C. Section 224(a) allows an above-the-line deduction equal to the amount of “qualified tips” received during the taxable year, provided such amounts are included in wage reporting under I.R.C.

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<sup>1</sup> See, Neil Aragonés et al., One Big Beautiful Bill Act (2025): An Analysis (Matthew Bender 2025).

<sup>2</sup> I.R.C. §§ 224, as added by H.R. 1, 119th Cong., Pub. L. No. 119-21, §§ 70201, 70202 (2025).

Sections 6041(d)(3), 6041A(e)(3), 6050W(f)(2), 6051(a)(18), or are reported voluntarily by the taxpayer on Form 4137 (or successor).<sup>3</sup>

However, the deduction is limited to a maximum of \$25,000 per year and is subject to a reduction of \$100 for every \$1,000 by which the taxpayer's modified adjusted gross income exceeds \$150,000 (\$300,000 if joint return).<sup>4</sup> I.R.C. Section 224(d)(1) defines "qualified tips" "as cash tips [including credit card and tip-sharing arrangements] received in occupations that customarily received tips as of December 31, 2024, as determined by the Secretary of the Treasury." Such term does not include any amount received by an individual unless the "tip" is paid voluntarily without any consequence in the event of nonpayment, is not the subject of negotiation, and is determined by the payor. I.R.C. Section 199A(d)(2).<sup>5</sup> If applicable, the deduction is available regardless of whether the individual itemizes or takes the standard deduction. Importantly, Social Security and Medicare taxes still apply to these earnings. Employers and contractors must separately report qualifying tips on W-2s or 1099s.

OBBBA required the IRS to publish a list of occupations within 90 days of enactment that "customarily and regularly" received tips on or before December 31, 2024. The proposed regulation lists 68 separate occupations of tipped workers, ranging from traditionally tipped occupations including bartenders and waitstaff to water taxi operators.<sup>6</sup> The proposed regulation further clarifies that in order to claim the deduction, a worker must both be in an occupation on the list and receive a "qualified" tip which considers various factors; expressly noting that event tickets, meals, services, and "other assets that are not exchangeable for a fixed amount in cash (such as most digital assets)" are ineligible and qualified tips do not include some service charges. For instance, if a restaurant imposes an automatic 18% service charge for large parties and distributes that amount to waiters, bussers and kitchen staff, it would not qualify as a "tip" or if the "tip" is added with no option for the customer to disregard or modify it, the amounts distributed to the workers from it are not qualified tips.

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<sup>3</sup> See I.R.C. §§ 224(a).

<sup>4</sup> See I.R.C. §224 (b)(1), (2)

<sup>5</sup> "Specified Service Trade of Business" is defined as:

(A) any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees,

(B) any banking, insurance, financing, leasing, investing, or similar business,

(C) any farming business (including the business of raising or harvesting trees),

(D) any business involving the production or extraction of products of a character with respect to which a deduction is allowable under section 613 or 613A, and

(E) any business of operating a hotel, motel, restaurant, or similar business.

<sup>6</sup> <https://www.irs.gov/newsroom/treasury-irs-issue-guidance-listing-occupations-where-workers-customarily-and-regularly-receive-tips-under-the-one-big-beautiful-bill>;

<https://www.federalregister.gov/documents/2025/09/22/2025-18278/occupations-that-customarily-and-regularly-received-tips-definition-of-qualified-tips>

Moreover, the tax will be paid up front and then there will be up to a \$25,000 deduction on the employee's tax return from federal taxes (subject to the AGI phase out). These tips are still subject to Social Security at 6.2% and Medicare at 1.45% withheld, the only savings will be less federal taxes paid. There are no exceptions for State tax. Employers should use caution with "tip credits"; as state and federal law diverge. There are some rumors that customers will tip less if the tip is "tax free."

**TAKE AWAY:** The No Tax on Tips further complicates reporting obligations for employers to have their employees report tips to the employer (especially for cash tips) and for the employer to report to the IRS. Employers also must differentiate between "qualified" and non-qualified tips, i.e. service charges and mandated "large party" tips added automatically to the dining bill will not be eligible for the deduction.

### **No Tax on Overtime:**

The OBBA introduced newly created I.R.C. Section 225 allowing for an above-the-line (subtracted directly from taxpayer's gross income to determine Adjusted Gross Income) deduction for "qualified overtime compensation," defined as overtime pay required under Section 7 of the Fair Labor Standards Act (FLSA) of 1938, paid in excess of the regular rate of pay.<sup>7</sup> An individual may only deduct such amount if it is included on Forms W-2 or equivalent information returns.<sup>8</sup>

The deduction is limited to a maximum of \$12,500 for individuals and \$25,000 for joint filers, beginning in tax year 2025 and sunseting in 2028. The deduction phases out for modified adjusted gross incomes over \$150,000 (\$300,000 for joint filers). The phase out uses the same formula as the deduction for the tax on tips in I.R.C. § 224, with a reduction of \$100 for every \$1,000 in MAGI (modified adjusted gross income) above \$150,000 (\$300,000 for joint filers).

Overtime compensation does not include amounts already deducted as qualified tips under I.R.C. Section 224.<sup>9</sup> Only overtime compensation due under the FLSA qualifies for the deduction, meaning discretionary bonuses, extra shifts, or hazard pay not subject to FLSA Section 7 are ineligible.

**TAKE AWAY:** Employers should review their recordkeeping and payroll systems to account for the distinction between FLSA-defined overtime and any additional overtime (e.g., double-time) that does not qualify for the deduction. Employers are required to accurately report qualifying overtime on W-2s or other IRS-specified forms (for nonemployees, under I.R.C. Section 6041(a) and (d)(4)). The IRS is granting transitional relief allowing employers to approximate reportable amounts

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<sup>7</sup> See I.R.C. § 225(c)(1).

<sup>8</sup> See I.R.C. § 225(a)

<sup>9</sup> See I.R.C. § 225(c)(2).

for periods before January 1, 2026.<sup>10</sup> Because these new deductions do not affect payroll taxes, employers still withhold FICA on all tips and overtime. OBBBA ushers in a new recordkeeping paradigm: employers need precise time-tracking systems that distinguish FLSA-required overtime from state-mandated or voluntarily paid premium rates, and robust payroll processes to tag and report each qualifying dollar at year-end.

### **Employee Benefits:**

#### **Paid Family and Medical Leave (PFML) Credit:**

The OBBBA makes permanent and expands the I.R.C. Section 45S tax credit, originally passed in 2017 as part of the Tax Cuts and Jobs Act, allowing a general business tax credit for employers who offer PFML to eligible employees. The tax credit was intended to be temporary when first passed in 2017 and was extended temporarily several times. The credit is equal to 12.5% of the wages paid to an employee on leave, increasing by 0.25% for each percentage point of wages paid over 50%, up to a maximum of 25%. The tax credit was set to expire on January 1, 2026.

The OBBBA expanded the credit to include employer eligibility for a credit based on a portion of insurance premiums paid for an employee on PFML and a credit for employers in states with mandated PFML laws. Previously, employers in states with mandated PFML programs were not eligible for the credit. OBBBA expands the availability of the tax credit if the PFML benefits paid by the employer exceed the state mandate. The credit may be applied to the difference between the employer's benefit and the state requirement.

The PFML expanded credit applies to tax years beginning after December 31, 2025.

#### **Childcare Credits:**

Starting in 2026, OBBBA permanently raises the annual income exclusion for dependent care assistance programs, which includes employee pretax contributions to dependent care flexible spending arrangements and employer-subsidized childcare expenses, such as onsite day care centers. The exclusion amount will increase from \$5,000 to \$7,500, and from \$2,500 to \$3,750 for married couples filing separately. These amounts are not indexed for inflation.

Starting in 2026, OBBBA also permanently expands the dependent care tax credit (non-refundable) making it more beneficial for qualifying employee taxpayers. The maximum applicable percentage of dependent care expenses increases from 35% to 50%. However, the dependent care tax credit begins to phase down gradually from 50% based on the individual's Adjusted Gross Income. The credit plateaus at 20% for those with an AGI exceeding \$103,000

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<sup>10</sup> See H.R. 1, 119th Cong., Pub. L. No. 119-21, § 70202(h) (2025).

(\$206,000 for joint filers). The maximum eligible dependent care expenses remain unchanged at \$3,000 for one qualifying individual and \$6,000 for two or more qualifying individuals.

Starting in 2026, OBBBA increases the maximum employer-provided childcare tax credit (non-refundable) from \$150,000 to \$500,000 (indexed for inflation), and the percentage of “qualified childcare expenditures” covered from 25% to 40% (\$600,000 and 50% for eligible small businesses). This employer tax credit is an incentive for employers to provide childcare services — such as onsite day care — to their employees. This employee benefit, however, would be subject to nondiscrimination testing. This test requires that the average benefits provided to non-Highly Compensated Employees (non-HCEs) be at least 55% of the average benefits provided to HCEs — for 2026 testing, generally, employees earning over \$160,000 in 2025 — across all dependent care assistance programs of the employer. If the test is not met, all benefits actually paid to or received by HCEs would be taxable. Similarly, if an employer offers a childcare subsidy, employees are limited by how much of the subsidy is treated as pre-tax income. Subsidies would be capped at \$5,000 (\$7,500 effective in 2026). Any amount exceeding the cap will be considered imputed income to the employee.

#### Student Loan Repayment:

Before 2020, any employer education assistance program that included payments towards an employee’s student loan debt were considered taxable income. The CARES Act, passed in March 2020, included a temporary provision expanding Section 127 of the Internal Revenue Code, which governs educational assistance programs. This expansion allowed employers to provide up to \$5,250 per year in tax-free assistance for student loan repayment. This benefit initially applied to payments made after March 27, 2020 and was set to expire at the end of 2020. The provision allowing for tax free payments toward student loan debt was extended through January 1, 2026 by the Consolidated Appropriations Act, 2021 (CAA), signed into law on December 27, 2020.

The OBBBA made the employer student loan repayment assistance tax exclusion permanent. Additionally, starting in 2027, the \$5,250 annual cap on these excluded payments will be adjusted for inflation. The inflation adjustment will be calculated based on the cost-of-living adjustment determined under Section 1(f)(3) of the Internal Revenue Code.

Employers offering education assistance programs that were expecting the student loan repayment provisions to sunset in January 2026 should adjust accordingly. Additionally, employers not currently offering education assistance programs may be incentivized to offer such programs now that the tuition assistance provisions are made permanent. Employers may also consider implementing such programs as part of employee compensation and benefits packages to attract and retain employees due to the Education Department resumption of collecting interest on student loans starting on August 1, 2025 from borrowers currently enrolled in the Biden-era SAVE plan, which was eliminated by the OBBBA.

### Expansion of Section 529 Plans:

The OBBBA expanded the provisions of Section 529 plans to include expenses for elementary, secondary or homeschool education. OBBA increases from \$10,000 to \$20,000 the limit of distributions for elementary or secondary schools. Expanded expenses are now eligible for tax-free withdrawals to include tuition, fees, books, supplies, equipment and expenses related to enrollment or attendance in a recognized post-secondary credentialing program.

### Health Savings Accounts (HSAs):

I.R.C. Section 223 authorizes individuals to establish Health Savings Accounts (HSAs). HSA accounts are “triple tax advantaged” meaning contributions through payroll are made pre-tax, earnings are tax free, and withdrawals for qualifying medical expenses are also tax free. HSAs are intended to encourage saving for qualified medical expenses. However, to be eligible to contribute to an HSA, an individual must be covered under a “high deductible health plan” (HDHP) and must not have other disqualifying health coverage.

Prior to OBBBA, an HDHP was defined in I.R.C. Section 223(c)(2)(A) as a health plan that had a minimum annual deductible and a maximum out-of-pocket cost threshold, adjusted annually for inflation. For calendar year 2025, these figures are \$1,650/\$3,300 for self-only/family minimum deductibles and \$8,300/\$16,600 for maximum out-of-pocket costs. Further, an HDHP, must not provide any benefit before the deductible is satisfied, subject to limited exceptions (e.g., preventive care).

The OBBBA expanded HSA compatibility to include all Bronze-level and catastrophic health plans on state insurance exchanges. Effective for months beginning after December 31, 2025, bronze and catastrophic plans offered through ACA exchanges will be deemed HDHPs for HSA purposes, regardless of whether they satisfy the standard deductible and benefit design requirements of I.R.C. Section 223(c)(2)(A). The OBBBA also permanently allows telehealth coverage before the deductible is satisfied in HDHPs without affecting HSA eligibility.

### Trump Accounts:

The OBBBA established the “Trump Account” program that provides for a savings program for all United States citizen children under age 18. A Trump Account will be established and funded for each child born between January 1, 2025, and December 31, 2028 with an initial \$1,000 from the federal government. The tax-advantaged accounts are established for children at the time of birth. A Trump Account can only be established by the Department of the Treasury on behalf of a minor child. Contributions to Trump Accounts may be made starting on July 4, 2026.

Under the program, parents, as well as other tax-paying entities – e.g. employers, may contribute to a Trump account on behalf of a child every year until the child turns 18. Up to \$5,000 per year of after-tax dollars (adjusted for inflation) may be contributed to a Trump Account. The

Trump Accounts will follow traditional IRA rules under Section 408 of the Internal Revenue Code after the child turns 18.

Unlike a traditional IRA, an employer may contribute directly to a Trump Account under new I.R.C. Section 128. An employer may choose to offer such benefit to employees to attract and retain employees with children or who are planning to have children. Employers will need to implement a written program relating to Trump Account contributions. I.R.C. Section 128(c) requires employers that choose to contribute to Trump Accounts to establish a written “Trump Account Contribution Program” that is a “separate written plan of an employer for the exclusive benefit of his employees to provide contributions to the Trump accounts of such employees or dependents of such employees which meets requirements similar to the requirements of paragraphs (2), (3), (6), (7), and (8) of section 129(d) (Section 129 relates to Dependent Care Assistance Programs).” Any contributions or benefits provided under the employer’s Trump Account Contribution Program may not discriminate in favor of employees who are highly compensated employees. Employers also will be required to provide reasonable notification of the availability and terms of the program to eligible employees. Employer contributions to Trump Accounts will be subject to the average benefits test applicable to Dependent Care Assistance Programs. The average benefits provided to non-highly compensated employees must be at least 55% of the average benefits provided to HCEs.

Employers may choose to contribute up to \$2,500 per year to a Trump Account which will count towards the annual \$5,000 limit and be indexed to inflation starting in 2027. Employer contributions to Trump Accounts will not be included in the employee’s gross income. An employer can contribute to the accounts of employees’ dependent children who are under 18, as well as to the accounts of employees who are under 18. Due to the complex nature of the Trump Accounts and some ambiguities relating to ERISA, agency guidance is expected to be released.

#### Moving Expenses:

The Tax Cuts and Jobs Act of 2017 temporarily suspended the deduction for qualified moving expenses under IRC Section 217 and the corresponding exclusion from income under IRC Section 132(g). The temporary suspension was scheduled to sunset in 2025. The OBBBA permanently eliminated the deduction and income exclusion, except for members of the armed forces or intelligence community beginning in 2026.

While employers should have already been aware of the elimination of the deduction for moving expenses, employers should review their relocation policies for federal tax compliance and continue to treat moving expense reimbursements as taxable compensation to employees.

**TAKE AWAY:** Benefit professionals should review the OBBBA changes relating to their benefit plans to assure compliance, as well as assess whether they may be able to take advantage of opportunities to enhance benefits and attract and retain workers.

## **Immigration and Border Enforcement:**

### **Immigration Application Fees:**

The OBBBA introduced additional and/or increased fees relating to filing applications for various immigration matters. Employers that sponsor immigrant employees should expect to pay higher fees for any related immigration applications on behalf of the employee. Applicants must submit the new fees with benefit requests postmarked on or after July 22, 2025. USCIS will reject any form postmarked on or after Aug. 21, 2025, without the proper fees. USCIS will deposit and retain a portion of the revenue from some of these fees in the Immigration Examinations Fee Account (IEFA). The remaining revenue will be deposited with the general fund of the Treasury. USCIS clarified in guidance issued July 18, 2025<sup>11</sup> that the new fees introduced in the OBBBA “do not supersede or replace those promulgated by the USCIS Fee Rule, rather they will be charged “in addition” to current fees.” Each fee must be submitted separately. The new OBBBA fees are not eligible for fee waiver under 8 C.F.R. 106.3(a). The new or additional fees are indexed for inflation, ensuring ongoing increases over time.

The new fees include:

- A new fee of \$100 for aliens who file Form I-589, Application for Asylum and for Withholding of Removal;
- Annual Asylum Fee (AAF) of \$100 (which must be paid online) for all aliens with a pending Form I-589 for each calendar year their application remains pending.
- A new fee for aliens who file Form I-765, Application for Employment Authorization, for asylum, parolee, and Temporary Protected Status (TPS) categories. The categories are (a)(4), (a)(12), (c)(8), (c)(11), (c)(19), and (c)(34). The fees are:
  - For initial EAD applications, \$550; and
  - For renewal or extension EAD applications, \$275.
- A new Temporary Protected Status application fee of \$500.
- A new fee of \$550 for filing initial application for TPS EAD.
- A new TPS EAD renewal and extension fee of \$275.
- A new fee of \$1,000 for those seeking a parole document by filing Form I-131 (unless one of ten exceptions applies based on the reason for seeking parole).<sup>12</sup>

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<sup>11</sup> “USCIS Updates Fees Based on H.R. 1” available at <https://www.uscis.gov/newsroom/alerts/uscis-updates-fees-based-on-hr-1>

<sup>12</sup> 1. The person has a medical emergency and the person cannot obtain necessary treatment in the country where the person resides or the medical emergency is life-threatening and there is insufficient time for the person to be admitted to the United States through the normal visa process.

2. The person is the parent or legal guardian of a person described in 1 and that person is a minor.

3. The person is needed in the United States to donate an organ or other tissue for transplant; and there is insufficient time for the person to be admitted to the United States through the normal visa process.

4. The person has a close family member in the United States whose death is imminent; and the person could not arrive in the United States in time to see such family member alive if the [noncitizen] were to be admitted to the United States through the normal visa process.

- Initial parole based EAD fee of \$550.
- Parole based EAD renewal and extension fee of \$275.
- Special Immigrant Juvenile Fee of \$250.
- Nonimmigrant visa fee of \$250 (expected to apply to any application for a nonimmigrant visa that requires the USCIS' approval of a petition or application, e.g. F, H, L and O visas).
- Application for I-94 fee of \$24.

In addition to the new fees, the OBBBA shortened the validity period of certain Employment Authorization Documents (EAD) for individuals holding TPS status and parolees. Parolees (category C11) are now only eligible for an employment authorization document that is valid for the shorter of one year or the duration of parole. Similarly, individuals in TPS status (categories A12/C19) will be eligible for an employment authorization document that is valid for the shorter of one year or the duration of TPS status. Individuals in TPS status that have a renewal EAD application pending or filed on or after July 22, 2025, will be eligible for an automatic extension of 1 year or the duration of TPS (whichever is shorter) past the EAD expiration date as shown on the EAD. USCIS guidance states that an expired or expiring EAD and Form I-797C, Notice of Action, receipt notice, will serve as acceptable proof of identity and employment authorization during the automatic extension period. Employers must be mindful of the shorter EAD validity periods for individuals in TPS and Parolee status and timely complete I-9 reverification. NOTE: On October 30, 2025, the Department of Homeland Security will publish an interim final rule ending the practice of automatically extending employment authorization documents for aliens filing renewal applications in certain employment authorization categories. Aliens who file to renew their EAD on or after Oct. 30, 2025, will no longer receive an automatic extension of their EAD, with limited exceptions, including extensions provided by law or through a Federal Register notice for TPS-related employment documentation.

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5. The person wants to attend the funeral of a close family member and the person could not arrive in the United States in time to attend such funeral if the [noncitizen] were to be admitted to the United States through the normal visa process.

6. The person is an adopted child who has an urgent medical condition, who is in the legal custody of the petitioner for a final adoption-related visa; and whose medical treatment is required before the expected award of a final adoption-related visa.

7. The person is a lawful applicant for adjustment of status under INA § 245 and is returning to the United States after temporary travel abroad.

8. The person has been returned to a contiguous country pursuant to INA § 235(b)(2)(C) (regarding applicants for admission who are not clearly and beyond a doubt entitled to be admitted); and is being paroled into the United States to allow the person to attend the immigration hearing.

9. The person has been granted the status of Cuban and Haitian entrant (as defined in section 501(e) of the Refugee Education Assistance Act of 1980 (Public Law 96-422; 8 U.S.C. 1522 note).

10. DHS determines that a significant public benefit has resulted or will result from the parole of the person who has assisted or will assist the United States Government in a law enforcement matter; whose presence is required by the United States Government in furtherance of such law enforcement matter; and who is inadmissible or does not satisfy the eligibility requirements for admission as a nonimmigrant; or for which there is insufficient time for the [noncitizen] to be admitted to the United States through the normal visa process. OBBA sec. 100004.

### Increased Funding:

The OBBBA significantly increases funding for immigration and border enforcement agencies like ICE and CBP. The OBBBA provides \$170.7 billion in additional funding to the Department of Homeland Security (DHS) and its sub-agencies, Immigration and Customs Enforcement (ICE) and Customs and Border Protection (CBP) as well as for the Department of Defense (DOD). With increased funding, employers should expect more frequent and rigorous I-9 audits and worksite enforcement actions, especially in industries commonly targeted including construction, hospitality, and agriculture. Employers should review I-9 records, train HR and front-line managers on document verification, and adopt a centralized compliance protocol to minimize enforcement risk.

TAKE AWAY: Employers who rely on foreign nationals to supplement their workforce must remain abreast of rapidly changing immigration policy and the increased costs of employing foreign labor. Employers also should be prepared for I-9 audits and proactively assure compliance.

### **Other Relevant Changes:**

#### No Tax on Social Security:

The OBBBA repealed the personal exemption tax deduction for most taxpayers. It establishes a temporary (2025-2028) personal exemption tax deduction of up to \$6,000 (\$12,000 jointly) for individuals who are 65 or older (subject to income limitations). The deduction begins to phase out for filers with a MAGI over \$75,000 for single filers and \$150,000 (married filing jointly).

#### Unemployment Benefits Capped for Millionaires:

The OBBBA prohibits payment under the federal unemployment program to individuals whose wages are above \$1 million. State agencies that administer the programs must recover overpayment.

#### Executive Compensation:

##### *Publicly Traded Companies:*

The OBBBA modifies the operation of the \$1 million deduction cap for executive compensation paid by publicly traded companies under I.R.C. Section 162(m). Section 162(m) limits a publicly held corporation's tax deduction related to employee compensation to \$1 million per taxable year per covered employee. Prior to the OBBBA amendments, Section 162(m) used the affiliated group rules under Section 1504 to determine the nondeductible amounts of compensation. Under the OBBBA amendments, the Section 162(m) limit applies to publicly traded corporations that are members of a controlled group. Thus, Section 162(m) applies to the aggregate compensation deduction for all members of the controlled group. A "controlled group"

under I.R.C. Sections 414(b), (c), (m) and (o) can include entities other than corporations, such as partnerships, unlike the affiliated group rule used prior to the OBBBA amendment. The OBBBA amendment to I.R.C. Section 162(m) is effective for taxable years beginning after December 31, 2025.

Section 162(m) was previously amended by the American Rescue Plan Act of 2021 (ARPA), to expand the definition of “covered employee” to include the top five highest-paid employees during the taxable year for tax years beginning after December 31, 2026. Under the OBBBA amendment, compensation paid to a covered employee by all members of the controlled group is aggregated and cannot exceed the \$1 million cap. Employers must analyze executive compensation under the new controlled group standard and adjust executive compensation as necessary.

*Applicable Tax-Exempt Entities:*

Introduced in the Tax Cuts and Jobs Act of 2017 (TCJA), I.R.C. Section 4960 imposes a 21% excise tax on remuneration in excess of \$1 million and on excess severance payments (amount equal to or exceeding three times their five-year average annual compensation) paid by applicable tax-exempt organizations to any “covered employee.” An employer could be subject to I.R.C. 4960 even if not paying any individual in excess of \$1 million if: (1) it had one or more “highly compensated” employees (HCEs) in any year after 2017 (i.e., it paid any employee \$160,000 or more for 2025); and (2) the employee was paid excessive severance due to the involuntary termination of the individual’s employment. Tax-exempt employers need to closely monitor compensation over \$1 million or excess severance payments to ensure that they are not be subject to the excise tax, as the tax is imposed on the employer, not the employee.

A “covered employee” includes any employee who is one of the five highest-compensated employees of the organization for the taxable year or was a covered employee in any preceding year beginning after 2016. The OBBBA expands the definition of covered employee for taxable years beginning after December 31, 2025, to include all employees (including former employees who were employed in 2017 or later years) of an applicable tax-exempt organization. Under the expansion, any individual who was employed by the organization in a taxable year beginning after December 31, 2016, and who receives compensation exceeding the threshold, may be subject to the tax—even if they are no longer employed at the time of payment. The new law requires that the individuals covered must have been employees of the organization during taxable years beginning after December 31, 2016. This change effectively broadens the scope of the tax to include severance or deferred compensation paid to former employees, regardless of whether they were among the top five highest-paid in any given year. This expansion is significant because it retains the same definition of an excess parachute payment, so it in essence applies to any employee compensated at or above the annual defined limit for a highly compensated employee who receives a severance payment.

## Conclusion

The OBBBA brings several notable changes impacting employers, particularly regarding tax deductions for tips and overtime, employee benefits, and immigration enforcement. Adapting to these changes will require proactive planning and potential adjustments to payroll and benefits strategies. Employers will need to adjust payroll systems to accurately track and report qualified tips and overtime for tax years 2025-2028. For 2025, employers can use reasonable estimation methods for these amounts, however, beginning in 2026, employers will need to accurately document these amounts.

By proactively aligning policies and technology, employers can turn these complex legislative shifts into competitive advantages — streamlining compliance, reducing tax burdens for employees, and updating and enhancing benefits programs. Employers should review employee handbooks, payroll systems, and employee benefit plans and update as necessary to ensure compliance with the OBBBA. Beyond mandatory compliance obligations imposed by the OBBBA, employers may use the OBBBA to their advantage by leveraging expanded tax-free benefits (e.g., child-care, student-loan assistance, enhanced HSA/DPC designs, and Trump Accounts) to attract and retain top talent.

Our Labor, Employment and Benefits attorneys are ready to assist employers in drafting, reviewing and revising employment-related policies and practices in light of these recent changes in the legal landscape to optimize both compliance and best practices.

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Our labor and employment attorneys, working with our pension and benefits attorneys, bring together one cohesive team with diverse capabilities to assist our clients in managing and addressing complex benefits and employment law issues which arise in the workplace. Our team understands the importance of learning about each client's business and culture.

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