



Bill Analysis

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Sponsor:

Bill Number: AB 1550

Related Bills: See Legislative
History

Introduced: January 7, 2026

SUBJECT

Qualified Tips and Overtime Compensation Deductions Conformity

SUMMARY

This bill would, under the Personal Income Tax Law (PITL), conform, with modifications, to the federal law that allows a deduction for qualified tips and overtime compensation for taxable years beginning on or after January 1, 2026, and before January 1, 2029.

RECOMMENDATION

No position—The three-member Franchise Tax Board has not formally voted or taken a position on this bill.

SUMMARY OF AMENDMENTS

Not applicable.

REASON FOR THE BILL

The reason for the bill is to help workers retain more of their earnings.

ANALYSIS

This bill would, under the PITL, for taxable years beginning on or after January 1, 2026, and before January 1, 2029, conform to the two federal provisions discussed below:

1. Deduction for Tips - Allow a deduction of up to \$25,000 for qualified tips received during the taxable year as specified under Internal Revenue Code (IRC) section 224. Qualified tips are tips received by an employee in an occupation where it is customary to receive tips on a regular basis. The qualified tips deduction is further limited by a taxpayer's modified adjusted gross income (MAGI) if such income exceeds a certain income threshold. See an expanded explanation of the requirements under the Federal Law portion of this analysis.
2. Deduction for Overtime - Allow a deduction of an amount equal to qualified overtime compensation received during the taxable year, not to exceed \$12,500 (\$25,000 for married filing jointly) as specified under IRC section 225. Qualified overtime compensation is overtime compensation paid to an employee, as

required by law, generally for working more than forty hours in a workweek, as required by law, that is in excess of their regular rate. The qualified overtime compensation is further limited by a taxpayer's MAGI if such income exceeds a certain threshold. See an expanded explanation of the requirements under the Federal Law portion of this analysis.

In addition, this bill would do the following:

- Provide that IRC section 224(e) and 225(d), does not apply, therefore a taxpayer would not be required to provide a valid Social Security number (SSN) on a return to claim the deduction.

In addition, this bill would do the following:

- Allow the deduction for qualified tips and overtime compensation when computing taxable income for those individuals who do not itemize deductions.
- Clarifies that the qualified tips and overtime compensation deduction is in addition to the standard deduction.

For purposes of complying with RTC section 41, this bill would require the Franchise Tax Board (FTB) to provide a report including the number of taxpayers deducting tips or overtime compensation from income and the average dollar value of the amount of those deductions to the Legislature no later than December 1, 2029, to the extent that data is available. The RTC section 41 reporting requirement would be treated as an exception to the general prohibition against disclosure of confidential taxpayer information.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and both provisions, the deduction for qualified tips and qualified overtime compensation, would be specifically operative for taxable years beginning on or after January 1, 2026, and before January 1, 2029.

Federal/State Law

Federal Law

Qualified Tips

Federal law allows a deduction of up to \$25,000 for qualified tips received during the taxable year beginning on or after December 31, 2024, and before January 1, 2029. The deduction is reduced by \$100 for each \$1,000 by which the taxpayer's MAGI exceeds \$150,000 (\$300,000 for married filing joint). This deduction is in addition to the standard deduction for taxpayers who do not itemize.

“Qualified tips” are defined as tips received from customers that are paid in cash or charged, and, in the case of an employee, tips received under any tip sharing arrangement, in an occupation that receives tips on a customary and regular basis. Qualified tips do not include amounts that are not provided voluntarily, not in a specified service trade or business, or excluded under guidance as established by the Secretary.

Federal law requires a valid SSN to be provided on the return to claim the deduction. An omission of the correct SSN on the return is treated as a math or clerical error. Additionally, in the case of a married individual, they must file a joint return to claim the deduction.

Qualified Overtime Compensation

Federal law allows a deduction of an amount equal to qualified overtime compensation received during the taxable year, not to exceed \$12,500 (\$25,000 for married filing joint), for taxable years beginning on or after December 31, 2024, and before January 1, 2029. Qualified overtime must be reported on information returns and statements furnished to the taxpayer. The deduction is reduced by \$100 for each \$1,000 by which the taxpayer’s MAGI exceeds \$150,000 (\$300,000 in the case of a joint return). This deduction is in addition to the standard deduction for taxpayers who do not itemize.

“Qualified overtime compensation” is defined as overtime compensation paid to an individual as required under section 7 of the Fair Labor Standards Act of 1938 that exceeds the regular rate of pay to the employed individual. Qualified overtime compensation does not include any qualified tips.

Federal law requires a valid SSN to be provided on the tax return to claim the deduction. An omission of the correct SSN on the return is treated as a math or clerical error. Additionally, in the case of a married individual, they must file a joint return to claim the deduction.

State Law

There is no comparable deduction for qualified tips or overtime compensation in state law.

Implementation Considerations

None noted.

Technical Considerations

In Section 17201.8(a)(2), replace, "Section 224(e) of the Internal Revenue Code, related to social security number required, and Section 225(d) of the Internal Revenue Code, related to social security number required, shall not apply." with "Section 224(e) of the Internal Revenue Code, *relating* to social security number required, and Section 225(d) of the Internal Revenue Code, *relating* to social security number required, shall not apply."

This bill, within RTC section 17201.8, includes both the qualified tips and overtime compensation deduction as defined in IRC sections 224 and 225. For consistency with deductions listed in the RTC and for taxpayer ease, it is recommended that two separate RTC sections be created for each deduction as follows:

- RTC section 17201.8 could be used for the Qualified Tips deduction as specified under IRC section 224.
- RTC section 170201.9 could be used for the Qualified Overtime Compensation deductions as specified under IRC section 225.

If the above suggestion is made to include the additional code section:

- In Section 17073(c) replace the phrase "and the deductions allowed pursuant to Section 17201.8" with "and the deductions allowed pursuant to Sections 17201.8 and 17201.9" to add the new RTC section as recommended above.
- In Section 17073.5(b) replace the phrase "except for the deductions allowed pursuant to Section 17201.8" with "except for the deductions allowed pursuant to Sections 17201.8 and 17201.9" to add the new RTC section as recommended above.

Policy Considerations

This bill requires the FTB to prepare a report on the performance of the deduction allowed by this bill on or before December 1, 2029. For a report that contains complete information for the 2026 through 2028 taxable years, it is recommended that the report due date be extended to July 2030 if this is a one-time report. If the reporting due date remains unchanged, the report would include the information available as of six months prior to the report due date.

LEGISLATIVE HISTORY

AB 1443 (Castillo, 2025/2026) would have under the PITL, for taxable years beginning on or after January 1, 2026, and before January 1, 2031, treat tips as gifts that would be excluded from gross income. Under the Administration of Franchise and Income Tax Laws (AFITL), this bill would also exclude tips from supplemental wages subject to withholding for purposes of the wage withholding tables that are prepared by the FTB. Under the Unemployment Insurance Code this bill would have excluded tips from wages for unemployment purposes. The bill would have also made changes to other related provisions. AB 1443 did not pass out of Assembly Revenue and Taxation Committee by the constitutional deadline.

SB 17 (Ochoa Bogh, et al., 2025/2026), would under the PITL, for taxable years beginning on or after January 1, 2026, treat tips as gifts that would be excluded from gross income. Under the AFITL, this bill would exclude tips from supplemental wages subject to withholding for purposes of the wage withholding tables that are prepared by the FTB. Under the Unemployment Insurance Code (UIC), this bill would exclude tips from wages for unemployment purposes. The bill would also make changes to other related provisions. SB 17 did not pass out of Assembly Revenue and Taxation Committee by the constitutional deadline.

AB 2080 (Donnelly, 2013/2014), would have under the PITL, treated tips as gifts that would be excluded from gross income, and under the AFITL, would have excluded tips from supplemental wages subject to withholding for purposes of the wage withholding tables that are prepared annually by the FTB. Finally, the bill would have, under the UIC, excluded tips from unemployment. AB 2080 did not pass out of the Assembly by the constitutional deadline.

PROGRAM BACKGROUND

None noted.

OTHER STATES' INFORMATION

None noted.

FISCAL IMPACT

The FTB's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be determined.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 1550
 Assumed Enactment after June 30, 2026

(\$ in Millions)

Fiscal Year	Revenue
2026-2027	-\$2,700
2027-2028	-\$1,600
2028-2029	-\$700

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

Revenue Discussion

This estimate is based upon a proration of the Joint Committee on Taxation (JCT) federal tax expenditure estimate for deductions of tipped income and overtime compensation. In July 2025, the JCT estimated the federal revenue impact of the tip income deduction to be \$10 billion in the 2025-26 fiscal year and the overtime compensation deduction to be \$33 billion in the 2025-26 fiscal year. The combined corresponding loss to California, after accounting for the modified conformity to the SSN requirement, is estimated to be \$1.8 billion in the 2026 tax year.

The tax year estimates are converted to fiscal year estimates and then rounded to arrive at the amounts reflected in the above table.

LEGAL IMPACT

None noted.

EQUITY IMPACT

None noted.

APPOINTMENTS

None noted.

SUPPORT/OPPOSITION

To be determined.

ARGUMENTS

To be determined.

LEGISLATIVE CONTACT

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