STATE OF CALIFORNIA
Franchise Tax Board

Bill Analysis

Author: Ochoa Bogh, et al.

Sponsor:

Bill Number: SB 17

Related Bills: See Legislative History

Amended: April 28 and May 5, 2025

SUBJECT

Tax Deduction - Tips

SUMMARY

Under the Personal Income Tax Law (PITL), for taxable years beginning on or after January 1, 2026, and before January 1, 2036, this bill would allow an above-the-line deduction for qualified tips received by a qualified taxpayer, not to exceed $20,000.

RECOMMENDATION

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

SUMMARY OF AMENDMENTS

The April 28, 2025, amendments removed the income exclusion provision of the bill, as well as the related provisions that would have amended the Unemployment Insurance Code (UIC) and replaced them with the provisions discussed in this analysis.

The May 5, 2025, amendments corrected an Internal Revenue Code (IRC) citation.

REASON FOR THE BILL

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

ANALYSIS

This bill would, for taxable years beginning on or after January 1, 2026, and before January 1, 2036, allow an above-the-line deduction (a deduction from gross income when calculating adjusted gross income (AGI)) equal to the qualified tips received by a qualified taxpayer during the taxable year. The deduction would be limited to $20,000 each taxable year.

A “qualified taxpayer” would mean a taxpayer who satisfies all of the following:

- Works in an occupation where the taxpayer regularly receives more than $20 per month in qualified tips.
- Does not currently hold a professional license issued by the Department of Consumer Affairs, pursuant to the Business and Professions Code, with the exception of a license issued by the State Board of Barbering and Cosmetology.
- Has an AGI, not including the deduction in this bill, that does not exceed the following:
    - A taxpayer who is a head of household, surviving spouse, or a married couple filing a joint return, $250,000.
    - Any other individual, $125,000.

“Qualified tips” would mean tips or voluntary monetary contributions received by a qualified taxpayer from a guest, patron or customer for services rendered to the guest, patron or customer, and the qualified taxpayer reports the tips for purposes of Section 6053 of the IRC, relating to reporting of tips, and the Federal Insurance Contributions Act (26 U.S.C. Sec. 3103 et seq.), relating to the collection of Social Security and Medicare taxes for employees in the United States.

A qualified taxpayer would be required to maintain records that are adequate to substantiate any deduction allowed by this bill and provide them to the Franchise Tax Board (FTB) upon request.

This bill would allow the FTB to adopt regulations necessary or appropriate for purposes of this deduction. Additionally, the FTB would be exempt from the requirements of the Administrative Procedure Act when establishing any standard, criterion, procedure, determination, rule, notice, or guideline.

For purposes of complying with Section 41 of the Revenue and Taxation Code (RTC), the FTB would be required to provide a report to the legislature no later than December 1, 2036, detailing the number of taxpayers deducting tips from income and the average dollar value of tips deducted. The Section 41 reporting requirements would be treated as an exception to the general prohibition against disclosure of confidential taxpayer information.

The deduction would be repealed on December 1, 2036.

Effective/Operative Date

As a tax levy, this bill would be effective immediately upon enactment and specifically operative for taxable years beginning on or after January 1, 2026, and before January 1, 2036.

Federal/State Law

Existing federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded.

Additionally, existing federal and state laws allow for the deduction of certain expenses, from gross income, when calculating AGI, such as moving expenses and interest on education loans, certain ordinary and necessary trade and business expenses, losses from the sale or exchange of certain property, contributions for pension, profit-sharing and annuity plans of self-employed individuals, and retirement savings. California also allows a deduction for alimony payments when the recipient is required to include the alimony payments in gross income. Thus, all taxpayers with these types of expenses receive the benefit of the deduction, regardless of whether the taxpayer itemizes deductions or uses the standard deduction. These are known as above-the-line deductions.

Implementation Considerations

The FTB has identified the following consideration and is available to work with the author’s office to resolve this and other considerations that may be identified.

The bill is silent on whether spouses filing a joint return or separate returns, who both meet the definition of a qualified taxpayer and receive qualified tips, would each be able to claim the deduction. The author may wish to amend the bill to clarify.

Technical Considerations

For consistency in terminology, in Section 17211(e)(2)(A), replace, “…the average dollar value of tips deducted.” with “…the average dollar amount of tips deducted.”

Policy Considerations

This bill would establish a deduction for which federal law has no counterpart; thus, increasing nonconformity and the complexity of California tax return preparation. Currently, there is federal legislation for both a deduction for tips (in H.R. 482) and an income exclusion (in H.R. 558). Although the issue is undecided for federal purposes, there are policy considerations for California law to match corresponding federal language to minimize state-federal differences should a federal bill be enacted. The author may wish to amend the bill once a decision is made at the federal level.

This bill would require the FTB to prepare a report on the performance of the deduction allowed by this bill no later than December 1, 2036. If the author's intent is to review a report that contains complete information for the 2036 taxable year, it is recommended that the reporting due date be extended to July of 2038. This date would allow time for the FTB to complete processing of personal income tax returns, which may be filed with an extension up until October 15 of each year. The FTB needs approximately six months to complete return processing and to compile the needed data to prepare a report. As a result, it is recommended that the reporting due date be no earlier than July of 2038 to provide information for the 2036 taxable year. If the reporting due date remains unchanged, the report would include the information available as of six months prior to the date the report is due. Additionally, it may be beneficial for the author to consider changing the one-time report to an annual report, with the initial report for the 2026 tax year, being due in July of 2028 and every year July thereafter, as long as the deduction is in effect.

LEGISLATIVE HISTORY

AB 1443 (Castillo, 2025/2026) would 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 UIC, this bill would exclude tips from wages for unemployment purposes. The bill would also make changes to other related provisions. AB 1443 is currently being held under submission in the Assembly.

SB 711 (McNearney, 2025/2026) amongst other provisions, would change the California RTC's general "specified date" of conformity to the IRC from January 1, 2015, to January 1, 2025, for taxable years beginning on or after January 1, 2025, and generally conform to the numerous changes to federal income tax laws during the ten-year period, except as otherwise provided. SB 711 is currently in the Senate Appropriations Committee.

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

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 SB 17 as Amended May 5, 2025
Assumed Enactment after June 30, 2025

($ in Millions)

Fiscal Year	**Revenue**
2025-2026	-$100
2026-2027	-$180
2027-2028	-$190

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 on a proration of the Yale Budget Lab's (YBL) estimate for the deduction of tips from gross income. In September 2024, the YBL published an analysis of the budgetary impact of allowing a federal deduction for tipped income. The YBL estimated a revenue loss of $9 billion in federal fiscal year 2025-2026. The corresponding loss to California is estimated to be $385 million in the 2026 taxable year.

Based on data from the IRS Statistics of Income, it is estimated that 13 percent of nationally reported income was from California, and that the state tax rate is 33 percent of the federal tax rate. These values were combined to estimate California's corresponding loss of $385 million for allowing a deduction for all tipped income.

It is further estimated that approximately 80 percent, or $320 million, tipped income would be earned by qualified taxpayers within the AGI amounts. Research indicates that after applying the $20,000 deduction limit, about 55 percent, or $175 million, in qualified tips would be deducted by qualified taxpayers in the 2026 taxable 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

None on file.

ARGUMENTS

None on file.

LEGISLATIVE CONTACT

FTBLegislativeServices@ftb.ca.gov