FORWARD ANALYTICS

OFF THE TAX ROLL

TIPS, OVERTIME, AND INCOME TAXES

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Executive Summary

Off the Tax Roll

During the 2024 presidential campaign, the idea of exempting earnings from tips and overtime from income taxes gained popularity. While this quickly became federal law, state level implementation of similar proposals has been mixed. Over the last 18 months, legislation exempting tips and overtime earnings from state income taxes was proposed twice, most recently in May 2026, with each failing to become law.

In its simplest form, a "no tax on tips and overtime" policy allows eligible taxpayers to deduct tipped and overtime income from their income taxes. This would not typically change a worker's weekly paycheck right away; instead, such a tax policy would allow for subtractions on annual state tax filings. In Wisconsin, the legislation proposed in LRB-6707 in May of 2026 would benefit tax filers in two ways.

Enabling a taxpayer to reduce Wisconsin adjusted gross income reduces state tax liability, but also, because of a lower state AGI, entitles that same taxpayer to a larger standard deduction due to Wisconsin's sliding scale standard deduction. This creates the potential for two similar individuals earning similar wages to have noticeably different tax liabilities based solely on the source of income.

The federal tax reduction, on which the Wisconsin proposals were based, is only available to a certain selection of workers. Those eligible come from a list of occupations that "customarily and regularly received tips" prior to December 31, 2024, and those who are eligible for overtime income under the Fair Labor Standard Act. If implemented, a Wisconsin law modeled after federal legislation could lead to a $716 difference in tax liability for two Wisconsin workers, each earning $40,000 annually - one with income derived partially from tips and one with traditional wages. Furthermore, the benefit would be greatest for those making $85,000-$132,500 per year, assuming a certain share of tipped income.

While beneficial for many taxpayers, this report also examines the revenue implications for the state. Given historical growth rates in employment and wages, combined with estimated attrition and deduction amounts, Wisconsin could lose as much as $2.76 billion in income taxes between 2028 and 2037 should the state pass legislation similar to federal law.

Finally, a "no tax on tips and overtime" policy creates another set of unintended consequences. While Wisconsin taxpayers appear to be shielded, at the federal level, the policy has the potential to affect benefits and eligibility for other tax credits such as the Earned Income Tax Credit, state and local tax deductions, and more. Additionally, it can encourage wage reclassification that pushes for more tipped and overtime pay among positions already receiving compensation this way and among occupations not typically seen as deriving significant income from tips or overtime.

Off the Tax Roll

Tips, Overtime, and Income Taxes

Jacob Anderson, Research Analyst, and Kevin Dospoy, Director

Few campaign promises became federal law as quickly as "no tax on tips and overtime." A product of the 2024 presidential campaign, the proposal to eliminate federal income tax on tip and overtime pay became reality with the signing of 2025 House Resolution 1, otherwise known as the "One Big Beautiful Bill," in July 2025. Since then, state lawmakers across the country have grappled with whether they should adopt similar policies in their states. The results have ranged from a full adoption to a full rejection of the provision.

In Wisconsin, a "no tax on tips" proposal, Senate Bill 36, was vetoed by Gov. Tony Evers in April of 2026, in part, because the law would be temporary. The following month, a permanent policy that included deductions for tipped and overtime income was included in the budget compromise bill (LRB-6707). However, the legislation failed to garner enough support in the legislature. At that time, a Legislative Fiscal Bureau (LFB) analysis showed that exempting tip and overtime pay from state income taxes could reduce tax collections by $430 million between 2026 and 2028.

Such a significant shift in tax liability along with general public support for such a policy will likely lead to similar legislation in the state Assembly and Senate during the next session. As such, an examination of the mechanics, structure, and potential impacts of the policy are discussed here.

To explore the implications of such a policy, this report uses data from the Wisconsin Department of Revenue, U.S. Federal Registry, Internal Revenue Service, U.S. Census Bureau, the Tax Policy Center, and the Bureau of Labor Statistics. The first section of the report explains the framework of a "no tax on tips and overtime" policy. The next section explains the effect this policy could have if implemented in Wisconsin. The focus of the report is on the amount of tax revenue likely lost due to the deduction, the implications to individual tax filers across the income spectrum, and the potential for behavioral changes due to incentives created by the policy. It does not explore the additional spending and consumer demand generated by those who would be able to claim such a deduction. That is a subject for future research.

WHY WISCONSIN IS DIFFERENT

At its most basic level, the federal "no tax on tips and overtime" law allows eligible taxpayers to deduct tipped and overtime income from their taxes. The most recent Wisconsin proposal mirrors federal limitations and deduction amounts.

Contrary to popular belief, neither the federal law or Wisconsin proposal would change a worker's weekly paycheck right away.[1] Instead, these deductions are claimed on annual tax returns, in addition to the standard or itemized deduction. The mechanics of the Wisconsin proposal differ from what was adopted federally. As such, a brief explanation of the federal law and the May 2026 Wisconsin proposal are discussed next.

The Federal Deduction

Federal adjusted gross income (AGI) is gross income minus certain "above the line" deductions, such as some retirement account contributions and student loan interest payments. Under the new law, after federal AGI is determined, a filer then can subtract the standard deduction and tipped income from their AGI to determine their tax liability.

The federal standard deduction is a fixed amount, set at $15,750 for single filers and $31,500 for married couples filing jointly in 2025. A filer can now also deduct tipped or overtime income up to $25,000 and $12,500 respectively ($25,000 married filing jointly).

These subtractions do not lower federal AGI, just the taxable income after the AGI is already calculated.

1 Weekly "take-home pay" may change in future years as taxpayers update their income tax withholdings at the state and federal levels.

Wisconsin's Double Benefit

The state AGI is equal to the federal AGI, subject to certain additions and subtractions listed in state statute. The proposal in LRB-6707 would have created another subtraction, which would have lowered state AGI by the amount claimed in tipped or overtime income, subject to deduction caps and income phaseout thresholds.

The federal deduction does not lower federal AGI, but the Wisconsin subtraction would lower state AGI. This is a significant distinction because of the unique mechanics of Wisconsin's standard deduction.

While the federal standard deduction is fixed, Wisconsin uses a sliding scale with a 2025 maximum of $13,560 available to single filers earning less than $19,550 per year. As income rises, the state standard deduction declines. The formula is as follows:

$13,560 - 12% x (state AGI - $19,550)

Because the Wisconsin proposal would have created its subtraction inside the calculation of state AGI – rather than after it, as the federal deduction does – claiming the tips or overtime subtraction removes that income from a filer's tax base and also lowers the state AGI that determines how large a standard deduction the filer is entitled to.

A lower state AGI produces a larger standard deduction. A filer who claims the tips or overtime subtraction therefore receives two benefits from a single dollar of exempted income: the direct exclusion of that dollar from taxable income and an indirect increase in the standard deduction available on the rest of their income. Federally, no equivalent second effect exists – the standard deduction is a fixed amount and is not impacted by the "no tax on tips or overtime" deduction.

> **A filer who claims the tips or overtime subtraction in Wisconsin gets two benefits from a single dollar – the direct exclusion of that dollar from taxable income and an indirect increase in the standard deduction available on the rest of their income.**

The magnitude of this secondary benefit and its effects across Wisconsin's income distribution are quantified in later sections.

Table 1: Occupations Reliant on Tips
% Workers in selected occupations reporting tipped income

Occupation	% With Reported Tips
Bartenders	82.8%
Waitstaff	74.5%
Gambling Dealers	70.9%
Barbers, hairdressers, hair stylists, and cosmetologists	52.4%
Taxi and rideshare drivers, and chauffeurs	24.9%
Home electricians	0.1%
Home plumbers	0.2%
Home heating and air conditioning mechanics and installers	0.2%

WHO QUALIFIES?

Under the new federal law, only specifically designated occupations are eligible for the deduction. These designations were mirrored in LRB-6707.

Tips

The U.S. Treasury created a list of occupations that "customarily and regularly received tips" on or before December 31, 2024. Using federal tax data, 71 occupations across eight categories were identified in which a meaningful share of workers reported at least $100 in annual tip income. The categories include occupations in beverage and food service; entertainment and events; hospitality and guest services; home services; personal services; personal appearance and wellness; recreation and instruction; and transportation and delivery. Table 1 shows a small sample of included occupations.
The final list also includes occupations that are not universally viewed as reliant on income from tips. Among these are electricians and plumbers. Their inclusion is notable as, according to the Federal Registry, only 0.1% of electricians, 0.2% of plumbers, and 0.2% of HVAC maintenance workers reported being tipped $100 or more over a year. The inclusion of such positions may create the incentive to move to wage structures more reliant on tips than traditional wages, which is something discussed in later sections of this report.

Overtime

Under the new federal law, the deduction for overtime income applies only to workers deemed eligible by the Fair Labor Standard Act (FLSA). Qualified overtime compensation is the half-time premium, which is the additional one-half of an employee's regular hourly wage paid for overtime hours.

According to the IRS, more than 143 million Americans, or about 84% of the labor force, are covered by the FLSA, either because they work for a covered employer or because their job regularly involves interstate commerce. However, many workers covered by the FLSA are exempt from the overtime requirements, including most salaried executives, administrative, and professional employees. Additionally, independent contractors and certain other categories of workers, such as movie theater employees and some workers covered by separate federal labor laws (for example, airline pilots), are ineligible.

As a result, the share of workers eligible for qualified overtime pay, and therefore a potential overtime tax deduction, is substantially smaller than the share covered by the FLSA. According to the Yale Budget Lab, about 98 million Americans—around 60% of the labor force—were eligible for FLSA overtime protections in 2023.

SIMILAR WORKERS, DIFFERENT TAX BILLS

To further illustrate the effect of the proposal in LRB-6707, we present two situations that show how an individual's tax bill would change under a no tax on tips or overtime policy. The examples in Table 2 compare hypothetical tax bills for four individuals earning $40,000 and $50,000 annually. Two examples compare taxpayers with and without tipped income, while the other two compare taxpayers with and without overtime income.

These scenarios demonstrate how the proposed policy would change a filer's tax liability based on the source of their income. They also highlight that Wisconsin taxpayers with similar earnings and filing statuses can owe different amounts in taxes depending on whether their income includes tips or overtime.

Individual 1 is a full-time waiter at a restaurant who makes $40,0000 a year ($25,000 wages and $15,000 in tips). Individual 2 is an administrative assistant who also makes $40,000, all from wages. Both individuals are single filers and take the standard deduction.

Individual 3 is a manufacturing worker who makes $50,000 a year ($40,000 in wages and $10,000 in overtime) and Individual 4 works in retail earning $50,000 (no overtime). Again, both individuals are single filers and take the standard deduction.

The examples described in Table 2 show that a taxpayer's state income tax liability under a "no tax on tips or overtime" policy depends not only on how much they earn, but on what kind of income they earn. The waiter and the administrative assistant both report $40,000 in total income, but the waiter's liability drops significantly after tips are subtracted and

Table 2: Wisconsin State Tax Liability Would Decline for Some Workers
Wages, deductions, and tips for selected workers under the proposed Wisconsin "no tax on tips and overtime" policy

	Tips			Overtime		
	Waiter		Administrative Assistant	Manufacturing Worker		Retail Worker
	Current Law	***Proposed***	***Unaffected***	***Current Law***	***Proposed***	***Unaffected***
Wages	$25,000	$40,000	$40,000	$40,000	$40,000	$50,000
Tips / Overtime	$15,000	$15,000	$0	$10,000	$10,000	$0
Total Income	$40,000	$40,000	$40,000	$50,000	$50,000	$50,000
Tipped/OT Income Deduction		$15,000			$10,000	
Wisconsin AGI	$40,000	$25,000	$40,000	$50,000	$40,000	$50,000
Standard Deduction	$11,106	$12,906	$11,106	$9,906	$11,106	$9,906
Taxable Income	$28,894	$12,094	$28,894	$40,094	$28,894	$40,094
Tax Liability	$1,139	$423	$1,139	$1,632	$1,139	$1,632
Difference		**-$716**			**-$493**	

> **The difference in tax owed is attributable entirely to job classification and the composition of income—wages versus tips or overtime—rather than to total earnings or the ability to pay.**

the increased standard deductions is applied. The same pattern holds for overtime. The manufacturing and retail workers both earn $50,000, but the manufacturing worker's liability falls once the overtime exemption is applied. In both cases, the difference in tax owed is attributable entirely to job classification and the composition of income – wages versus tips or overtime – rather than to total earnings or ability to pay.

BENEFIT CURVE ACROSS INCOME LEVELS

The benefit received by a tax filer is based on their income tax bracket. Here, a "benefit" is defined as a reduced income tax liability. A notable feature of the policy is that as income rises, so does the benefit amount. For a Wisconsin tax filer, deducting $1,000 in tips yields a benefit of $35 for a filer in the 3.5% bracket and $76 for someone in the 7.65% bracket. The amount one can deduct is reduced by $100 for every $1,000 that a taxpayer's AGI exceeds $150,000 for individual filers and $300,000 for married-joint filers. The deduction is fully phased out at $275,000 ($550,000 married-joint) for overtime income and $400,000 ($550,000 married-joint) for tipped income.

To further illustrate the effects on individual tax filers, this section examines the tax implications to a single-filing waiter earning 63.5% of their income as tips (which is a typical share of total income for a waiter according to the U.S. Bureau of Labor Statistics).

Figure 1 below shows the tax benefits for such a worker under a "no tax on tips" policy. The subtraction first reduces state AGI, which then increases the standard deduction. Because of the standard deduction formula listed in the previous section, a $1 reduction in the Wisconsin AGI produces around $1.12 reduction in taxable income.

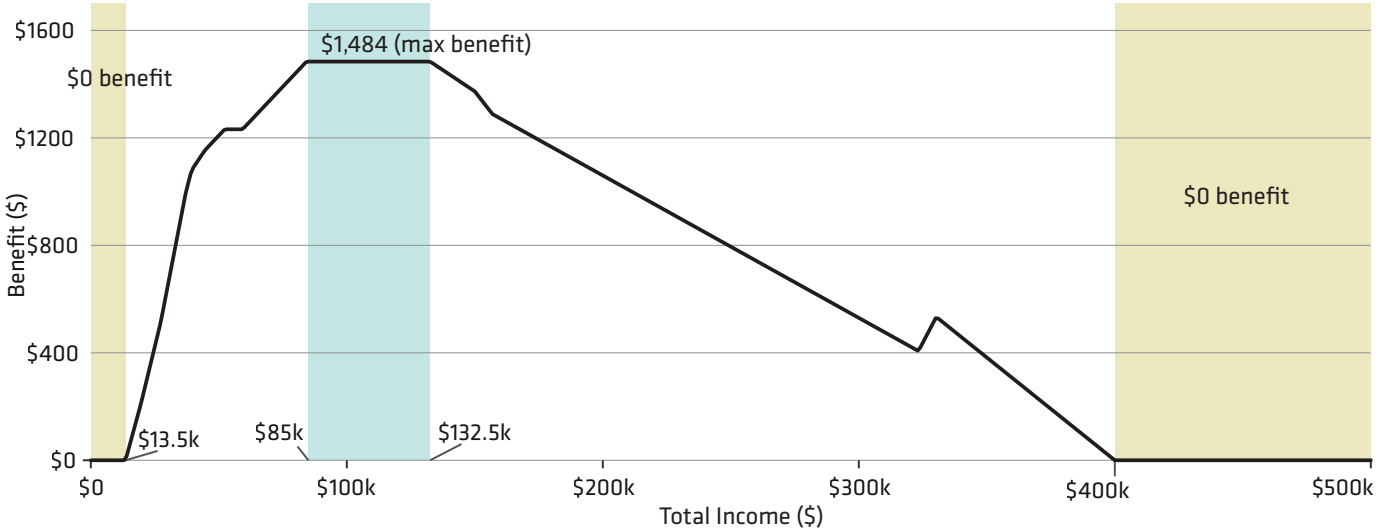
Zero Benefit Range

A single filer earning $13,560 or less already has a $0 tax liability because the standard deduction reduces state AGI to zero. Since the state "no tax on tips" proposal is not a refundable tax credit, those who already face a $0 tax liability would not directly benefit and would see no change in their Wisconsin tax liability.

At the other end of the spectrum, the "no tax on tips" deduction would fully phase out at $400,000. Single filers earning more than this would not benefit from such a policy.

In Figure 1, the "zero benefit range," (with incomes between $0 and $13,560 and at $400,000 and above) is represented by the beige shaded region.

Figure 1: No state tax benefit of a "no tax on tips" policy at low and high incomes
Reduction in tax liability for a waiter earning 63.5% of income in tips



Maximum Benefit Range

Under a Wisconsin "no tax on tips" policy, this hypothetical tax filer earning up to $37,150 could claim both deductions (standard and tipped income) and reduce taxable income to $0. The benefit (that is, reduction in income tax liability) of such a policy, as shown in Figure 1 on the previous page, begins to climb at incomes of $13,560 before maxing out at a benefit of $1,484 for those earning about $85,000 per year. Beginning with incomes around $132,500, the benefit begins to decline until it phases out completely at $400,000. The maximum benefit range is highlighted in blue in Figure 1.

These brackets provide valuable insight into implications to the individual taxpayer, but they do not capture the potential collective cost to the state. To better understand high level impacts, we examine the number of Wisconsinites who could benefit and the long-term fiscal impacts of such a policy.

REVENUE IMPLICATIONS

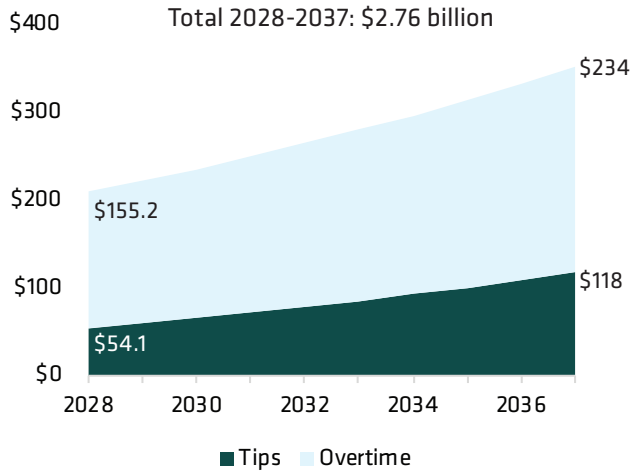
The fiscal impacts of a "no tax on tips and overtime" policy should be examined from both the state and individual perspective. The state would be losing tax revenue if overtime and tips were granted a special deduction, similar in many ways to how the state loses tax revenue when filers claim the student loan interest deduction or some retirement savings deductions. At an individual level, a tax filer retains more of their wages and either spends more or saves more, thereby stimulating the local and state economy in other ways. The goal of this analysis is to examine the loss of tax revenue for the state. The benefits to the individual, and secondary benefits to the local and state economies through additional spending and savings by individual tax filers is a subject for further research.

Revenue Estimates

In May of 2026, the Wisconsin Legislative Fiscal Bureau (LFB) released estimated effects of the "no tax on tips and overtime" proposal for the next two fiscal years. In 2026-27, LFB projected a reduction in individual income tax collections of $232.8 million ($179.9 million in overtime and $52.9 million in tipped income). For 2027-28, they projected a reduction of $197 million ($148.1 million in overtime and $48.9 in tipped income).

Measuring the impacts to the state beyond the two fiscal years covered by the LFB requires examining trends in employment and wages to forecast future growth. Specifically, we focus on North American Industry Classification System (NAICS) industries that contain a significant concentration of occupations that would benefit from the tip and overtime deduction.

FIGURE 2: State Income Tax Revenue Loss Accumulates
Cumulative state revenue loss due to overtime and tips deduction, in millions, 2028-2038



Our analysis places certain NAICS industries into two groups: the overtime group (construction, manufacturing, transportation and warehousing, and health care and social assistance) and the tipped group (arts, entertainment, and recreation and accommodation and food services). These classifications were chosen because of the relatively high likelihood that workers in these industries derived a meaningful share of their income from overtime or tips.

To calculate the total lost tax revenue, we began from a "base" revenue loss equal to the LFB's 2027-28 estimates for overtime and tipped income deductions. From there, we analyzed the effect of existing workers and projected new employees in both the overtime and tipped workers groups.

Using historical data, we estimated annual wage growth for the next decade and combined these estimates with an attrition rate (which accounts for a subset of workers who would meet the maximum allowed deduction). We also calculated employment growth in each sector (starting from a base of nearly 600,000 tipped workers and 1.2 million overtime eligible workers) using a similar process.

By 2037, the loss in annual tax revenue is projected to rise to $118 million from the tipped income deduction and $234 million from overtime income. A full breakdown of the yearly revenue amounts can be seen in Figure 2. In total, Wisconsin could expect to lose $2.7 billion in tax revenue between 2028 and 2037.

OTHER ECONOMIC CONSEQUENCES

Beyond the immediate impacts of a state "no tax on tips and overtime" policy, there are several potential tax and behavioral consequences not often mentioned during policy discussions, ranging from wage reclassification to eligibility determinations for other tax credits and means tested programs.

Interactions with Other Tax Credits

Wisconsin tax policies have no mechanism to change federal income measures that federal law uses to determine eligibility for programs such as BadgerCare Plus, SNAP, or the size of the federal Earned Income Tax Credit (EITC). Because the federal government already enacted a no tax on tips or overtime law, and determinations for such programs are based on federal income levels, a similar Wisconsin law would have no further effect on eligibility for such programs.

However, state income taxes do impact the state and local tax (SALT) deduction claimed by those who itemize on their federal tax deduction.

One issue that the LFB raised with LRB-6707 is the potential effect on the Homestead Credit. The proposal included a cross reference ensuring that excluded tipped and overtime income would continue to be counted in household income for Homestead Credit purposes. Thus, workers who benefit from both deductions would see their income tax liability shrink while maintaining the benefits of the Homestead Credit.

Wage Reclassification and Tipping Expansion

Charlie Munger, long-time vice chair of Berkshire Hathaway, once said, "Show me the incentive, and I'll show you the outcome." Any legislation that fundamentally alters tax policy will, at the same time, alter behavior. Because of these deductions, and the incentives they would create, it is likely employers and employees would begin to push for more of their wages to be paid as tips or as overtime under the new federal law, which could be exacerbated if the state passes similar legislation.

Positions that historically were not viewed as reliant on tips, such as electricians, may have an incentive to convert some of their compensation to tipped income. This trend applies to overtime pay as well. Employers in construction, healthcare, or manufacturing may have an incentive to offer lower base wages and greater overtime opportunities. These potential changes are not modeled here, but policymakers should anticipate changes in compensation models.

The last potential consequence relates to SSTBs or Specified Service Trade or Business. These are businesses where the key asset is the skill or reputation of its owners or employers, such as law firms or health clinics. While not as common, this is a situation where changes could be seen. For example, a massage therapist employed by a health clinic could reorganize their employment into a non-SSTB entity, allowing them to deduct tipped income.

GOING FORWARD

The aim of this report is to explain the mechanics behind a "no tax on tips or overtime" policy both at the federal level, and as introduced in the Wisconsin legislature in May 2026. If implemented, Wisconsin could expect to lose as much as $2.7 billion in income tax revenue over the course of the next decade. This figure could be driven higher as employers and workers respond to a tax policy that incentivizes more tips and overtime relative to standard wages and salary.

While this report did not examine all state and federal tax deductions and means-tested program, Wisconsin taxpayers appear to be somewhat shielded from any negative impacts as it relates to the interaction between a Wisconsin specific "no tax on tips or overtime" policy and the federal AGI, with some minor exceptions such as the SALT deduction.

If the political and public support for this type of policy remains strong, it is important that future political debates have an analytical foundation that clearly explain who benefits, what the short and long-term costs are, and broader consequences for the Wisconsin tax structure and economy.



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