

**DEPARTMENT OF TAXATION
2025 Fiscal Impact Statement**

1. **Patron** Ryan T. McDougle
3. **Committee** Senate Finance and Appropriations
4. **Title** Individual Income Tax
Deduction for Cash Tips

2. **Bill Number** SB 763
House of Origin:
 X **Introduced**
 Substitute
 Engrossed
- Second House:**
 In Committee
 Substitute
 Enrolled

5. Summary/Purpose:

This bill would provide an individual income tax deduction for the amount of cash tips, including tips paid by electronic means, that are included on statements furnished to the taxpayer's employer for federal tax purposes.

This bill would become effective for taxable years beginning on and after January 1, 2026

6. **Budget amendment necessary:** No.
7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)
8. **Fiscal implications:**

Administrative Costs

The Department of Taxation (the "Department") considers implementation of this bill as routine and does not require additional funding.

Revenue Impact

This bill would have a negative General Fund revenue impact of \$35.0 million in FY 2026, \$64.7 million in FY 2027, \$66.3 million in FY 2028, \$67.9 million in FY 2029, \$69.5 million in FY 2030, and \$71.1 million in FY 2031. No budget amendment is needed because the revenue impact of this bill is assumed in the Introduced Executive Budget.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Federal Taxation of Cash and Noncash Tips

Tips are optional payments that customers make to employees. Four factors determine whether a payment qualifies as a tip. Generally, all four must apply:

- The customer makes the payment free from compulsion;
- The customer must have the unrestricted right to determine the amount;
- The payment should not be the subject of negotiations or dictated by employer policy; and
- Generally, the customer has the right to determine who receives the payment.

Tips are generally subject to federal income and payroll taxes. However, special rules apply regarding how they must be reported and paid, which depend on whether the tip is a "cash tip" or "noncash tip."

"Cash tips" include tips received directly from customers, electronically paid tips distributed to the employee by their employer, and tips received from other employees under any tip-sharing arrangement. Employees must report all cash tips to their employer. Tips reported to the employer are included on the employee's Form W-2, Wage and Tax Statement, for reporting on an individual tax return.

"Noncash tips" are goods or services received in any medium other than cash. This would include tickets, passes, or other goods or commodities that a customer gives the employee. Noncash tips are not reported to the employer, but the fair market value of such tips is required to be reported to the Internal Revenue Service as income for tax purposes. Any tips that the employee didn't report to the employer must be reported separately and the employee must pay the employee share of Social Security and Medicare tax owed on such tips.

Virginia's Individual Income Tax Modifications

Federal Adjusted Gross Income

Virginia's Individual Income Tax substantially conforms to federal income tax law by using federal adjusted gross income ("FAGI") as the starting point for computing Virginia income taxes. Virginia law then provides various modifications to FAGI that must be taken into account that figure in determining Virginia taxable income.

Virginia Adjusted Gross Income

When completing a Virginia individual income tax return, a taxpayer starts with the amount of FAGI reported on his federal return. A taxpayer then calculates Virginia adjusted gross income by making two types of adjustments: (1) "additions" which increase the amount of income taxable by Virginia and (2) "subtractions" which reduce such amount. These adjustments are made only to the extent that they have not already been included or excluded from FAGI.

Virginia Taxable Income

The taxpayer calculates his Virginia taxable income by making another type of modification referred to as “deductions,” which further reduce the amount of income taxable by Virginia. These modifications are made regardless of federal treatment unless specifically stated otherwise in the provision.

Please find below an illustration of how taxable income is computed for federal and Virginia income tax purposes and how they interrelate:

Federal Income Tax	Virginia Income Tax
+Wages and Other Income	= <i>Federal Adjusted Gross Income</i> (“FAGI”)
+Federal Adjustments	+Virginia Additions (only if not included in FAGI)
-Federal Adjustments	-Virginia Subtractions (only if not excluded from FAGI)
= <i>Federal Adjusted Gross Income</i> (“FAGI”)	= <i>Virginia Adjusted Gross Income</i> (“VAGI”)
-Federal Standard Deduction or Itemized Deductions	-Virginia Standard Deduction or Federal Itemized Deductions (depends on federal election)
-QBI Deduction	-Deduction for Virginia Exemptions -Virginia Deductions (regardless of federal treatment)
= <i>Federal Taxable Income</i>	= <i>Virginia Taxable Income</i>

Because this bill would establish a new Virginia deduction, the amount allowed under this bill could be taken whether the taxpayer chooses to take the Virginia standard deduction or itemized their deductions.

Proposed Legislation

This bill would provide an individual income tax deduction for the amount of cash tips that are included on statements furnished to the taxpayer’s employer for federal tax purposes. The deduction would be to the extent such amounts are included in federal adjusted gross income and would include tips paid by electronic means.

This bill would be effective for taxable years beginning on and after January 1, 2026.

Similar Bills

HB 1562 is identical to this bill.

cc : Secretary of Finance

Date: 1/10/2025 JLOF
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