
SENATE COMMITTEE ON REVENUE AND TAXATION

Senator Jerry McNerney, Chair
2025 - 2026 Regular

Bill No:	SB 984	Hearing Date:	5/6/26
Author:	Ochoa Bogh	Tax Levy:	Yes
Version:	4/29/26	Fiscal:	Yes
Consultant:	Grinnell, Summers		

PERSONAL INCOME TAX LAW: DEDUCTIONS: TIPS

Conforms state law to the federal deduction for tipped income.

Background

Tax expenditures. California law allows various income tax credits, deductions, exemptions, and exclusions. The Legislature enacts such tax incentives either to compensate taxpayers for incurring certain expenses, such as child adoption, or to influence certain behavior, such as charitable giving. The Legislature uses tax incentives to encourage taxpayers to do something that they would not otherwise do. The Department of Finance is required annually to publish a list of state tax expenditures, currently totaling around \$94.5 billion per year in foregone General Fund revenue.

Income. Existing federal and state laws provide that gross income includes all income from any source, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded. Existing federal and state laws provide that certain types of income are excluded from gross income, such as amounts received as a gift or inheritance, certain compensation for injuries and sickness, qualified scholarships, educational assistance programs, foster care payments, and interest received on certain state or federal obligations.

Existing federal and state laws allow for the deduction of certain expenses from gross income when calculating adjusted gross income (AGI). Some examples include moving expenses for members of the armed service, as well as certain ordinary and necessary trade and business expenses. These are known as “above the line” deductions. Unlike itemized deductions, such as charitable deductions and mortgage interest deductions, all taxpayers with these types of expenses may take the corresponding deduction. In other words, the taxpayer can take above-the-line deductions regardless of whether the taxpayer claims the standard or itemized deduction.

Tips. Tips have always been considered income, even though enforcement has been ineffective. The Congressional Joint Committee on Taxation estimated the tips tax compliance rate for 1981 to be as low as 16%, noting that the only type of income with a lower compliance rate was illegal income at 5%. In response, Congress enacted the Tax Equity and Fiscal Responsibility Act in 1982, which, among other requirements, directed employees who receive tips to report them to their employers if they receive \$20 or more for 1 month. Employers must withhold income and social security taxes on reported tips and remit the withheld taxes to the IRS. Even with these requirements, enforcement is far from perfect; in its estimates of unreported income, the IRS

notes that, “since a significant portion of tip income is paid in cash by customers, tip income is subject to less information reporting than most wages and salaries.”

HR 1. In July 2025, Congress enacted H.R. 1 (Public Law 119-21, One Big Beautiful Bill Act, or “OBBBA”). Section 70201 of H.R. 1 allows a deduction of up to \$25,000 for qualified tips received, applicable for the 2025 through 2028 taxable years. The deduction is reduced for taxpayers whose modified adjusted gross income exceeds \$150,000 for single taxpayers, or \$300,000 for married filing joint taxpayers. The deduction applies to tips reported by employees to employers under current requirements in federal law. H.R. 1 defined “qualified tips” as cash paid, or amounts charged, including amounts received by an employee under any tip sharing arrangement in an occupation that receives tips on a customary and regular basis, but excludes amounts that are not provided voluntarily, not in a specified service trade or business, or excluded under guidance to be established by the Secretary of the U.S. Department of the Treasury. Additionally, the tip deduction is available to taxpayers regardless of whether they itemize deductions or claim the standard deduction, similar to an above-the-line deduction.

Unlike other similar tax preferences, H.R. 1 limited the tip deduction solely to taxpayers with Social Security Numbers (SSNs), thereby excluding those who file using an Individual Taxpayer Identification Number (ITIN), which is a 9-digit number issued by the Internal Revenue Service (IRS) for federal income tax purposes when an individual is not eligible for an SSN.

Conformity. State law does not automatically conform to changes in federal tax law, except for specific retirement provisions. Instead, the Legislature must affirmatively conform to federal changes, which it can do in two different ways. First, the Legislature can pass an individual tax bill that conforms to a specific federal provision, such as the Regulated Investment Company Modernization Act (AB 1423, Perea, 2011). Second, the Legislature can enact an omnibus bill to provide that state law conforms to federal law as of a specified date. Currently, state law generally conforms to federal tax law as of January 1, 2025 (SB 711, McNERNEY, 2025).

As H.R. 1 was enacted after SB 711’s conformity date of January 1, 2025, California has not conformed to the new tip deduction. The author wants to conform to the deduction to provide tax relief to tipped workers in California.

Proposed Law

Senate Bill 984 conforms state law to H.R. 1’s tip deduction, commencing in the 2026 taxable year and ending after the 2028 taxable year. The measure provides that the SSN requirement does not apply, thereby allowing any California filer to claim the deduction. The bill also contains legislative findings and declarations to comply with Section 41 of the Revenue & Taxation Code, and sunsets its provisions on December 1, 2029.

State Revenue Impact

According to the Franchise Tax Board (FTB), the 2/5/26 version of SB 984 results in revenue losses of \$600 million in 2026-27, \$410 million in 2027-28, and \$200 million in 2028-29.

Comments

1. **Purpose of the bill.** According to the author, “Tipped workers – who are disproportionately of color and female – are more than twice as likely to live in poverty compared to non-tipped

workers. Tipped workers are also more likely to be single parents. Nearly three in 10 female workers who earn tips have a child under 18. In part due to the overrepresentation of vulnerable groups in the tipped workforce, both former Vice President Harris and President Trump expressed support for some form of a tax break on tips during the 2024 presidential campaign. In July 2025, President Trump signed HR 1, which allows taxpayers to take a federal deduction on tips they have earned, starting in 2025. To provide relief to workers who rely on tips, SB 984 would align state law to federal law so California workers could take advantage of the deduction for tips on their state income tax return. By ensuring our state's employees can retain more of their pay, the bill will serve as an economic stimulus, lifting all sectors of the economy.”

2. Equity. Tipped work is a significant, but not especially large, segment of the U.S. economy. The Yale Budget Lab estimates that about four million, or 2.5%, of workers across the country work in jobs that regularly receive tips.¹ That report also states that while workers in various sectors receive tips (like hairstylists or dog walkers), most tipped workers are in the hospitality industry, with more than half in food service. According to the same report, tipped workers have very low incomes: 37% had incomes low enough that they paid no federal income tax in 2022, even before accounting for tax credits; for non-tipped occupations, the equivalent share was only 16%. However, while SB 984 would provide a significant tax benefit for tipped employees whose incomes are generally lower than average, its deduction does not apply to workers in other occupations with similarly low incomes, violating the core principle of equity in taxation. Additionally, SB 984's benefit does not apply to workers who provide core public services, such as teachers, law enforcement, and first responders, whose income is fully taxable. The Committee may wish to consider the criteria under which professions can deduct income and which should not.

3. Revenue loss. Existing tax law provides various credits, deductions, exclusions, and exemptions for certain taxpayers. Since these items are enacted to accomplish some governmental purpose and are determined to have a cost (in the form of foregone revenues), state law refers to them as “tax expenditures.” This bill would create a new tax expenditure, costing the General Fund in foregone revenue. As a result, the state will have to reduce spending or increase taxes to match the foregone revenue. Additionally, because Proposition 98 establishes a minimum funding guarantee for K-14 education in California, which generally represents roughly 40% of the state's General Fund revenues, every dollar of General Fund loss results in approximately 40 cents less of funding for K-14 education.

4. Who qualifies? H.R. 1 set a significant precedent by limiting several of its tax benefits to filers with SSNs, including the tip, overtime, and senior deductions. An SSN requirement excludes taxpayers who file using ITINs, which can include noncitizens working in the United States, dependent spouses of U.S. Citizens or residents, and other nonresidents with tax filing obligations. ITIN filers also include foreign students, foreign nationals, and investors working or doing business in the U.S, as well as workers with “unsatisfactory immigration status.” While the federal Earned Income Tax Credit (EITC) requires an SSN, California has allowed ITIN filers to claim the Cal EITC for several years. As introduced, SB 984 would have conformed to the tip deduction's limitation for filers with SSNs. On April 29th, the author amended SB 984 to decouple from that requirement. Additionally, H.R. 1 only allows married taxpayers who file jointly to claim the deduction, but not when they file separately; SB 984 maintains this restriction.

¹ Ernie Tedeschi, “The ‘No Tax on Tips Act’: Background on Tipped Workers,” The Budget Lab at Yale, June 24, 2024.

5. Who’s affected? According to the Yale Policy Lab, women are more likely than men to be tipped workers, representing more than 71% of tipped workers nationally in June 2024, despite representing 47% of total workers. Women of color are especially likely to be tipped workers, making up more than 29% of all tipped workers. The typical tipped worker is a full 10 years younger (31) than the median non-tipped worker. A third, or 33%, of tipped workers are below 25 years of age, (versus 12% for non-tipped), with 13% being teenagers (3% for non-tipped). Among workers in the bottom half of hourly wages — those earning below \$25 an hour in 2023 — less than 4% were in a tipped occupation. Recent research defined tipped employees to include waiters and waitresses; bartenders; gaming services workers; barbers, hairdressers, hairstylists, and cosmetologists; and miscellaneous personal appearance workers in all industries.²

6. Section 41. Section 41 of the Revenue and Taxation Code requires any bill enacting a new tax expenditure to contain, among other things, specific goals, purposes, and objectives that the tax expenditure will achieve and detailed performance indicators, along with data collection and reporting requirements (SB 1335, Leno, 2014). To comply with Section 41, SB 984:

- States that its goal is to help workers retain more of their earnings.
- Identifies, as performance indicators for the Legislature to use in determining whether the exclusion achieves its goal, the number of taxpayers excluding tips from income under the bill, and the average dollar value of tips excluded from income.
- Directs FTB to provide a report to the Legislature detailing the number of taxpayers excluding tips from income under this section, and the average dollar value of tips excluded, by December 1, 2029.

7. Related legislation. Last year, before Congress enacted H.R. 1, the Committee unanimously approved SB 17 (Ochoa Bogh). By conforming to H.R. 1, SB 984 would align state law to federal law except with regard to the requirement for taxpayers to supply a social security number to claim the deduction. Differences between SB 17 and SB 984 include:

Item:	SB 984 (2026)	SB 17 (2025)
Amount of Deduction:	<ul style="list-style-type: none"> • \$25,000 per taxable year per taxpayer. • Allowed as a deduction in addition to the standard deduction (above the line deduction) for TPs who do not itemize. 	<ul style="list-style-type: none"> • \$20,000 per taxable year. • Allowed as an above-the-line deduction.
Applicable Taxable years:	<ul style="list-style-type: none"> • 2025 to 2028 	<ul style="list-style-type: none"> • 2026 to 2035
Definition of tips:	Cash paid, or amounts charged, including amounts received by an employee under any tip sharing arrangement in an occupation that receives tips on a customary and regular basis.	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

² Heidi Schierholz, David Cooper, Julia Wolfe, and David Zipperer, “Employers would pocket \$5.8 billion of workers’ tips under Trump administration’s proposed ‘tip stealing’ rule,” *Economic Policy Institute*, December 12, 2017.

	Must be reported on the recipient’s W-2, Forms 1099, 1099-K	purposes of Section 6053 of the IRC, relating to reporting of tips, and the Federal Insurance Contributions Act
Definition of qualified taxpayer/criteria for tips:	<ul style="list-style-type: none"> • Tips received by an individual in an occupation that customarily and regularly received tips on or before 12/31/2024. ((d)(1)) • Married taxpayers must file jointly to claim the deduction (MFS not allowed to claim). • Tips must be voluntary, not negotiated, and not received in specified service trades or businesses. <p>The IRS is required to publish a list of occupations that customarily and regularly received tips on or before December 31, 2024, no later than 90 days after the date of the enactment of this Act.</p>	<p>A taxpayer who satisfies all of the following:</p> <ul style="list-style-type: none"> • 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.
AGI limitation:	<p>Modified AGI does not exceed \$150,000 or \$300,000 for MFJ.</p> <ul style="list-style-type: none"> • Modified AGI includes certain income from foreign sources. 	<p>Has an AGI, not including the qualified tips deduction, that does not exceed the following:</p> <ul style="list-style-type: none"> • A taxpayer who is a head of household, surviving spouse, or a married couple filing a joint return, \$250,000. <ul style="list-style-type: none"> ○ Any other individual, \$125,000.
Self-employed:	Can take the deduction if the business’ gross income exceeds business related deductions.	Does not include a definition.

Support and Opposition (5/1/26)

Support: California Restaurant Association
California Society of Enrolled Agents
Howard Jarvis Taxpayers Association
Southwest California Legislative Council
Six Individuals

Opposition: California Teachers Association
One Individual