

Memo

Date: October 16, 2025

To: Agency Payroll, Accounting and Human Resources Staff

From: Katie Karow, Director, Statewide Payroll Services

RE: Federal Reconciliation Bill (H.R. 1) - Update

The *Federal Reconciliation Bill (H.R. 1)* recently signed into federal law, introduces several changes that may impact the taxation of employee compensation and benefits. While some aspects of the law are clear, other areas require further clarification from the IRS. This bulletin outlines what agency Payroll and Human Resources staff should focus their attention on, based on current understanding of the bill.

Student Loan Reimbursements

Under the *Federal Reconciliation Bill (H.R. 1)* the non-taxable treatment of employer-provided student loan reimbursements has been made permanent. To ensure employees can take advantage of this benefit:

- Agencies that have not yet updated their **educational assistance plans** should do so now to reflect the expanded provisions.
- Agencies should review the language of their plan. If a sunset date of 12/31/2025 was included in the plan, they may need to be revise the plan to avoid future confusion.

Tips/Gratuity

Under *Federal Reconciliation Bill (H.R. 1)*, the core tax treatment of tips remains **unchanged**:

- Tips are **still considered taxable income** and are subject to:
 - **FICA** (Social Security and Medicare) **taxes**
 - **Federal income tax withholding**
 - **State income tax withholding**

Starting in 2025, employees may be able to deduct tips in some situations. In 2026, the law may also add new reporting and compliance requirements for employers. Agencies are encouraged to review their procedures for reporting tips to ensure continued compliance. Additional information will be communicated after IRS provides guidance on implementation.

Overtime Pay

Employees with qualified overtime are eligible for tax deductions on the overtime pay portion. The overtime portion refers to pay received above the employee's regular rate of pay—for example, the additional "half" in the "time-and-a-half" rate required under the Fair Labor Standards Act (FLSA).

Effective in 2025, employees may be eligible to deduct overtime under specific conditions. In 2026, the law may also require employers to meet new rules for reporting and compliance. At this time, agencies should continue current payroll practices but be aware that further IRS clarification is expected. We will provide updates as guidance becomes available.

Note: If an agency pays overtime under a CBA (but not under FLSA), agency staff should review their earnings codes and be prepared for possible updates.

Relocation Benefits

There are **no changes** to the tax treatment of relocation benefits under *Federal Reconciliation Bill (H.R. 1)*. These payments remain taxable income to the employee and must be reported accordingly.

Questions?

Agency Payroll, HR, and Accounting staff should contact Lorelei Peters at 651-201-8066 or lorelei.peters@state.mn.us if there are questions.

PLEASE SHARE THIS INFORMATION WITH APPROPRIATE AGENCY STAFF