

## New Overtime Compensation Deduction FAQs

### Background

For tax years 2025 through 2028, a new income tax deduction for qualified overtime compensation is available for individuals.<sup>1</sup> It is a below-the-line taxable income deduction, available for both itemizers and those taking the standard deduction but does not reduce adjusted gross income (AGI). Qualified overtime compensation is still subject to payroll taxes and is required to be reported on an information return. Reporting relief has been made available for the 2025 tax year only.

Limitations:

- Deduction limited to \$25,000 MFJ/\$12,500 other, per year
- Deduction phases out once MAGI exceeds \$300k MFJ/\$150k other
- Cannot include qualified tips deducted under §224
- If married, must file a joint return to take the deduction (no MFS)

### FAQs

#### What is qualified overtime compensation?

Overtime compensation paid to an individual required under section 7 of the Fair Labor Standards Act of 1938 (FLSA) that is in excess of the regular rate (as used in such section) at which such individual is employed. [Sec. 225(c)(1)]

Section 7 of the FLSA, or 29 USC 207, is the FLSA section which sets forth statutorily required overtime. 29 USC 207(a)(1) requires in general that employees receive “a rate not less than one-half times the regular rate” for each hour worked over 40 hours of work in a workweek.

In plain language: The deduction is for the “premium” portion of mandatory overtime pay required under FLSA Section 7.

Example:

Sam works 40 hours/week at \$50/hr + 10 hours/week overtime at \$75/hr

Qualified overtime compensation = \$25 premium (75-50) \* 10 overtime hours = \$250

#### Are exempt employees eligible for the deduction?

No. A worker must be eligible for mandatory overtime compensation under FLSA Section 7.

Employees who are exempt from mandatory FLSA overtime requirements cannot take the deduction, even if state law or union agreements mandate overtime pay. Individuals seeking a deduction must make a reasonable effort to determine if they are FLSA-eligible. Notice 2025-69 provides an example of an employee asking an employer for their FLSA status.

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<sup>1</sup> IRC Section 225 added by P.L. 119-21, commonly referred to as the One Big Beautiful Bill Act (OBBBA)

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### **What amount of compensation is eligible for the deduction?**

The deduction is on the “premium” portion of overtime pay.

In Notice 2025-69 the IRS has narrowly defined eligible overtime as only the “half” portion of time-and-a-half pay required under FLSA, not anything more.

Examples:

Hanna earns \$20/hour and is paid \$30/hour for overtime. The deductible portion for Hanna is \$10/hour (\$30 – \$20) on overtime hours worked.

Charlie earns \$20/hour and is paid \$40/hour for overtime. The deductible portion for Charlie is \$10/hour for overtime hours worked (not \$20/hr) because \$10 is the “half” portion of mandatory time-and-a-half.

### **Does daily overtime qualify for the deduction?**

The deduction applies only to hours worked over 40 in a “workweek,” as defined by the FLSA. State laws or union agreements requiring daily overtime or other variations do not override the federal standard for a deduction.

Example:

Goldie lives in California and works 10 hours on Monday, 8 hours on Wednesday, 8 hours on Friday. California law requires Goldie be paid overtime rates for any hours above 8 worked in a day, so she is paid for 2 hours of overtime at premium rates for Monday.

This CA rule alone does not qualify Goldie for a federal overtime pay deduction; she must have worked over 40 hours in a workweek to be eligible to deduct any overtime premiums paid.

Under this fact pattern, since Goldie worked less than 40 hours this workweek, her 2 hours over overtime pay would not be eligible for a qualified overtime compensation deduction on her personal tax return. The same result occurs regarding union agreements for daily or holiday overtime pay.

### **Does voluntary overtime paid to an employee qualify for the deduction?**

No. Overtime wages must be required under FLSA Section 7.

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### Reporting Relief for 2025

In August 2025, the IRS announced that there will be no changes to information returns for tax year 2025 related to the new OBBBA deductions, including qualified overtime compensation.<sup>2</sup> However, the statute requires that the amount of qualified overtime compensation be reported to the taxpayer and the IRS on an information return [Section 225(a)]. Draft Form W-2 for 2026 has been updated to include information reporting on new OBBBA deductions.

#### Reporting Relief for Employers

To provide formal 2025 transition relief, Treasury released Notice 2025-62 that provides favorable reporting penalty relief for employers and payors regarding new tips and overtime compensation reporting. The Notice merely encourages reporting for 2025 but does not require it.

The Notice includes examples how employers could provide alternative documentation:

- An online portal
- Additional written statements furnished to the employees or payees
- Other secure methods
- In the case of qualified overtime compensation in Form W-2 Box 14

#### Substantiation Relief for Individuals

Notice 2025-69 was also issued to provide guidance to individuals seeking a deduction, who may not be provided amounts on an information return or statement from an employer in 2025.

Substantiation alternatives provided for 2025:

1. Amounts voluntarily included by an employer on Form W-2, box 14
2. Amounts voluntarily provided by an employer in a statement
3. Pay statements, invoices, or similar statements

If amounts listed include just the “half” portion of overtime pay, the amount can be used without an adjustment. However, if the amounts include total overtime compensation (e.g., both premium pay and regular pay), an adjustment is needed. If the overtime rate of pay is time and half, use 1/3 of reported overtime compensation; if it is double time, use 1/4 of reported overtime compensation.

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<sup>2</sup> <https://www.irs.gov/newsroom/irs-announces-no-changes-to-individual-information-returns-or-withholding-tables-for-2025-under-the-one-big-beautiful-bill-act>