

THE AUTO DEALER'S GUIDE TO NEW "NO TAX ON OVERTIME" RULES: KEY TIPS TO AVOID SURPRISES UNDER THE HOOD

Insights
Jan 28, 2026

Auto dealerships might be surprised by some important nuances in the "No Tax on Overtime" rules that rolled out nationwide last year, and now is the time to get familiar with the fine print and set expectations before driving off the lot. The new federal tax rules are surrounded by misconceptions and inherently more complicated for employers in the auto dealer industry. You're more likely to have employees who qualify for federal overtime exemptions but are treated as nonexempt due to state law requirements or other reasons. We'll break it all down and give you the top employer takeaways + next steps.

Quick Overview

The One Big Beautiful Bill Act (OBBBA), which President Trump signed into law last year, includes a new federal income tax deduction related to overtime pay. This new rule (which applies for tax years 2025 through 2028):

- **allows an eligible worker to take a deduction on their individual tax return** of up to \$12,500 (or \$25,000 if married filing jointly) in "qualified overtime compensation" they received during the applicable tax year; and
- **imposes new filing and information reporting requirements on employers** related to such qualified overtime compensation.

Under the OBBBA, "qualified overtime compensation" means overtime compensation (excluding qualified tips) paid to an individual that:

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- **is required by federal law** – specifically, under section 7 of the Fair Labor Standards Act (FLSA); and
- **exceeds the individual's "regular rate"** as determined by the FLSA.

Is "No Tax on Overtime" a Misnomer?

There are plenty of misconceptions floating around related to the OBBBA's "No Tax on Overtime" provisions. We previously dispelled some of the top mistaken beliefs, which you can read here: [Separating Myth From Reality on New "No Tax on Overtime" Law: Key Facts Employers Must Know This Tax Season and Beyond.](#)

This Insight focuses on one of the key nuances that may be especially challenging for auto dealerships: OT pay that is not required by the FLSA is not "qualified overtime compensation" under the OBBBA.

How "No Tax on Overtime" Gets Extra Complicated for Auto Dealerships

Employers in the auto dealer industry often have workers that that qualify for one or more of the FLSA's exemptions – including exemptions uniquely available to retail automotive dealerships, as well as commonly used "white collar" exemptions available to all types of employers. (For a deeper dive on these exemption types, check our prior insight: [The Auto Dealer's Guide to FLSA Exemptions: An Inventory of Commonly Used Categories + Your Maintenance Plan to Stay Compliant.](#))

However, some states have laws that make it harder to qualify for those exemptions or do not recognize certain auto dealer exemptions at all. For example, the following groups of employees may qualify as exempt under the FLSA but be required by a state law to be treated as nonexempt:

- Technicians
- Salespersons
- Outside salespersons
- Service advisors
- Parts employees

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- Finance salespersons
- Certain [non-sales employees who are paid commissions](#)

Want more? For a general look at how the new federal tax deduction rules are impacted in a state with overtime mand that go beyond what's required by the FLSA, check out our insight: [California Employer Guide to Federal "No Tax on Overtime" Law: Key Takeaways That May Surprise and Change Your Workplace.](#)

In addition, some auto dealer employers might choose to treat an individual as nonexempt, even if they could qualify for an exemption under both state and federal law.

All of the above scenarios could **potentially** lead to situations where an employee receives significant OT pay and expects to claim a tax deduction for it but cannot do so because the overtime compensation was not "required" by the FLSA.

Legal Gray Areas?

Of course, the low hanging fruit for IRS audits may be when dealer reports "qualified overtime compensation" to include **overtime** required by state law but *not required* by the FLSA. it's unclear for now whether this will be the main focus of the auditors.

Apart from the state daily overtime that won't count, several areas remain – including when an employee qualifying as exempt under federal law but not under state law **actually works and is paid overtime for over 40 hours in a work week.**

- Practically speaking, if overtime over 40 hours was actually worked, paid, and recorded in the correct format, some dealers may assume the IRS would treat that payment as "required" by the FLSA when that actually may not be the case.
- On the other hand, other dealers may question whether they will take a more aggressive approach and use a list of dealer positions commonly exempt under the FLSA from overtime. They may summarily reject or audit overtime reported and/or deducted for those positions.

- In short, at this early juncture, it's uncertain how narrowly will interpret "qualified" FLSA overtime or how zealously audit the employer-reported and employee-deducted overtime. **Because FLSA "required" overtime may be narrowly interpreted and strictly enforced, until the agency issue regulations that explicitly address these gray areas, we recommend that dealers be cautious in these scenarios**

Employer Impact + Next Steps

While the OBBBA's new overtime deduction is a tax benefit for employees filing individual tax returns, it impacts employers in several important ways:

- **New Filing and Information Reporting Requirements.** The OBBBA requires employers to include the total amount of "qualified overtime compensation" on the employee's Form W-2. Properly tracking, calculating, and reporting these amounts may be especially challenging and burdensome for auto dealerships. For the 2025 taxable year, the IRS is [granting employers penalty relief](#) related to failures to separately report qualified overtime compensation. **However, this relief will not be available for the 2026 tax year or future years, so it is important that dealers work with counsel to correctly calculate and report qualified overtime compensation.**
- **Payroll Withholding.** All overtime pay remains subject to payroll taxes and withholding requirements (although employees may opt to adjust their Forms W-4 to reflect any expected deductions for qualified overtime compensation). **Dealers must be aware of their withholding obligations in light of the new tax rules for qualified overtime compensation and look out for any employee updates to Forms W-4.**
- **Employee Relations.** Many employees may be attracted to certain roles or motivated to work more overtime hours based on the OBBBA's new overtime deduction, and employers should be prepared to respond to any employee confusion – and perhaps anger – related to any misconceptions surrounding it. **You may consider working with counsel to determine the best approach here. In general, however, you should avoid giving employees any tax planning advice and remind them that the dealership is following IRS rules.**

Conclusion

All employers should work with counsel on filing, reporting, and withholding issues, as well as employee communications, related to qualified overtime compensation. This is especially true for auto dealers since industry-specific issues will likely make compliance more challenging.

We will continue to monitor this and all areas of labor and employment law. We expect the IRS to release more guidance in the near future, so make sure you are subscribed to our [Fisher Phillips' Insight System](#) to get the most up-to-date information. If you have questions, contact your Fisher Phillips attorney, the authors of this Insight, any member of our [Wage and Hour Team](#), any attorney on our [Employee Benefits and Tax Team](#), or any attorney on our [Auto Dealership Team](#).