

SEPARATING MYTH FROM REALITY ON NEW “NO TAX ON OVERTIME” LAW: KEY FACTS EMPLOYERS MUST KNOW THIS TAX SEASON AND BEYOND

Insights
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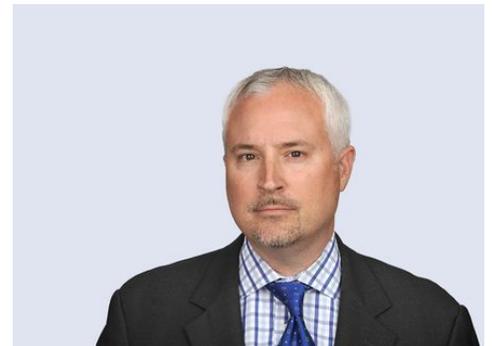
A new federal law enacted last year provides a tax benefit to employees who receive overtime pay – but calling it a “No Tax on Overtime” law is a bit of misnomer. For starters, OT pay remains taxable and subject to withholding rules. And while a new income tax deduction may be available to some employees who work overtime, only a limited portion of *federally* required overtime compensation is tax deductible. We’ll clear up some of the biggest misconceptions surrounding these new rules and provide some key employer takeaways – which will become especially important this tax season and beyond as more employees learn the realities of these rules and the IRS cracks down on employers’ new filing and information reporting obligations.

Overview of “No Tax on Overtime”

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 deduction:

- applies for tax years **2025 through 2028**;
- allows eligible workers to claim up to **\$12,500** (or **\$25,000** if married filing jointly) in “**qualified overtime compensation**” they received during the applicable tax year;
- **phases out** for individuals whose modified adjusted gross income (MAGI) for the year exceeds **\$150,000** (**\$300,000** if married filing jointly); and

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- is **not available** if the individual's MAGI is at or above **\$275,000 (\$550,000 if married filing jointly)**.

The deduction is allowed for **both itemizers and non-itemizers**, so long as the individual includes their **social security number** on their tax return. If an individual is married, they must file a joint return in order to claim this deduction.

(The Big Beautiful Bill also contains a number of other workplace-related changes – [you can read our full summary here.](#))

The Big Question: What Does "Qualified Overtime Compensation" Mean?

The law defines "qualified overtime compensation" as "overtime compensation paid to an individual required under section 7 of the Fair Labor Standards Act" (FLSA) that exceeds the individual's "regular rate" (as determined by the FLSA), excluding qualified tips. This language expressly conditions an employee's right to claim the federal tax benefit on federal labor law requirements, specifically excluding overtime compensation mandated solely by state law.

Is "No Tax on Overtime" a Misnomer? Top 3 Misconceptions and Employer Challenges

There are plenty of misconceptions floating around related to the implications of the Big Beautiful Bill, especially related to the "No Tax on Overtime" provisions. In order to separate myth from reality, here are **three key clarifications** on the top mistaken beliefs.

1. The new tax deduction is only available for overtime pay required by the FLSA.

The FLSA generally requires employers to pay covered, nonexempt employees at least 1.5 times their "regular rate" of pay for all hours worked beyond 40 hours in a given workweek. This is very important to keep in mind because some states have overtime laws that overlap with, but also go beyond, the requirements of the FLSA. For example:

- Some states impose **daily overtime rules** in addition to weekly overtime requirements.



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- California requires **double-time pay** for hours worked beyond certain thresholds (in addition to daily, weekly, and other overtime requirements).
- Several states make it harder (compared to federal rules) for employers to classify employees as “exempt” from overtime pay requirements. **Exemption rules** can differ at state versus federal levels in terms of salary thresholds and/or industry- or job-specific criteria.

Therefore, if an employee receives overtime pay that is required by state, but not federal, law, such amounts are not “qualified overtime compensation” under the OBBBA, and no portion is deductible by the employee for federal income tax purposes.

2. The deductible amount may be less than you think.

As explained above, the new deduction related to overtime pay is capped at \$12,500 (\$25,000 for joint filers) and is reduced or phased out completely based on an individual's MAGI for the year. In addition, the amount that is deductible is not the full amount of the individual's FLSA-required overtime compensation – rather, it is the portion that exceeds the individual's “regular rate” of pay as determined under federal law.

Here's an example:

- **Scenario.** Let's say an employee's regular rate of pay under the FLSA is **\$20 per hour** and they worked **200 overtime hours** in a given tax year. (Assume they are single and had MAGI of less than \$150,000 for that tax year). The employee is a covered, nonexempt employee under the FLSA and therefore required to be paid 1.5 times their regular rate of pay for each hour of overtime worked. The employee therefore received **\$6,000** (200 x \$30) in FLSA-required overtime compensation during that tax year.
- **Outcome.** Because the employee's regular rate of pay for 200 hours worked would total \$4,000 (200 x \$20), the employee's “qualified overtime compensation” is **\$2,000** (\$6,000 - \$4,000). The employee therefore may only claim \$2,000 for the overtime pay deduction that year. (The actual *value* of this tax benefit would depend on the employee's marginal tax bracket since tax deductions,

unlike tax credits, do not give you a dollar-for-dollar tax reduction.)

3. All overtime pay remains subject to payroll taxes and withholding rules.

The phrase “No Tax on Overtime” is misleading because it doesn’t actually mean that overtime pay is no longer taxable. To the contrary, all OT pay remains subject to federal income tax (though, as explained above, employees may be eligible to claim a limited income tax deduction for qualified overtime compensation) and therefore subject to income tax withholding rules. However, employees may opt to adjust their Forms W-4 to reflect any expected deductions for qualified overtime compensation.

In addition, all overtime compensation remains fully subject to other payroll taxes, such as Social Security and Medicare taxes (both the employer’s share and the employee’s share), because the OBBBA’s new tax deduction applies only for federal income tax purposes.

Why Should Employers Care About Any of This?

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. 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 in future tax years, so it is essential to understand how to correctly calculate qualified overtime compensation. (You can check out the agency’s [proposed 2026 General Instructions for Forms W-2 and W-3](#) to get an idea of the applicable reporting requirements you can expect to roll out).
- **Payroll Withholding.** As mentioned above, employers must be aware of their withholding obligations in light of the new tax rules around 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 company is following IRS rules.

Conclusion

Overtime pay remains taxable – though some employees may be allowed to claim a portion of it as a federal income tax deduction. Employers should work with counsel on filing, reporting, and withholding issues, as well as employee communications, related to qualified overtime compensation.

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, or any member of our [Wage and Hour Team](#).