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PREPARE YOUR ORGANIZATION FOR THE NEW OVERTIME RULES.

If your employees earn overtime, there are new rules to know for the upcoming tax year.

What is the overtime tax deduction?

Beginning with the 2025 tax year and continuing through 2028, the new One Big Beautiful Bill Act introduces a new federal income tax deduction specifically for qualifying overtime pay.

This provision allows eligible employees to deduct up to $12,500 from their federal taxable income, or $25,000 for those filing jointly, based on the premium portion of their overtime earnings. Discover the new rules and learn how your organization should prepare.

What is premium overtime pay?

Under the Fair Labor Standards Act (FLSA), overtime pay is typically calculated as time-and-a-half. The premium portion refers to the extra "half" paid above the employee's regular hourly rate.

Only overtime mandated by the FLSA qualifies for this deduction — overtime earned under state-specific laws does not.

What are the overtime deduction income limits and phase-out?

The deduction begins to phase out for individuals earning more than $150,000 annually, or $300,000 for joint filers. Employees above these thresholds may see reduced or no benefit from the deduction.

New IRS rules on tip reporting are also changing the game for restaurants. Learn how they can affect your payroll, reporting, and employees.

How the overtime tax deduction works.

The new overtime tax rule is a deduction, not an exemption from withholding. Overtime wages, including the premium portion, remain subject to:

Federal income tax withholding
State and local taxes
Social Security and Medicare contributions
The deduction is applied when employees file their Form 1040, potentially lowering their overall federal tax liability or increasing their refund.
Employees receive their overtime pay as usual through their paycheck.

What are the employer reporting requirements?

Employers must accurately track and report qualified overtime compensation through their payroll systems. This information will be included on employees' W-2 forms.

How should employers report overtime tax for 2025?

The IRS confirmed for the 2025 tax year, there will be no changes to Form W-2, Form 941, or other federal tax forms related to the new overtime and tip deductions under the new tax law. Employers should continue reporting overtime and tips using the same procedures as in previous years.

There will be transition relief for employers so they won't face penalties in the 2025 tax year for not meeting the new reporting requirements, as long as they comply with the current federal FLSA overtime requirements.

Employers are encouraged (but not required) to provide employees with a separate accounting of qualified overtime compensation. Employers can choose to provide their employees with a separate statement reporting the total overtime compensation and overtime hours for the year. This voluntary information can help employees accurately determine their qualified overtime compensation.

Reporting changes beginning in tax year 2026.

Starting in 2026, new reporting requirements will apply to Form W-2:

Box 12 will include:
Code TT for qualified overtime compensation
Code TP for qualified tips
Box 14b will be used to report the Treasury Tipped Occupation Code, identifying employees in occupations eligible for the tip deduction
Draft Form W-4 updates for 2026
The IRS has released a draft Form W-4 for 2026, which includes an updated deductions worksheet. Employees can use this worksheet to claim estimated deductions for qualified tips and overtime compensation directly through payroll. Employees will receive the tax deduction through their paycheck rather than waiting to claim potential tax savings when filing their personal Form 1040.

Key employer action items

Continue current reporting practices for 2025
Educate employees on the new deductions and how they affect withholding
Prepare payroll systems for 2026 Form W-2 changes
Monitor IRS updates for additional guidance
To meet the new rules, employers may need to update payroll and accounting systems and adjust their reporting to accurately disclose overtime amounts to employees.