

# "No Tax on Overtime": What Government Employers Need to Know

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BUSINESS ADVISORS



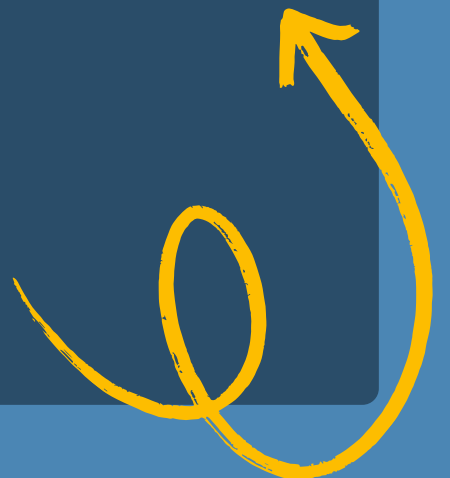


# Introduction & Legislative Background

# Purpose and Policy Goals

**Purpose: The idea of reducing taxes on both overtime and tips gained traction during the election, with bipartisan support for the overall concept.**

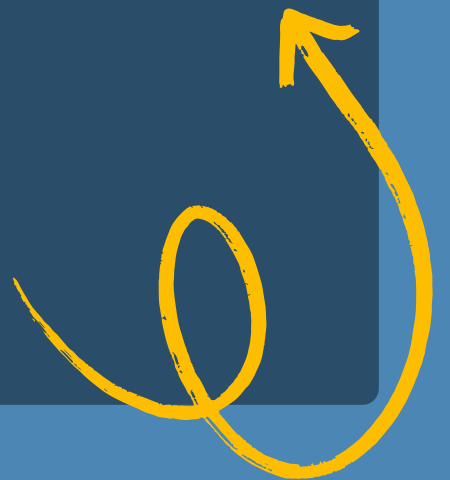
- Appealing to working class and middle income voters.
- Encourage workforce participation without raising base wages
- “Anti-tax” branding
- Cultural messaging: “Rewarding work”
- Avoids structural reform
- Budget and revenue strategy



# Purpose and Policy Goals

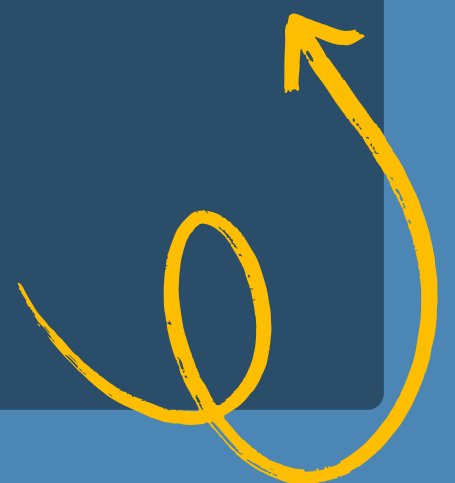
**Policy Goals:** In summary – to enhance transparency and compliance in reporting overtime amounts.

- Encourage accurate reporting of tips and overtime.
- Provide tax relief to workers in tipped and overtime-eligible occupations.
- Modernize and standardize information reporting for both employees and non-employees.



# OBBBA enacted

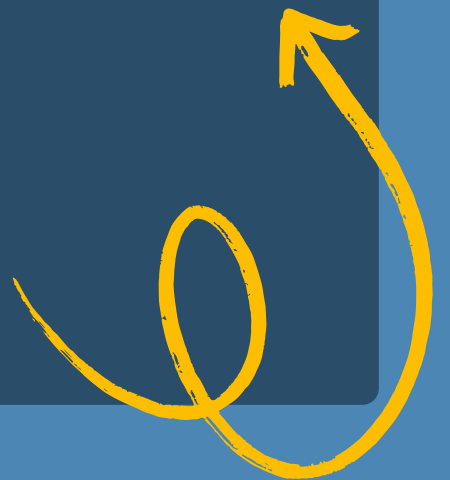
- July 4, 2025 H.R. 1 is signed into law and the “No Tax on Overtime” deduction is created under Section 225 of the Internal Revenue Code
- Allows individual taxpayers to deduct certain overtime compensation from their federal taxable income for tax years 2025 through 2028.
- The deduction is intended to provide tax relief for workers who receive overtime pay required by the **Fair Labor Standards Act (FLSA)**.



# Key Provisions of Section 225

## Employer vs. Employee

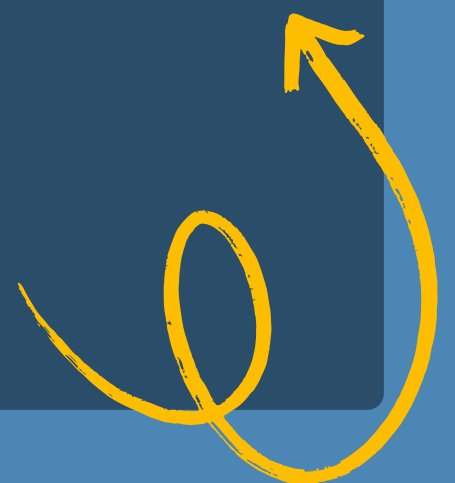
- This deduction is an employee-focused benefit, meaning it does not alter gross wages or provide direct employer payments.
- Employer responsibility is to ensure proper reporting and tracking of eligible overtime for compliance.



# Key Provisions of Section 225

## Deduction Amount

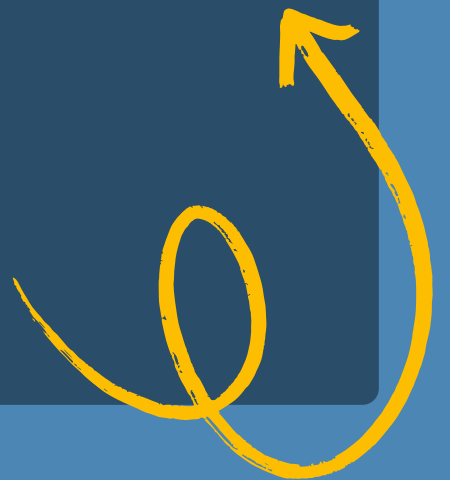
- Taxpayers may deduct the amount of "qualified overtime compensation" received during the taxable year and included on statements furnished to the individual (such as Forms W-2 or 1099).
- The deduction is capped at \$12,500 per year for single filers and \$25,000 for joint filers.
- The deduction is reduced by \$100 for every \$1,000 by which the taxpayer's modified adjusted gross income exceeds \$150,000 for single filers and \$300,000 for joint filers.



# Key Provisions of Section 225

## Timing and Termination

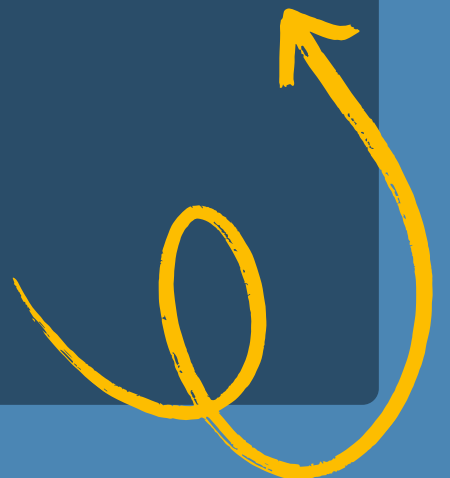
- Effective retroactively from January 1, 2025
- Temporary deduction not available for tax years beginning after December 31, 2028.



# Polling Question #1

Which of the following was a primary reason for the enactment of the OBBBA's new overtime reporting and deduction rules?

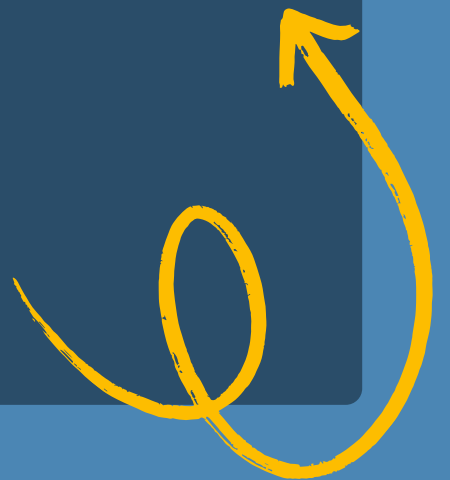
- A) To increase the federal minimum wage
- B) To provide tax relief and improve transparency in reporting qualified tips and overtime compensation
- C) To eliminate overtime pay for government employees
- D) To reduce the number of IRS forms required for employers



# Polling Question #1 - Answer

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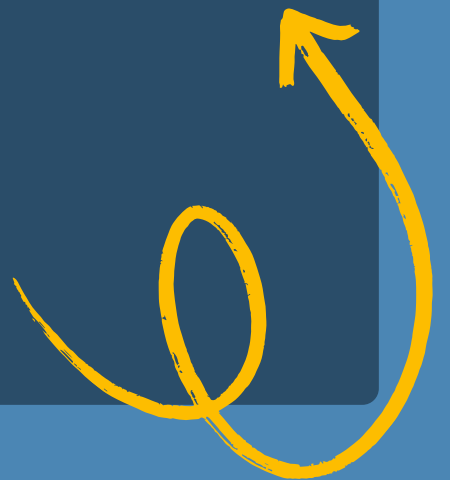
# Qualified Overtime Compensation



# Qualified Overtime Compensation

## Fair Labor Standards Act

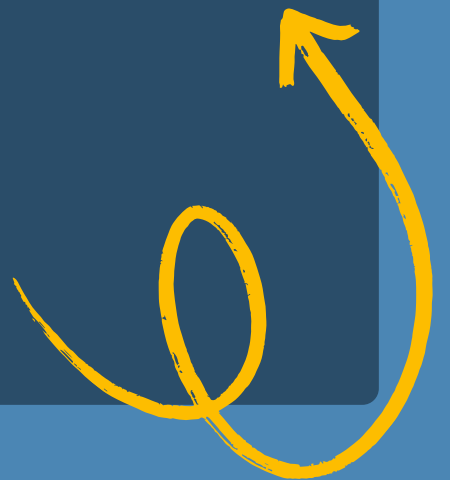
- Overtime must exceed regular pay AND be **required by Section 7 of the Fair Labor Standards Act**
- Only non-exempt employees covered under FLSA can claim the deduction
- Overtime required by State law but NOT FLSA is ineligible for deduction



# Qualified Overtime Compensation

## Overtime Premium

- The amount of overtime pay that exceeds regular pay
- The HALF portion of time and a half



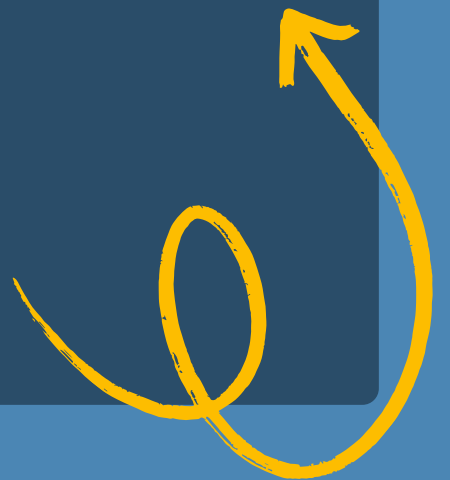
# New Federal Reporting Rules



# Information Reporting Requirements

## Employers must:

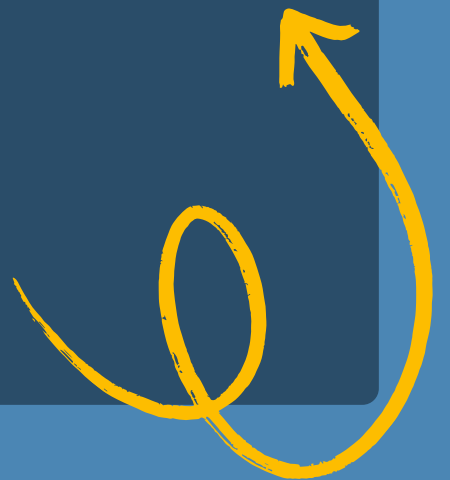
- Include on the written statement (Form W-2) the total amount of qualified overtime compensation
- For non-employees, payors must separately account for qualified overtime on information returns (e.g., 1099s)



# Information Reporting Requirements

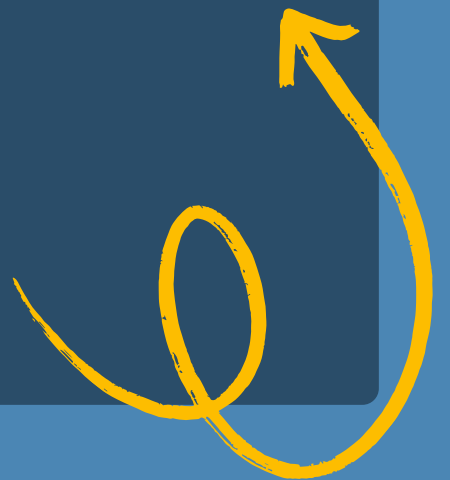
## Transition for 2025:

- For tax year 2025, Forms W-2 and 1099 were NOT be updated to reflect these new requirements.
- Employers were not required to separately account for qualified overtime on 2025 forms; penalty relief applied



# What Must Be Reported (Starting 2026)

- **Form W-2:** Box for “qualified overtime compensation”
- **Form 1099-NEC/MISC:** Separate line for qualified overtime for non-employees.
- **Supporting Documentation:** Employers should maintain payroll records substantiating overtime calculations.



# Draft: 2026 Form W-2

OMB No. 1545-0029

## Box 12—Codes.

**TT**—Total amount of qualified overtime compensation. Use this amount when determining the qualified overtime compensation deduction in Part III of Schedule 1-A (Form 1040).

**Code TT—Total amount of qualified overtime compensation.** (Forms W-2AS, W-2CM, W-2GU, or W-2VI should check with the respective territory for applicability.) Qualified overtime is compensation that is paid to an individual required under section 7 of the Fair Labor Standards Act (FLSA) of 1938 that is more than the regular rate at which the individual is employed. For example, only the “half” portion of “time-and-a-half” compensation would be reported using code TT. Overtime compensation is still generally subject to federal income tax withholding and both the employer share and employee share of social security tax and Medicare tax.

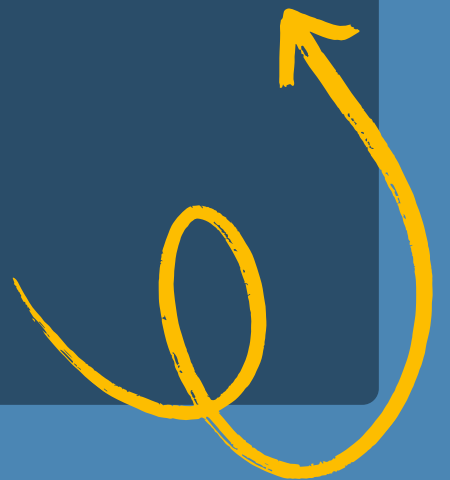
	<b>1</b> Wages, tips, other compensation	<b>2</b> Federal income tax withheld
	<b>3</b> Social security wages	<b>4</b> Social security tax withheld
	<b>5</b> Medicare wages and tips	<b>6</b> Medicare tax withheld
	<b>7</b> Social security tips	<b>8</b> Allocated tips
	<b>9</b>	<b>10</b> Dependent care benefits
	<b>11</b> Nonqualified plans	
Suff.	<b>13</b> Statutory employee <input type="checkbox"/> Retirement plan <input type="checkbox"/> Third-party sick pay <input type="checkbox"/>	<b>12a</b>
	<b>14a</b> Other	<b>12b</b>
	<b>14b</b> Treasury Tipped Occupation Code(s)	<b>12c</b>
		<b>12d</b>
<b>7</b> State income tax	<b>18</b> Local wages, tips, etc.	<b>19</b> Local income tax
		<b>20</b> Locality name

2026

# Polling Question #2

**For the 2026 tax year, what is the federal reporting requirement regarding qualified overtime compensation on Form W-2?**

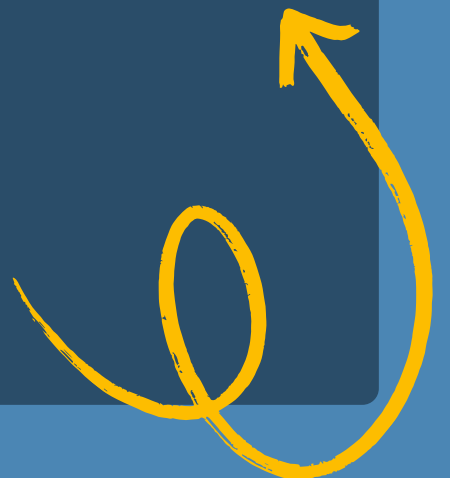
- A) Employers must separately report the total amount of qualified overtime compensation on Form W-2, using the designated box or field
- B) Employers may report qualified overtime compensation only if requested by the employee
- C) Employers are not required to report qualified overtime compensation separately on Form W-2 for 2026
- D) Employers must file a separate IRS form for each overtime payment



# Polling Question #2- Answer

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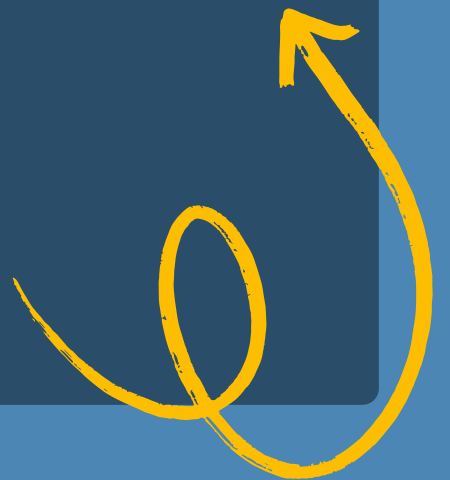


# Calculating Qualified Overtime Compensation



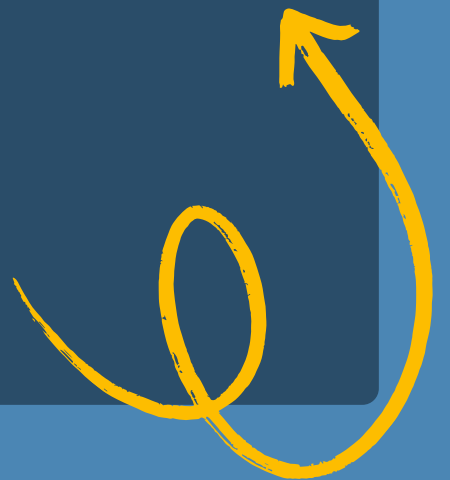
# Calculation Methods for 2025 (Transition Year)

- **Statement Separately Accounting for FLSA Overtime Premium**
- **Statement Showing Total Overtime**
- **Overtime Paid at a Rate Higher Than Time-and-a-Half**
- **Adjusted Method for Underestimation**
- **Reasonable Method When No Statement Is Available**
- **Special Rules for Alternative FLSA Overtime Structures**



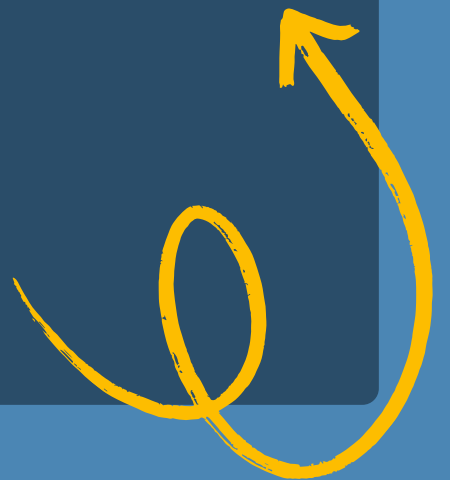
# FLSA Overtime Rules for Certain Government Employees

- Law enforcement and fire protection: Overtime may be based on work periods longer than 40 hours/week
- Hospitals and residential care: May use 8/80 rule (overtime for >8 hours/day or >80 hours/14 days)



# Law Enforcement and Fire Protection

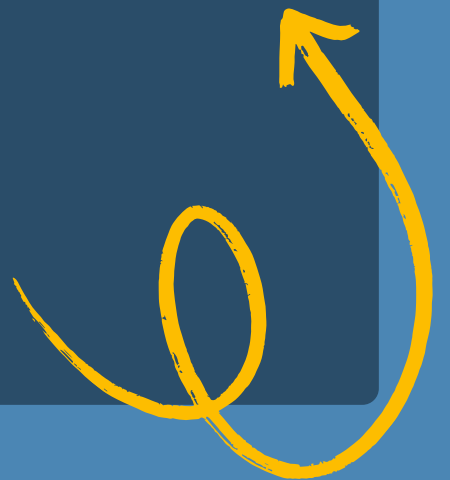
- Fire protection personnel are due overtime after 106 hours worked during a 14-day work period.
- Law enforcement personnel must receive overtime after 86 hours worked during a 14-day work period.



# Calculation Methods for 2025:

## Statement Separately Accounting for FLSA Overtime Premium

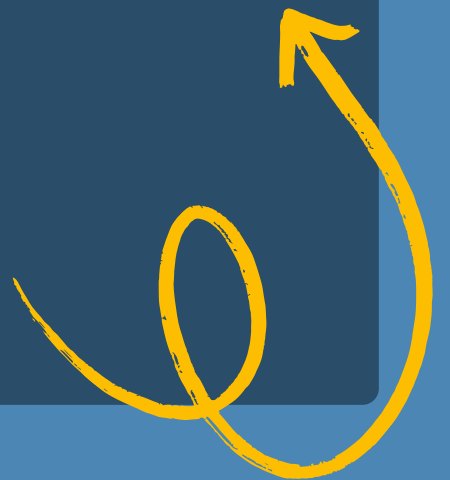
- **Example: Andrew's payroll system shows \$5,000 as the "overtime premium" paid in 2025.**
- **Andrew may use \$5,000 as his qualified overtime compensation.**



# Calculation Methods for 2025:

## Statement Showing Total Overtime (Premium Plus Regular Wages)

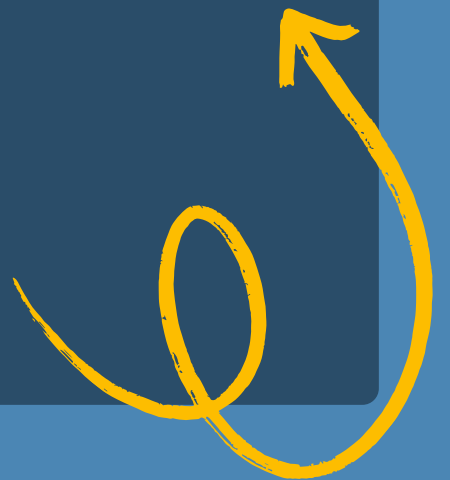
- **Example: Andrew's pay stub shows a total "overtime" amount of \$15,000 (including both the FLSA overtime premium and the regular wages for overtime hours).**
- **Andrew may use \$5,000 ( $\$15,000 \div 3$ ) as his qualified overtime compensation.**



# Calculation Methods for 2025:

## Overtime Paid at a Rate Higher Than Time-and-a-Half

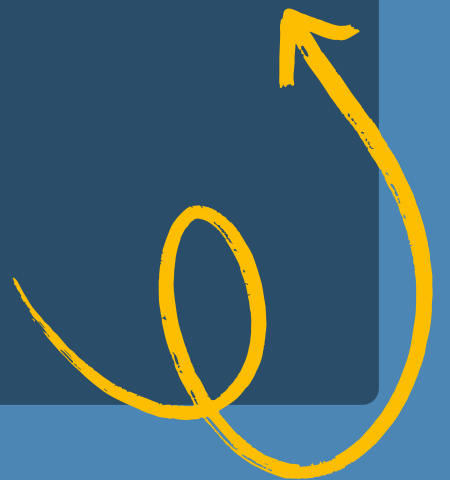
- **Example: Brad's employer pays overtime at double the regular rate. Brad's last pay stub for 2025 shows "overtime" of \$20,000 paid in 2025.**
- **Brad may use \$5,000 ( $\$20,000 \div 4$ ) as his qualified overtime compensation.**



# Calculation Methods for 2025:

## Adjusted Method for Underestimation

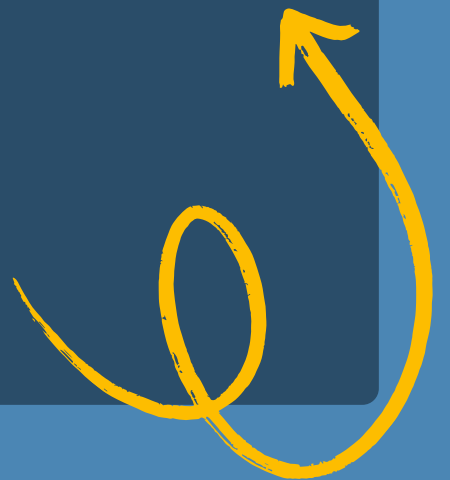
**If a nondiscretionary bonus increases the regular rate, and the standard one-third method would understate the FLSA overtime premium, the taxpayer may adjust the calculation using payroll records or employer-provided information to reflect the actual FLSA overtime premium.**



# Calculation Methods for 2025:

## Reasonable Method When No Statement Is Available

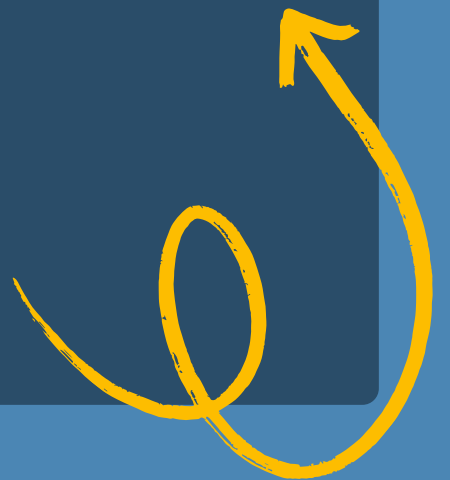
- **Example: The taxpayer knows their regular rate is \$20/hour and worked 200 overtime hours in 2025.**
- **The FLSA overtime premium is  $0.5 \times \$20 \times 200 = \$2,000$ . The taxpayer may use \$2,000 as their qualified overtime compensation.**



# Calculation Methods for 2025:

## Special Rules for Alternative FLSA Overtime Structures

- **Example (Law Enforcement):** Carol is a law enforcement officer paid \$15,000 of overtime pay on a 14-day “work period” basis that complies with the FLSA.
- Carol may use \$5,000 ( $\$15,000 \div 3$ ) as her qualified overtime compensation.



# Penalties for Noncompliance



# What are the potential penalties?

- Penalties under IRC §6721 (Failure to File Correct Information Returns)
- Penalties under IRC §6722 (Failure to Furnish Correct Payee Statements)
- Intentional Disregard

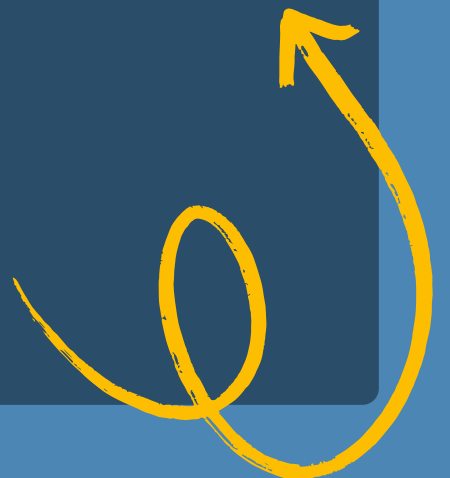
Timing of Correction/Furnishing	Penalty per Return/Statement	Maximum Penalty (Large Business)	Maximum Penalty (Small Business)
Within 30 days	\$60	\$698,500	\$244,500
By August 1	\$130	\$2,095,500	\$698,500
After August 1/Not Corrected	\$340	\$4,191,500	\$1,397,000
Intentional Disregard	\$690 (no max)	No limit	No limit

**\*\*SMALL BUSINESS DEFINITION: A SMALL BUSINESS IS ONE WITH AVERAGE ANNUAL GROSS RECEIPTS OF \$5 MILLION OR LESS FOR THE MOST RECENT THREE TAXABLE YEARS**

# Polling Question #3

**Which statement best describes the penalty and reporting requirements for governmental employers under the OBBBA for the 2026 tax year?**

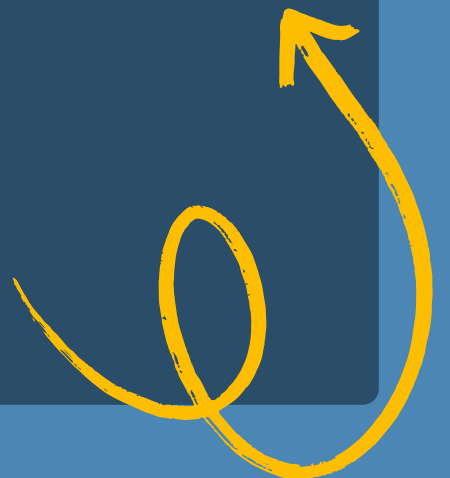
- A) Penalties will be imposed for failure to separately report qualified overtime compensation on Forms W-2, unless the employer can show reasonable cause
- B) Government employers are exempt from all federal overtime reporting requirements for 2026
- C) Only private employers are subject to penalties for overtime reporting errors in 2026
- D) Penalty relief automatically applies for all reporting errors in 2026



# Polling Question #3 - Answer

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# Nuances for Government Employers



# Understanding Comp Time Regulations

- Public agencies may provide comp time instead of cash overtime
- Deduction applies when comp time is paid out



# Exclusions from the Deduction

- Holiday premium pay not tied to FLSA thresholds
- Collective bargaining agreements provisions that exceed FLSA requirements
- Comp time accrued but not paid



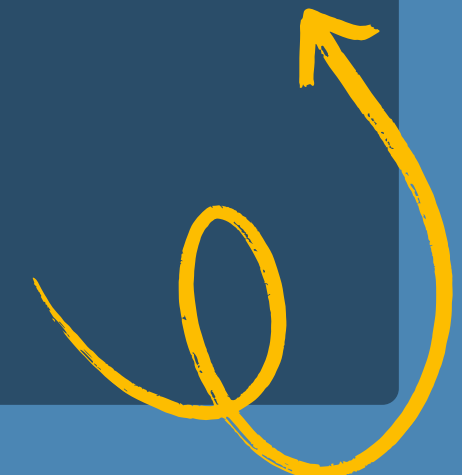
# Frequently Asked Questions



# Impact on State Tax Revenue?

State	Conformity Type	Overtime Deduction Incorporated?	Estimated Revenue Loss (2026)
Colorado	Rolling	No (decoupled)	\$0
Idaho	Static-Current	Yes (if conformity date updated)	\$78.7 million
Iowa	Rolling	Yes	\$104.3 million
Montana	Rolling	Yes	\$47.1 million
North Dakota	Rolling	Yes	\$17.1 million
Oregon	Rolling	Yes	\$322.0 million
South Carolina	Static-Current	Yes (if conformity date updated)	\$224.2 million

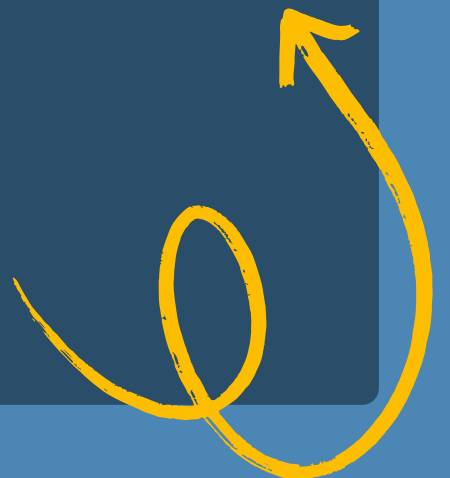
No affect on Ohio which uses an AGI base.



# Polling Question #4

**When is an employee allowed to claim the federal deduction for qualified overtime compensation under the OBBBA for compensatory time off (comp time) accrued under special FLSA overtime provisions?**

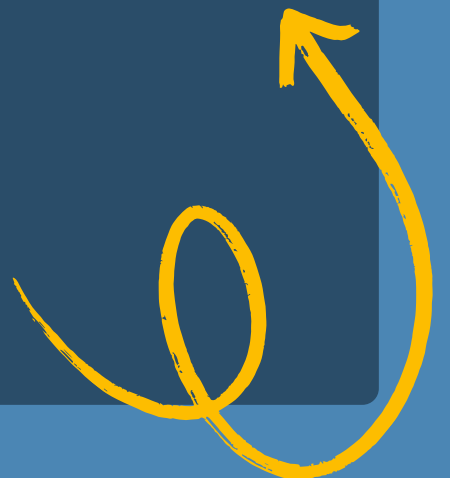
- A) In the year the comp time is accrued
- B) In the year the comp time is scheduled to be used
- C) In the year the comp time is paid out as wages (e.g., upon separation or cash-out)
- D) In any year the employee chooses



# Polling Question #4 - Answer

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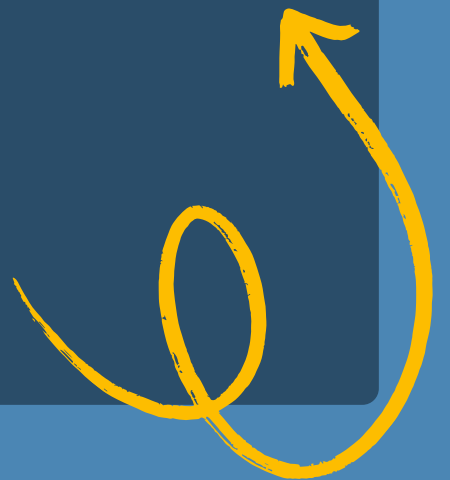


# Action Steps for Ohio Government Employers



# Special Considerations and Challenges

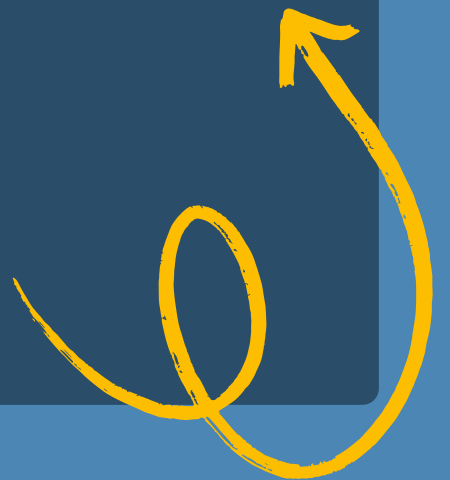
- **Complex FLSA Coverage**
- **Compensatory Time**
- **Multiple Bargaining Units**
- **System Upgrades**
- **Training and Communication**
- **Potential for Increased Inquiries**



# Practical Steps and Recommendations

**For 2025:**

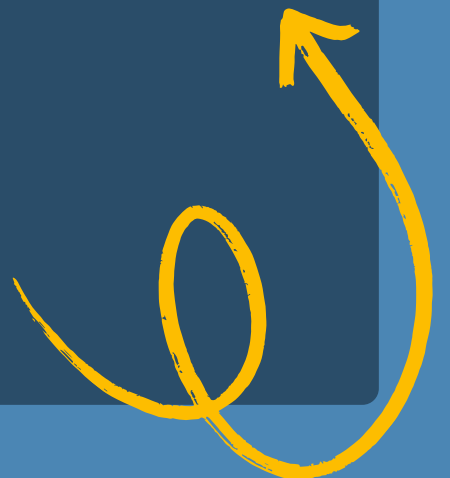
- **No separate reporting of qualified overtime required on W-2s/1099s.**
- **Encouraged voluntary reporting in Box 14 or separate statements to assist employees.**
- **Educate employees on how to calculate and substantiate their deduction.**



# Practical Steps and Recommendations

**For 2026 and Beyond:**

- **Update payroll and reporting systems to comply with new federal requirements.**
- **Train payroll and HR staff on FLSA rules and OBBBA requirements.**
- **Establish Internal Controls**
- **Maintain Policy and Procedure Documentation**
- **Monitor IRS and DOL guidance for updates.**





# Questions