

# Federal Income Tax Deduction for Qualified Overtime Compensation

The "One Big Beautiful Bill Act" (OBBBA) created an above-the-line federal income tax deduction for "qualified overtime compensation." This applies to overtime mandated by the federal Fair Labor Standards Act (FLSA) time-a-half requirements triggered by an employee working over 40 hours in a week. It is available for tax years 2025 through 2028. Below is a general outline of the deduction and its requirements and limitations.

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**Qualified Overtime Deduction:** The OBBBA "No Tax on Overtime" deduction allows eligible employees to deduct up to \$12,500 annually (\$25,000 for married filing jointly) of "qualified overtime compensation" from federal taxable income.

- The deduction applies exclusively to overtime compensation required under the FLSA—the premium portion of pay above the regular rate for hours worked beyond forty in a workweek (the "half" in "time-and-a-half")—payable to an employee covered by and not exempt from the FLSA.
  - For example, an eligible employee earning \$20/hour straight time and \$30/hour overtime can only deduct the \$10/hour FLSA-mandated overtime premium portion for hours work over 40 in a week.
- The deduction does not apply to:
  - Overtime paid under collective bargaining agreements that exceeds FLSA requirements to pay time-and-a-half overtime. (e.g., the deduction does not apply to overtime required by a CBA for work beyond eight hours in a day; it only applies to overtime triggered by working over 40 hours in a week).
  - Voluntary premiums paid by employer policy not required by the FLSA.
  - Shift differentials, weekend premiums, or other non-FLSA mandated overtime.
  - Overtime paid pursuant to state law requirements that exceed FLSA requirements (e.g., daily overtime in California).

**Income Limitations:** The deduction phases out for individuals with modified adjusted gross income (MAGI) exceeding \$150,000 (\$300,000 for married filing jointly), reducing \$100 for every \$1,000 over the threshold.

- Married taxpayers **MUST** file jointly to get deduction and include the SSNs of **BOTH** spouses to ensure the deduction is not benefitting undocumented immigrants.

**Federal Income Tax Only:** The deduction applies only to federal income tax. It does not alter payroll taxes such as Social Security and Medicare, state taxes and local taxes.

**Employer Reporting:** Employers must track and separately report OBBA “qualified overtime compensation” on Form W-2.

For tax year 2025 only, Treasury has issued guidance providing penalty relief from the new information reporting requirements for qualified overtime.

- For tax year 2025 only, Treasury has issued separate guidance providing reasonable methods for an employer to report employees’ qualified overtime compensation, such as using box 14 on Form W-2.
- Beginning on January 1, 2026, employers must maintain records distinguishing FLSA-required “qualified overtime compensation” under the OBBBA from other overtime and premium pay.
- For tax year 2026 be sure your payroll system can separately track FLSA-required overtime from other overtime and premium pay for W-2 reporting.

For advice on the applying this new law refer to IRS resources and your tax advisor.

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