



No Tax on Overtime Premium? Understanding the Qualified Overtime Deduction



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What's New

Recent federal legislation created a new above-the-line federal income tax deduction for certain qualified overtime compensation for tax years 2025 through 2028. This provision does not change wage-and-hour requirements, overtime eligibility and overtime pay rules under the FLSA (and applicable state law) remain the same. Instead, it's a tax filing benefit that may be available to eligible individuals.

What part of overtime is deductible

Based on current IRS/Treasury guidance, the deduction generally applies to the overtime premium, the portion paid above an employee's regular rate (often thought of as the "extra half" in time-and-a-half).

Example: If an employee's regular rate is \$20/hour and overtime is paid at \$30/hour, the premium is \$10/hour. In most cases, that \$10/hour premium is the portion treated as deductible. Employees still receive the full overtime rate; the difference is how part of that pay may be handled for federal income tax purposes.

Dollar limits and who may qualify

IRS resources describe the deduction for qualified overtime compensation and note that additional FAQs and instructions address items like eligibility, reporting, and limits. You may also see payroll and tax vendors reference annual caps (often summarized as \$12,500 for single filers and \$25,000 for joint filers). For employer planning purposes, we recommend treating those figures as preliminary summaries and relying on official IRS/Treasury guidance and any forthcoming instructions for final reporting and operational requirements

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Payroll and reporting considerations for employers

In most cases, employees claim this deduction on their personal tax return. That said, employers may need to ensure payroll can clearly identify and report the qualified overtime amounts so employees have the information they need at year end. The IRS has released guidance and FAQs that outline how the qualified overtime portion is treated for reporting and how individuals may claim the deduction.

Payroll and tax vendors have also indicated that updates to Forms W-2/W-4 and related overtime reporting fields may be part of the 2026 reporting cycle. Employers should plan now to confirm their payroll system can track the overtime premium portion accurately. It's also important to note that withholding changes may not align perfectly for every employee, some employees could see differences between amounts withheld during the year and their final tax result when they file.

What employees should know

This provision does not make overtime "tax-free." Instead, it creates a federal income tax deduction that generally applies to the premium portion of overtime pay (the amount above the regular rate). Regular payroll taxes (such as FICA) and any applicable state/local taxes may still apply under normal rules.

In most cases, employees claim the deduction when they file their federal return (for example, 2025 wages are claimed on the return filed in 2026). Employees with questions about how this may impact their personal tax situation should refer to IRS resources or speak with a qualified tax professional.

Recommended employer actions

- *Confirm payroll tracking*- Make sure your payroll system can separately capture (1) total overtime paid and (2) the overtime premium portion (regular rate vs. premium component).
- *Coordinate with your payroll vendor*- Ask what changes are expected for 2026 year-end reporting, including any W-2 reporting updates or new fields related to qualified overtime.
- *Update employee communications*- Provide a short FAQ or intranet post that explains: what the provision is, what it is not, and that it impacts federal income tax at filing (not overtime pay rules).
- *Prepare HR/Payroll support teams*- Align on a standard response and clear escalation path for more complex questions.
- *Monitor guidance*- Continue to watch for IRS/Treasury updates, including any additional instructions or form revisions.

Questions/Support

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