

One Big Beautiful Bill Act – No Tax on Overtime and the Overtime Deduction

What NYS School Employers Need to Know

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Purpose of Today's Presentation

Discuss the new individual deduction for qualified overtime (and how employers should respond operationally and in communications).

Overview of the Qualified Overtime Deduction

What employees can deduct:

- Qualified overtime premium for tax years 2025-2028.
- Maximum annual deduction: \$12,500 (single/per return) \$25,000 (joint filers).
- Phaseout: deduction phases out for taxpayers with modified AGI over \$150,000 (single filers) (\$300,000 joint filers).

**This is an “above the line” deduction, and therefore available to both itemizing and non-itemizing taxpayers.

IRS Notice 25-69: Key Guidance Overview

- Issued November 21, 2025 by the Internal Revenue Service (IRS) and U.S. Treasury.
- Provides taxpayer and employer guidance for reporting “qualified overtime”.
- Defines the deductible “qualified overtime” as **FLSA required overtime** that **non-exempt** employees are legally entitled to (i.e. hours worked in a week beyond 40, the “half” in one-and-one-half times rate).

Non-exempt Employees

- There are three requirements that must be met for an employee to be classified as exempt (i.e. not legally entitled to overtime per FLSA):
 1. **Salary Basis Test** – employee is paid a fixed amount not subject to docking.
 2. **Salary Level Test** – must exceed the FLSA threshold (for 2025 this amount is \$1,128 per week under 29 C.F.R §541.600).
 3. **Duties Test** – must fit a recognized exemption category (executive, administrative, professional, computer, outside sales, etc.).

If any one of the three fail, employee is non-exempt and overtime is legally required. Definitions of the “duties” test exemptions can be found at <https://www.dol.gov/agencies/whd/fact-sheets/17a-overtime>

Exempt vs Non-exempt Employees

Examples of commonly non-exempt school district roles:

1. Teacher aides / paraprofessionals
2. Clerical or administrative support staff
3. IT support technicians (non-managerial)
4. Monitors/aides
5. Custodial staff
6. Network support staff not meeting “computer professional exemption”

Examples of exempt salaried school district roles:

1. Teachers
2. Administrators
3. Central Office Professionals (CPAs, HR directors, managers, IT director)

2025 Transition Rules

- For the 2025 tax filing year, employers are **not required** to separately report qualified overtime on Form W-2.
- The IRS grants penalty relief for 2025 for failure to separately report these amounts.
- Notice 2025-69 instructs individual taxpayers how to compute the deductible amount using “reasonable methods”, such as their pay-stubs or employer statements.

** Language from IRS Notice 2025-69: “On November 5, 2025, the Internal Revenue Service (IRS) published Notice 2025-62, IRB 2025-48 , which provides **penalty relief** from the new information reporting requirements for cash tips and **qualified overtime** compensation under the OBBBA to employers and other payors for not filing correct information returns and not providing correct payee statements to employees and other payees. Specifically, this notice provides relief from the penalty under section 6721 for failure to file correct information returns and the penalty under section 6722 for failure to furnish correct payee statements. This relief applies only for taxable year 2025. See IRS News Release IR-2025-110.”

FLSA Rules on Lunch Breaks and Other Breaks

- FLSA rules determine whether lunch breaks and other miscellaneous breaks count towards hours worked (towards the 40-hour base per week).
 - A meal period is not counted toward the 40 hours if all of the following are true:
 - Typically 30 minutes or more
 - Employee is completely relieved from duty
 - Employee is free to leave the workstation
 - No work is performed (including answering phones/emails)
 - If these conditions are met:
 - Meal period is not hours worked
 - Does not count towards the 40-hour threshold
 - Does not generate overtime for FLSA or OBBBA purposes.
- Under FLSA – breaks of 20 minutes or less count as hours worked. If the breaks are longer than 20 minutes, then they're not considered hours worked if the employee is:
 - Completely relieved of their duties
 - Free to use the time for their own purposes

2025 Transition Rules – Examples of How Employees May Calculate Their Deductible OT Premium

(Based on IRS Notice 2025-69 “reasonable methods” for 2025)

Example A – Employer pays OT at 1.5x, and the payroll system clearly breaks out and shows the overtime premium amount

A custodian checks the district payroll portal, which shows:

- “Overtime premium paid in 2025: \$5,000”
- Because the system already breaks out the FLSA premium, the employee can deduct \$5,000 as qualified overtime compensation.

Example B – Employer pays OT at 1.5x but the payroll system shows only a combined “overtime” total

A bus driver earns \$15,000 of “overtime” shown as a single line on their paystub. This includes both:

- Regular hourly pay for overtime hours, and
- The *½-time* premium required by FLSA.
- Under IRS rules, for 1.5× overtime, the premium equals one-third of the total. So the deductible amount = $\$15,000 \div 3 = \$5,000$.

2025 Transition Rules – Examples of How Employees May Calculate Their Deductible OT Premium

(Based on IRS Notice 2025-69 “reasonable methods” for 2025)

Example C – Employer pays OT at 2.0x and the payroll system clearly breaks out and shows the overtime premium amount

A grounds crew employee is paid 2x their regular rate for emergency snow-removal overtime. Their paystub shows:

- “Overtime premium paid in 2025: \$10,000”

Only the FLSA-required half-time portion is deductible. For 2x pay, the premium contains twice what FLSA requires, divide by 2 (deductible amount = $\$10,000 \div 2$).

Example D – Employer pays OT at 2.0x, but the payroll system shows only a combined “overtime” total

A maintenance worker receives a total of \$20,000 of “overtime” shown as a single line on their paystub. This includes both:

- Regular hourly pay for overtime hours, and
- Premium amounts at 2x pay.

IRS method: for 2x overtime, the FLSA-required premium is one-fourth of the combined amount (deductible amount = $\$20,000 \div 4$).

2025 Transition Rules – Examples of How Employees May Calculate Their Deductible OT Premium

(Based on IRS Notice 2025-69 “reasonable methods” for 2025)

Example E – Comp time instead of cash overtime

A clerical employee at a district that gives compensatory time (1.5 hours of comp time for every 1 overtime hour worked) receives a cash payout for accrued comp time in 2025 and receives \$4,500 in wages for those hours.

- IRS says only one-third of comp-time-payout wages represent the FLSA premium (deductible amount = $\$4,500 \div 3$).

Important clarification: If the employee simply takes the comp-time as time off (i.e., uses the days or hours instead of getting a cash payout), that does not produce wages — and under IRS guidance there is no “qualified overtime compensation” to deduct.

2026-2028 Employer Reporting Requirements

1. W-2 Reporting Requirement Begins for tax year 2026.
 - Employers must report qualified overtime compensation on employees' W-2s.
 - Applies only to FLSA non-exempt employees
 - Reporting applies to both cash OT and cash-out of comp-time (where applicable)
2. Transition Period Ends
 - 2025 provides transition relief – reporting not required yet.
 - Starting in 2026, reporting is mandatory each calendar year

2026-2028 Employer Reporting Requirements

3. Documentation Requirements – Employers Should Maintain:

- Payroll records showing OT hours worked
- Comp-time accrual and cash-out calculations
- FLSA classification for each employee

4. Practical Implications

- Systems may need updates to track qualified OT separately.
- Misclassification of employees (exempt vs non-exempt) could result in:
 - Payroll errors
 - W-2 reporting inaccuracies
 - Potential penalties for non-compliance

Recommended payroll practice changes

1. Update paystub layout to clearly show either:
 - A separate line labeled “Overtime premium (FLSA premium)”, or
 - A clear “total overtime paid” plus a note showing the employer’s overtime multiplier (e.g. 1.5x, 2x).
 - Consult legal counsel before changing paystub language if CBAs have strict language about pay notices.
2. Make a year-end supplemental statement available that shows total overtime premium (if payroll can compute it).
3. Log compensatory time payouts with a note on how to compute the deductible portion (e.g. “one-third of comp-time payout = overtime premium).



Questions?

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