No Tax on Overtime

History of overtime taxation. Historically, overtime pay-defined as compensation for hours worked beyond 40 in a workweek, as required by the Fair Labor Standards Act (FLSA)-has always been fully taxable under the Internal Revenue Code. Employees pay regular income and payroll taxes on all wages, including overtime.

There has never been a special deduction or exclusion for overtime pay for individual taxpayers. Employers are required to report all compensation, including overtime, on IRS Form W-2, and employees must include all such compensation in their gross income. The Tax Cuts and Jobs Act (TCJA) of 2017 did not alter the taxability of tips for employees.

Creation of a temporary deduction for overtime pay. Section 7202 of the Act creates a new, temporary deduction for individuals who receive "qualified overtime compensation."

Deduction amount and phaseout. Taxpayers may deduct up to $12,500 per year in qualified overtime compensation ($25,000 for joint filers). The deduction phases out by $100 for every $1,000 of modified adjusted gross income (MAGI) above $150,000 (single filers) or $300,000 (joint filers).

Definition and qualifying criteria for overtime. "Qualified overtime compensation" is defined as overtime pay required under section 7 of the Fair Labor Standards Act that is in excess of the regular rate. The deduction does not apply to any amounts already deducted as qualified tips.

Overtime must be properly reported on IRS forms such as W-2s (for employees) or 1099s (for non-employees). The deduction is only available for overtime compensation, not for regular wages or other forms of compensation.

Additional requirements. To claim the deduction, taxpayers must include a valid Social Security Number (SSN) on their return. Married individuals must file jointly to be eligible for the deduction. The omission of a required SSN is treated as a mathematical or clerical error under IRC §6213(g)(2), allowing the IRS to correct the return without a formal audit. The IRS is authorized to issue regulations to prevent abuse or misclassification of income.

Non-itemizer eligibility. The deduction is available to non-itemizers, meaning it can be claimed in addition to the standard deduction.

Reporting requirements. Employers must report the total amount of qualified overtime compensation on employees' W-2 forms. Businesses must also report this information for non-employees on applicable 1099 forms. For overtime compensation earned before January 1, 2026, reporting entities may use reasonable methods to estimate and report qualifying amounts during the transition period.

Withholding and IRS guidance. The IRS must update withholding procedures beginning in 2026 to reflect the new deduction (IRC §3402). The IRS is authorized to issue regulations or guidance to prevent abuse of the deduction.

Effective date. The new overtime deduction and related provisions apply to taxable years beginning after December 31, 2024. The deduction is temporary and will expire for taxable years beginning after December 31, 2028 (Act Section 70202, adding new IRC §226).