



ATTORNEYS AT LAW

No Tax on Overtime
What Signatory Contractors Need to Know

Brian T. Benkstein

((612)373-8508

bbenkstein@felhaber.com



OVERVIEW

The *One Big Beautiful Bill Act (OBBBA)* provides certain income tax deductions for employees for overtime payments driven by Federal Law (**Fair Labor Standards Act (FLSA)**)

Overtime payments mandated by exclusively by a collective bargaining agreement, or state law, does not qualify.

OBBBA can have a **direct impact** on employees' income tax obligations (more accurately relief).

OBBBA has an **indirect impact** on employers in the form of recordkeeping, tracking of overtime.

Contractors will need to adjust payroll systems, coordinate with unions, and communicate clearly with employees.

BBB OVERTIME MYTHS

The OBBBA enables a business to deduct overtime payments as a business expense.

The OBBBA allows a business to avoid making overtime payments to employees altogether.

The OBBBA impacts business payroll tax withholdings.

BBB REALITY

Employees may deduct the **half-time premium portion** of FLSA-defined overtime from their federal income taxes.

They **cannot deduct the full overtime wage**, only the premium (half-time) amount.

Overtime owed **solely under union agreements**, state law, or company policy that does not meet the FLSA definition does **not qualify**.

Federal payroll taxes (Social Security and Medicare) remain unaffected.

DIFFERENCE BETWEEN FLSA OVERTIME AND CONTRACTUAL OVERTIME

FLSA Overtime – the product of Federal law. It is a legal requirement.

- Employees are entitled to overtime at 1.5 times their “Regular Rate” for hours worked in excess of 40 in a work week.
- **The OBBBA focuses on the “.5” premium paid to employees.**
- Weekly tracking, not by payroll periods (if on a two-week cycle).

Contractual Overtime and Premium Payments – driven by Collective Bargaining Agreement. Examples:

- Overtime after 8 hours worked in a day
- Overtime after 32 hours in a week
- Double time on weekends or holidays

DIFFERENCE BETWEEN FLSA OVERTIME AND CONTRACTUAL OVERTIME

FLSA overtime requirements and **contractual overtime** requirements can overlap.

Example –

- FLSA requires overtime payments at 1.5X for hours worked over 40 in a work week
- Contract states same thing and/or that the Employer will follow the requirements of federal overtime law.
- The overtime premium (.5) **is subject to the deduction**

DIFFERENCE BETWEEN FLSA OVERTIME AND CONTRACTUAL OVERTIME

Example –

- Contract requires employer to pay overtime (1.5X) if an employee works more than 10 hours in a day. The hours in question do not exceed 40 in a work week.
- The overtime premium (.5) **is NOT subject to the deduction.**



EMPLOYEE OT DEDUCTION NUTS & BOLTS

Effective Date: Retroactive to **January 1, 2025** (enacted July 4, 2025).

Who Qualifies: Non-exempt employees (hourly, non-professional, or earning less than \$35,568 annually).

Deduction: Above-the-line deduction for “qualified overtime compensation” (the FLSA half-time premium).

Deduction Limits: Up to **\$12,500 per individual / \$25,000 joint filers**.

Phase-Out: Begins at modified adjusted gross income of \$150,000 (individual) or \$300,000 (joint), reducing at 10%. Once the phase-out reduction equals or exceeds the maximum deduction (\$12,500 or \$25,000), the taxpayer loses the deduction entirely.



EMPLOYEE OT DEDUCTION NUTS & BOLTS

Calculation Example – Single Filer

- Employee earns \$160,000 MAGI.
- Excess over \$150,000 = \$10,000
- 10% of \$10,000 = \$1,000
- Deduction reduced by \$1,000.
- If originally eligible for \$12,500, new deduction = \$11,500.



WHY DOES THIS MATTER?

To reiterate, deduction applies **only to overtime covered by FLSA** (“*qualified overtime compensation*”)

- Hours worked over 40 per week at 1.5X the regular rate
- Only the “.5” portion of the rate is subject to the tax deduction.

As discussed, **Union contracts may differ** in how overtime is calculated (e.g., daily overtime, different multipliers, or thresholds). Those differences will result in contractual overtime **not qualifying** for the deduction.

Employers must track and report “qualified overtime compensation” separately on employee W-2s (or equivalent) and differentiate OT driven by contract or state law, policy, etc.

- **Instructions from IRS – in process?**



WHY DOES THIS MATTER?

Legal compliance - OBBBA

- There are affirmative requirements to track and report qualified OT to employees.

Labor unrest

Disgruntled employees

Risk of IRS audit?

WHAT DO EMPLOYERS NEED TO DO?

Develop an implementation plan: HR, payroll, accounting

Update Payroll Systems: Ensure systems capture FLSA-qualified overtime separately and can differentiate and distinguish between non-qualified overtime.

Train Payroll Staff and HR: Clarify distinctions between types of overtime.

Coordinate with Union Representatives: Ensure compliance while maintaining transparency with employees. Be prepared to respond to questions and dispel “misinformation.”



WHAT DO EMPLOYERS NEED TO DO?

Provide Required Documentation: Supply employees with accurate records of qualified overtime (via W-2s, 1099s, or payroll statements).

Inform Employees: Consider using the FCA template sent on 8.7.25

Be Prepared to Answer Questions: Employees will surely have questions about what this all means. Although employers should help facilitate employees' ability to capture the OT deduction, *set expectations that the deduction is a personal income tax filing obligation, not something the company will take on for them.*

END

Questions?