

# NO TAX ON OVERTIME

## EMPLOYER COMPLIANCE GUIDE (2025-2028)



### CRITICAL COMPLIANCE OVERVIEW

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- **2025:** No penalties, no W-2 changes required — transition year
- **2026+:** Must report qualified overtime in Box 12, Code TT
- Only federal FLSA-required overtime premium qualifies (not state law or voluntary OT)
- Payroll taxes (Social Security/Medicare) still apply to all overtime
- Must process employee W-4 updates for withholding adjustments

#### GOOD NEWS FOR 2025

The IRS will NOT penalize employers for failing to separately report qualified overtime on 2025 Forms W-2, provided all other reporting requirements are met. However, you're encouraged to provide this information via Box 14 or supplemental statements to help employees.

### YEAR-BY-YEAR REQUIREMENTS

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#### 2025 (Transition)

- **No mandatory reporting changes** to Forms W-2
- **No penalties** for not tracking qualified overtime separately
- **Encouraged:** Provide qualified overtime amounts via Box 14 or supplemental statements
- **Begin preparing:** Review FLSA classifications and overtime tracking systems
- **Employees calculate their own deductions using pay stubs**

#### 2026 & Beyond (Full Compliance)

- **REQUIRED:** Report qualified overtime in Box 12, Code TT on Form W-2
- **REQUIRED:** Track and calculate FLSA overtime premiums separately
- **REQUIRED:** Process employee W-4 updates for withholding adjustments
- **Payroll systems must be updated to isolate FLSA premium portions**
- **Use Publication 15-T procedures for withholding calculations**

QUALIFIES	DOES NOT QUALIFY
FLSA-required overtime premium (hours over 40/week for non-exempt employees)	State law overtime (e.g., California daily OT), collective bargaining agreement overtime, or overtime paid voluntarily by employers
Only the premium portion (the "half" in time-and-a-half)	Not the regular hourly rate portion (the "time" in time- and- a-half)
Non-exempt employees under FLSA	Exempt employees under FLSA

## WHAT OVERTIME QUALIFIES FOR TAX EXEMPTION?

### FLSA-EXEMPT EMPLOYEES (NOT ELIGIBLE)

Salaried executives, administrative personnel, professional employees (doctors, lawyers, teachers, engineers), outside sales employees, highly compensated employees, and certain computer professionals are generally FLSA-exempt and do not receive overtime.

## CALCULATING THE QUALIFIED OVERTIME PREMIUM

### Formula for Time-and-a-Half (1.5x)

An employee earning \$20/hour regular and \$30/hour overtime has a \$10/hour premium.

Total Overtime Compensation ÷ 3 =  
Qualified Overtime Premium

**Example:** \$15,000 total overtime ÷ 3 =  
\$5,000 qualified

### Formula for Double-Time (2x)

An employee earning \$20/hour regular and \$40/hour overtime has a \$20/hour premium.

Total Overtime Compensation ÷ 4 =  
Qualified Overtime Premium

**Example:** \$20,000 total overtime ÷ 4 =  
\$5,000 qualified

### Note: Not all double-time pay qualifies for tax exemption.

For example, in CA, double-time pay is required if you work 12 or more hours in a single day. If an employee worked a total of 36 hours in a week and two of those days were 12-hour shifts, 8 hours of work would be paid at the double-time rate. However, FLSA requires a 40-hour work week for overtime, so the 8 hours of double-time pay would not qualify for tax exemption.

## EMPLOYEE W-4 WITHHOLDING ADJUSTMENTS

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Starting in 2026, employees can adjust their Form W-4 to reduce their federal income tax withholding based on expected overtime deductions.

- Employees will be directed to login to MyFrankCrum to make changes to their W-4s
- Use Publication 15-T procedures for withholding calculations
- Reduce federal income tax withholding (NOT FICA taxes)
- The 2026 Form W-4 includes an expanded deductions worksheet (Step 4b) for qualified overtime

### IMPORTANT REMINDER

**Payroll taxes still apply:** Qualified overtime remains subject to Social Security and Medicare taxes (FICA). The deduction only affects federal income tax liability when employees file their returns. Continue withholding all payroll taxes as normal.

## ACTION PLAN FOR EMPLOYERS

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### NOW (Late 2025)

- Review employee FLSA classifications
- Audit overtime tracking systems
- Consider voluntary reporting in Box 14
- Communicate with employees
- Plan payroll system upgrades

### Ongoing (2026+)

- Track qualified overtime separately each pay period
- Process employee W-4 updates promptly
- Generate accurate W-2s with Code TT
- Maintain documentation and records
- Monitor IRS guidance for updates

### Before January 2026

- Configure systems to isolate FLSA premiums
- Train payroll staff on calculations
- Prepare W-4 processing procedures
- Develop employee FAQs and resources

## FREQUENTLY ASKED QUESTIONS

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### Q: Do I need to change anything for 2025 W-2s?

No. The IRS won't penalize you for not reporting qualified overtime separately on 2025 Forms W-2. However, providing this info (via Box 14 or supplemental statements) helps your employees and builds goodwill.

### Q: What if I can't determine exact qualified overtime for 2025?

You can use reasonable approximation methods for 2025. The key is having accurate tracking systems ready for 2026.

### Q: Does state-mandated overtime qualify?

No. Only federal FLSA-required overtime qualifies. For example, California's daily overtime (over 8 hours/day) doesn't qualify — only hours over 40/week under federal law count.

### Q: What if an employee is misclassified as exempt?

Review all classifications carefully. Misclassification carries separate penalties beyond this overtime provision. Consult with legal counsel if uncertain about FLSA status.

### Q: Can I ignore employee W-4 updates?

No. You're required to process updated W-4 forms and adjust withholding according to Publication 15-T. However, this only affects income tax withholding, not FICA taxes.

### Q: What records should I maintain?

Keep detailed records of: FLSA classifications, overtime hours worked, overtime rates paid, qualified overtime calculations, and W-4 forms submitted by employees.

## KEY RESOURCES

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- **IRS.gov:** Latest guidance and updates on IRC Section 225
- **Publication 15-T:** Federal income tax withholding methods
- **Form W-2 Instructions:** Box 12 Code TT reporting requirements (2026+)
- **DOL FLSA Resources:** Employee classification guidance

## EFFECTIVE FOR TAX YEARS 2025-2028

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Monitor [IRS.gov](https://www.irs.gov) for TTOC list updates and additional guidance. Consult with payroll professionals or tax advisors for specific situations.

### TAX DISCLAIMER

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