

FLSA/OT Tax Deduction and the Big Beautiful Bill...



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What is the new Federal Overtime Tax Deduction?

- ▶ Applies nationwide under new federal tax rules
- ▶ Designed to provide tax relief to employees who work overtime
- ▶ Operates as a **tax deduction** that allows workers to **reduce taxable income**
 - ▶ A federal income **tax deduction, not a tax credit**
 - ▶ Reduces total taxable income you report to IRS on tax return, not your paycheck withholding
 - ▶ Applies only when YOU file your federal tax return
 - ▶ Available for tax years 2025 through 2028
 - ▶ Retroactive to tax year January 1, 2025

Types of Overtime and Which Ones Qualify

Fair Labor Standards Act (FLSA) Overtime

- **Qualifies for the deduction**
- Deduction applies to overtime pay earned when you work more than the FLSA hourly thresholds. (“FLSA Overtime”)

State Law Overtime

- **Does not qualify for the deduction**
- Additional overtime pay above what is required by FLSA will not qualify. (ORS 652.060)

Contractual Overtime

- **Does not qualify for the deduction**
- Overtime, double time, premium pay provided by a collective bargaining agreement will not qualify.

What is FLSA Overtime for the “Regular” Employee?

- ▶ Regular employees, 40-hour per week workers, those who do not engage in fire suppression: FLSA requires overtime pay for hours worked **over 40 per workweek** at a rate not less than one and one-half times the regular rate of pay.
 - ▶ Single Roles
 - ▶ Maybe prevention positions
 - ▶ Community care workers
 - ▶ Clerical/office positions that work 40-hours per week
- ▶ Exemptions: NOT everyone gets FLSA overtime pay!
 - ▶ Executive, Administrative, Professional, Outside Sales, Computer are exempt from FLSA overtime pay. (Battalion Chiefs).
 - ▶ **IF YOU DO NOT GET FLSA OT, YOU DO NOT QUALIFY FOR DEDUCTION.**

What is FLSA Overtime for Fire Fighters?

- ▶ Fire protection and law enforcement employees are **special**. Section 7(k) exemption permits longer work periods before overtime pay is required.
- ▶ Employer can select a “work period” provided by the law and FF receives overtime for hours worked in excess of the maximum hours permitted in that work period.



Maximum Hours Worked (Rounded) Before Overtime

CONSECUTIVE DAYS WORK PERIOD	HOURS OF FIRE PROTECTION	HOURS OF LAW ENFORCEMENT
28	212	171
27	204	165
26	197	159
25	189	153
24	182	147
23	174	141
22	167	134
21	159	128
20	151	122
19	144	116
18	136	110
17	129	104
16	121	98
15	114	92
14	106	86
13	98	79
12	91	73
11	83	67
10	76	61
9	68	55
8	61	49
7	53	43

What is FLSA Overtime for Fire Fighters?

- ▶ FLSA Overtime for Fire Fighters is paid at 1.5 x regular rate of pay for all hours worked in excess of the hourly threshold in the employer's designated work period. (Example: 182 hours in 24-day period).
- ▶ FLSA overtime is based **ONLY on actual hours “worked”**. Paid leave (vacation/sick leave) do NOT count toward the FLSA overtime threshold. ****Oregon law requires this, but not FLSA****
- ▶ Example: FF works for employer with FLSA work period of 24 days/182 hours. FF works 192 hours in the 24-day period. FF is entitled to 10 hours of FLSA overtime pay.

What About Contractual Overtime?

- ▶ Union contracts provide overtime pay that is ***different*** from FLSA overtime pay. Contractual overtime, by itself, is NOT included in the new federal tax deduction.*
- ▶ Examples of Contractual Overtime Pay:
 - ▶ OT pay for working on a holiday
 - ▶ OT pay for hold over at the end of the shift
 - ▶ OT pay for call back
 - ▶ Double time pay

**Unless these work hours put you over the FLSA threshold!*

Back to the Big, Beautiful ...

When filing your tax return for tax year 2025, **you can ONLY deduct the “premium” portion of your FLSA overtime pay from your taxable income:**

- ▶ Premium portion = the “half” pay **above** your normal hourly rate
- ▶ Often referred to as the “extra half” in the “time-and-a-half” pay.
- ▶ Example:
 - ▶ Regular hourly rate: \$20/hour
 - ▶ FLSA Overtime rate @ time and a half: \$30/hour
 - ▶ \$20 = regular pay (NOT tax deductible)
 - ▶ \$10 = premium portion (**YES** tax deductible)
 - ▶ Only the \$10/hour counts toward the deduction

Back to the Big, Beautiful ...

EXAMPLE:

- ▶ FLSA work period is 24-day cycle (182 hours)
- ▶ FF works 192 hours in the 24-day cycle @ OT rate* of \$30/hr
- ▶ **Tax Deduction:**
 - ▶ FLSA “premium” is \$10/hr
 - ▶ FF worked 10 hours of OT
 - ▶ $\$10/\text{hr} \times 10 \text{ hours} = \100 deducted

*OT rate is 1.5 x regular rate, which includes any differentials

You won't like this part...

EXAMPLE:

- ▶ FLSA work period is 24-day cycle (182 hours)
- ▶ FF is scheduled to work 192 hours in the 24-day work period @ OT rate of \$30/hr
- ▶ **FF takes 48 hours of paid vacation leave**
 - ▶ Paid leave does NOT count as “hours worked” under FLSA.
 - ▶ FF has only “worked” 144 hours in the 24-day period.
 - ▶ FF is not entitled to any OT pay under FLSA.
 - ▶ No deduction is permitted.

How Much FLSA Overtime “Premium” Can You Deduct?

- ▶ Maximum deduction amounts:
 - ▶ \$12,500 for single filers
 - ▶ \$25,000 for married filing jointly
- ▶ These are **annual** limits
- ▶ You can deduct less if you earned less qualifying overtime
 - ▶ Ex. A single filer who earns \$8,000 in qualifying overtime premium pay can deduct the full \$8,000 since it's under the \$12,500 cap.

How Much FLSA Overtime “Premium” Can You Deduct?

- ▶ Deduction Phases Out with Higher Income Earners:
 - ▶ Deduction phases out for those with a modified adjusted gross income (MAGI) **above \$150,000 for single filers** and **\$300,000 for joint filers**.
 - ▶ For every \$1,000 over the MAGI limit, the OT tax deduction is reduced by \$100.
 - ▶ Examples:
 - ▶ A couple with MAGI of \$200,000 will be able to claim the full deduction because they are under the joint limit.
 - ▶ A single filer with a MAGI of \$155,000 can claim a max deduction of \$12,000 since they are \$5,000 over the limit.

Who Is Not Eligible for the Deduction?

- ▶ Exempt employees (they don't qualify for FLSA OT. **Battalion Chiefs**)
- ▶ Married filing separately taxpayers
- ▶ Workers without an SSN
- ▶ Most independent contractors (currently excluded)

NOTE: This law is not changing who qualifies/does not qualify for FLSA Overtime or how overtime pay is calculated.



What is an above-the-line deduction?

- ▶ The overtime deduction is an **above-the-line** deduction
- ▶ That means:
 - ▶ You do **not** need to itemize deductions
 - ▶ It directly reduces **Adjusted Gross Income (AGI)**
 - ▶ Ex. If your AGI is \$60,000, and you deduct \$5,000 of qualifying overtime, your AGI becomes \$55,000.
- ▶ Lower AGI can:
 - ▶ Reduce taxes owed
 - ▶ Increase eligibility for other tax benefits

What Does NOT Qualify?

- ▶ Regular wages (even if worked long hours)
- ▶ Bonuses or incentive pay
- ▶ Hazard pay or shift differentials
- ▶ Overtime required only by contract or state law
- ▶ Premium pays
- ▶ Double time (but a portion *could* count if it the double time is treated as OT pay for FLSA qualifying hours).

KEY: Only FLSA overtime hours count and only the extra “half” pay in the time-and-a-half can be deducted.

Is Overtime Pay Still Taxed Normally?

- ▶ YES!
- ▶ Overtime pay is still subject to:
 - ▶ Federal income tax withholding
 - ▶ State and local taxes
 - ▶ Social Security and Medicare (FICA)
- ▶ The tax benefit happens **later**, when filing your tax return

How Qualifying OT pay Is Reported in 2025

- ▶ An employer's payroll system must be updated to segregate and track the specific premium amount of FLSA-required overtime **for 2026**.
- ▶ The law is retroactive to January 1, 2025, but IRS acknowledges system updates take time.
- ▶ IRS has issued guidance providing penalty relief for the 2025 tax year for employers who are unable to file returns showing the new separate accounting.

How Qualifying OT pay Is Reported in 2025

- ▶ For tax year 2025 only, employers must provide employees with information that allows them to report qualified overtime compensation calculated by a “reasonable method.” Can be provided in any of the following ways:
 - ▶ Report the amount in Box 14 on Form W-2;
 - ▶ Providing a separate year-end statement; **or**
 - ▶ Making the information available to employee.

How Qualifying OT pay Is Reported in 2025

- ▶ Employees may need to use pay stubs to calculate their qualifying FLSA premium pay.
- ▶ ***Technically***, employees should calculate all hours “actually worked” over the FLSA threshold in the work period, backing out any paid vacation/sick leave. ***However***, see “Reasonable Method” guidance from IRS on next slide.
- ▶ If employer incorrectly reports amount on W-2, employees should ask for W-2 to be amended to match what they report on tax return.

IRS “Reasonable Method” Guidance for 2025

- ▶ On December 8, 2025, the IRS issued a Bulletin that provides guidance on the “Reasonable Method” an individual may use to calculate their FLSA OT premium portion.
- ▶ <https://www.irs.gov/pub/irs-irbs/irb25-50.pdf>
- ▶ **Example 5.** Individual C works in law enforcement and is paid \$15,000 of total annual overtime pay on a “work period” basis of 14 days that complies with section 207(k) of the FLSA.²² For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual C may include \$5,000 (\$15,000 divided by 3).

IRS “Reasonable Method” Guidance for 2025

- ▶ <https://www.irs.gov/pub/irs-irbs/irb25-50.pdf>
- ▶ **Example 6.** Individual D works for a State or local government agency that gives compensatory time at a rate of one and one-half hours for each overtime hour worked. In 2025, Individual D was paid wages of \$4,500 for compensatory time off. For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual D may include \$1,500, one-third of these wages for purposes of determining qualified overtime compensation.

Reporting Changes Starting in 2026

- ▶ New W-2 reporting rules begin
- ▶ Box 12 will include:
 - ▶ Code TT for qualified overtime
- ▶ Makes the deduction easier to identify and claim
- ▶ New W-4 allows estimated deductions through payroll
- ▶ Prepare for further guidance after 2025

How to Calculate the Deduction for 2025

- ▶ Use your payroll records to identify FLSA overtime pay
- ▶ If FLSA overtime premium pay is not listed:
 - ▶ IRS allows “reasonable methods” for determining.
 - ▶ Ex. Relying on pay stubs and employer documents to determine the overtime premium portion.
- ▶ For time-and-a-half pay for hours over FLSA threshold:
 - ▶ One-third of total overtime pay is usually deductible.
 - ▶ “Reasonable Method” guidance from IRS doesn’t require more.



Scenario

- ▶ I am single and made \$37,500 in overtime last year. I don't receive any overtime pay over 1.5 times my hourly wage. Can I assume I can write off the full \$12,500?
 - ▶ IRS “Reasonable Method” guidance for 2025 only would appear to allow this.
 - ▶ ***But for correct amount***, the overtime pay for each work period must be analyzed to determine FLSA OT pay, then back out paid leave hours.

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How to Claim the Deduction

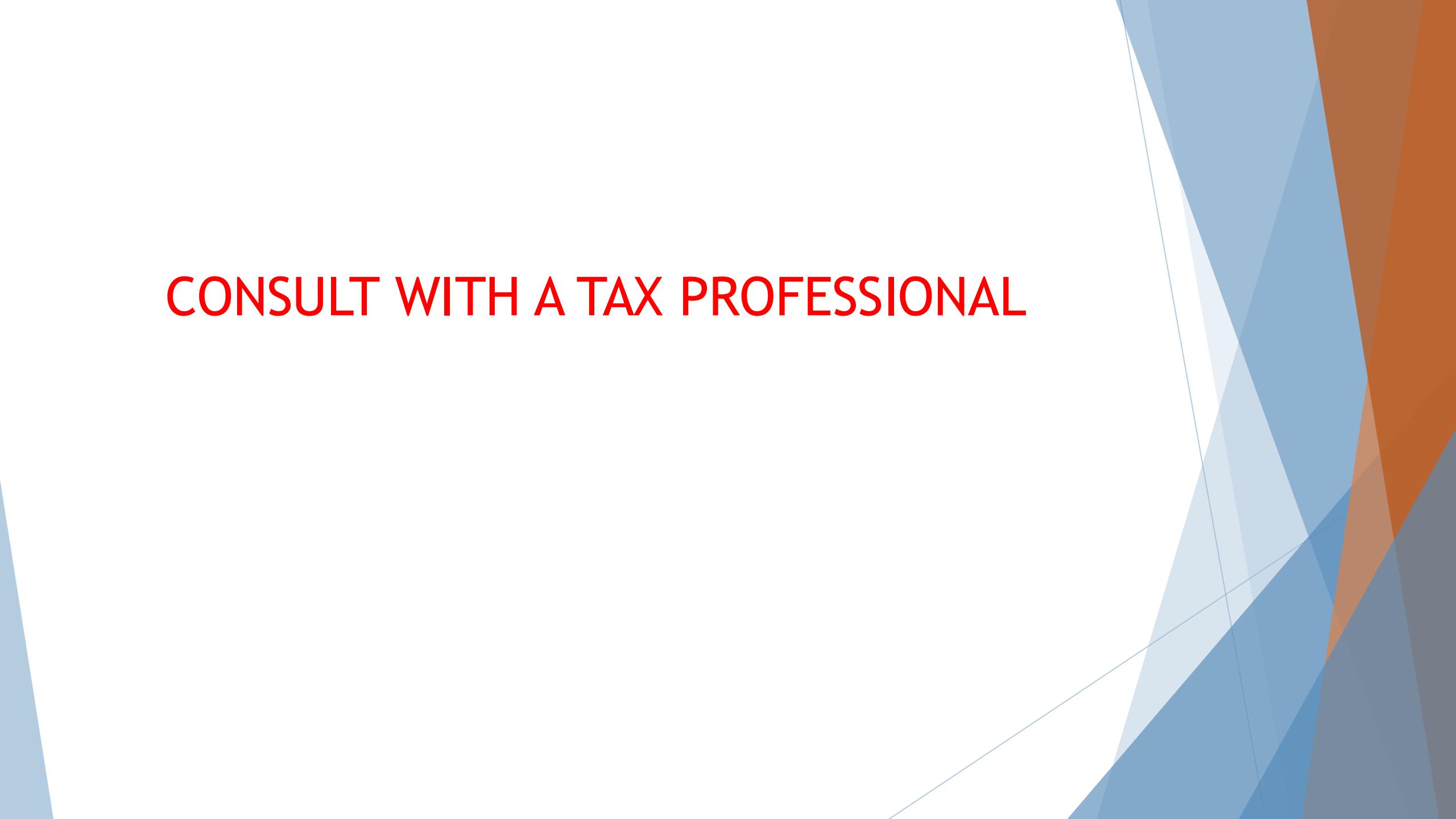
- ▶ When filing your tax return, report your qualifying overtime pay. Deduction is claimed on Form 1040.
- ▶ Keep payroll records for proof!
- ▶ YOU are responsible for claiming deduction on tax return. Get the information you need from the employer.
- ▶ If employer incorrectly reports amount on W-2, seek amendment of W-2.

How Do We Get Employers to Accurately Calculate and Report?

- ▶ Communicate with employers NOW about how they will calculate.
- ▶ Option to demand bargain Per ORS 243.698*
- ▶ Employer calculation, documentation and reporting impacts a “direct or indirect monetary benefit” since amount of FLSA OT calculated and reported impacts your tax liability.
- ▶ In bargaining, discuss employer’s plan for calculating qualifying FLSA OT premium pay and determine how information will be provided to employees, consider process for disputing employer calculation.
- ▶ For 2025 only, consider having employer only provide information to employee, but NOT report on W-2. Avoids disputes, need for amending W-2.

Key Takeaways

- ▶ New overtime tax deduction begins in 2025
- ▶ Only the **premium portion** of overtime qualifies
- ▶ Deduction lowers taxable income, not withholding
- ▶ Only available for tax years 2025-2028
- ▶ Employee is responsible for claiming amount of deduction on tax return
- ▶ Employers not required to report accurately for 2025
- ▶ Better reporting starts in 2026
- ▶ Overtime work still pays the same
- ▶ Taxes are still withheld as usual



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Additional Resources

- ▶ IAFF FLSA Manual:
 - ▶ https://www.iaff.org/wp-content/uploads/FLSA-Manual-2022-Edition_FINAL.22Aug01.pdf
- ▶ No Tax On Overtime Explained | TaxAct:
 - ▶ <https://blog.taxact.com/no-tax-on-overtime-explained/>
- ▶ Changes to Taxes on Tips & Overtime: Your 101 Guide | Intuit TurboTax Blog
 - ▶ <https://blog.turbotax.intuit.com/tax-deductions-and-credits-2/the-tldr-on-tips-and-overtime-for-2025-tax-year-132842/>
- ▶ New Overtime Tax Deduction What Employers Need to Know: CLA
 - ▶ <https://www.claconnect.com/en/resources/articles/25/overtime-tax-deduction>
- ▶ Treasury, IRS provide guidance for individuals who received tips or overtime during tax year 2025 | Internal Revenue Service
 - ▶ <https://www.irs.gov/newsroom/treasury-irs-provide-guidance-for-individuals-who-received-tips-or-overtime-during-tax-year-2025>