MEMORANDUM

To: Employers

Subject: OBBBA Overtime Reporting – Comprehensive Employer Guidance

Date: November 17, 2025

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1. Overview

The One Big Beautiful Bill Act (OBBBA), effective for tax years 2025 through 2028, introduces a new federal income tax deduction for "qualified overtime compensation." The overtime is still subject to Social Security, Medicare, and Federal Withholding Tax. The deduction is taken on the employee's Form 1040 and not on the payroll reporting forms. This memo summarizes what employers need to know about OBBBA overtime reporting, including definitions, compliance obligations, and the connection to Section 7 of the Fair Labor Standards Act (FLSA).

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2. Definition and Scope

- **Qualified Overtime Compensation:**

Under OBBBA, "qualified overtime compensation" is defined as the premium portion of overtime pay required by Section 7 of the FLSA—generally, the extra 50% paid for hours worked over 40 in a workweek. Only this premium portion is eligible for the deduction, not the entire overtime amount or other pay differentials such as double time. For example, if an employee earns $20/hour and works 10 overtime hours at $30/hour, only the $10/hour premium ($100 total) qualifies for the deduction, not the full $30/hour overtime rate. If they were paid double time and works 10 hours overtime hours at $40/hour, only the $10/hour premium ($100 total) qualifies for the deduction. The employer must distinguish between time and a half or double time for reporting in their system.

- **Deduction Limits:**

The deduction is capped at $12,500 per year for individuals and $25,000 for joint filers, with phaseouts beginning at $150,000 modified adjusted gross income ($300,000 for joint filers).

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3. Section 7 of the FLSA

- **Statutory Requirement:**

Section 7 of the FLSA (29 U.S.C. § 207) requires that non-exempt employees receive overtime pay at a rate not less than one and one-half times their regular rate for all hours

worked over 40 in a workweek. The OBBBA deduction applies only to the "premium" portion (the extra half-time pay above the regular rate) required by Section 7.

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4. Employer Reporting and Compliance Obligations

- **Reporting Requirements:**

Employers must report the total amount of qualified overtime compensation paid to each employee annually. This information must be provided on the employee's Form W-2, starting with the 2026 tax year. The IRS has released draft versions of the 2026 Form W-2, which include a new Box 12 code "TT" for total qualified overtime compensation.

- **2025 Transition Year:**

For tax year 2025, Forms W-2 and 941 remain unchanged, and there are no new reporting boxes or codes for overtime. Employers should continue to use current forms and procedures but are advised to track qualified overtime compensation in anticipation of the 2026 reporting requirements. The IRS will not issue further guidance on how to report qualified overtime for 2025 as it is an informational reporting. The employees will need their overtime amount in 2025 in order to qualify for the deduction on their Form 1040. See additional guidance on this under Addendum: 2025 Informational Reporting to Assist Employees below.

- **Recordkeeping:**

Employers should maintain detailed records of overtime payments, distinguishing between regular and premium (overtime) pay, to support accurate reporting and compliance.

- **Employer Responsibility:**

Employers are not responsible for determining employee eligibility for the deduction or for applying the deduction; their obligation is to accurately report the total qualified overtime paid.

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5. Recent Updates and Transition Relief

Addendum: 2025 Informational Reporting to Assist Employees

For tax year 2025, the IRS has confirmed that there will be no changes to Forms W-2, 1099, or 941 to accommodate the new OBBBA deduction for qualified overtime compensation. However, employers are still required to provide employees with the information necessary to claim the deduction on their individual tax returns. The following guidance applies:

- **Separate Informational Reporting:**

Employers must separately report the total amount of qualified overtime compensation for each employee for 2025. This is necessary because the 2025 W-2 will not have new boxes or codes for these amounts.

- **Reasonable Methods Permitted:**

Employers may use any reasonable method to approximate and report the qualified overtime amounts for 2025. Examples of reasonable methods include using payroll records, timekeeping systems, or other contemporaneous records that reflect overtime. Employers should document the methodology used and retain supporting records in case of IRS inquiry.

- **How to Provide the Information:**

Employers should provide this information to employees via a supplemental year-end statement or other written communication, separate from the W-2. The statement should clearly indicate the total qualified overtime compensation for the year. A common method that is being used for 2025 is informational reporting in box 14 with the code "QUALOT." This is how some software companies are handling the reporting.

- **Employee Communication:**

Employers should inform employees that this supplemental information is necessary for them to claim the new OBBBA deduction on their 2025 tax returns, and that the deduction is not automatically applied through payroll withholding.

- **Recordkeeping:**

Employers should retain documentation of the amounts reported and the methods used, in anticipation of possible IRS review or employee inquiries.

- **Monitor for Further Guidance:**

Employers should continue to monitor IRS guidance for any further clarifications or templates for 2025 reporting, and prepare for the transition to updated W-2 reporting in 2026.

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6. Additional Compliance Considerations

- **Employee Communication:**

Employers should inform employees that, although the deduction is available, overtime pay remains subject to FICA taxes and regular withholding until the deduction is claimed on the individual's tax return.

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7. Action Steps for Employers

1. **Begin tracking qualified overtime compensation now, distinguishing between regular and premium pay.**
2. **Maintain robust records to support accurate reporting.**
3. **Monitor IRS guidance for 2025 transition reporting.**
4. **Prepare payroll systems for new W-2 codes and reporting requirements effective for 2026.**
5. **Communicate with employees about the reporting and deduction process.**

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8. Key Citations

- OBBBA, P.L. 119-21
- Section 7 of the FLSA (29 U.S.C. § 207)
- IRS Draft 2026 Form W-2 Guidance
- IRS Transition Relief and Employer Guidance

Summary:

Employers must prepare for OBBBA overtime reporting by tracking and separately reporting the FLSA overtime premium, as defined by Section 7 of the FLSA, on employee wage statements. For 2025, employers must provide employees with a supplemental statement showing the total qualified overtime compensation using any reasonable method, as the W-2 will not yet reflect these amounts. This will enable employees to claim the OBBBA deduction on their 2025 tax returns. Employers should document their approach and retain supporting records. For 2026 and beyond, use the new W-2 codes and structures. Maintain robust records and communicate with employees about the continued taxation of overtime for FICA and withholding purposes until the deduction is claimed on the individual return.

If you need further details or have specific questions about implementation, please refer to the cited sources or contact your tax advisor.