



Taxation of Tips and Overtime Under OBBBA

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Tips and Overtime

- Two of the most discussed topics coming out of the One Big Beautiful Bill Act (OBBBA) are the deduction for tips (§ 224) and the deduction for overtime (§ 225)
- Tax practitioners need to understand these complex provisions because they are effective for 2025
- IRS Notice 2025-69 provides guidance to individual taxpayers who are eligible for the federal income tax deductions for qualified tips or qualified overtime compensation for tax year 2025
- There will be no changes to the 2025 Form W-2, Form 1099-NEC, Form 1099-MISC, or Form 1099-K to account for the new reporting requirements in the OBBBA

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IRS Notice 2025 Provides Penalty Relief

- Forms W-2, 1099-NEC, 1099-MIS, and 1099-K will be updated for tax year 2026 to provide separate reporting of the employee's qualified tips and qualified overtime compensation
- On November 5, 2025, the IRS published Notice 2025-62 to provide penalty relief from the new information reporting requirements for cash tips and qualified overtime compensation under the OBBBA to employers and other payors for not filing correct information returns and not providing correct payee statements to employees and other payees
- Notice 2025-62 provides relief from the penalty under Section 6721 for failure to file correct information returns and the penalty under Section 6722 for failure to furnish correct payee statements
- Notice 2025-62 provides relief only for taxable year 2025



Notice 2025-69

- Notice 2025-69 provides guidance for individual taxpayers on how to determine the amount of the qualified tips or qualified overtime compensation for tax year 2025
- Notice 2025-69 provides transition relief for taxpayers regarding the requirement that qualified tips must not be received in the course of a trade or business that is a specified service trade or business (SSTB)
- For 2025, the SSTB status of a business is not relevant — only the IRS's list of customarily tipped occupation status is relevant — see:
<https://www.federalregister.gov/documents/2025/09/22/2025-18278/occupations-that-customarily-and-regularly-received-tips-definition-of-qualified-tips>
- The SSTB guidance remains applicable until the year after the year the IRS releases final regulations on point



Background to Section 224 and Section 225

- OBBBA added Section 224 to the IRC to provide an income tax deduction for qualified tips that are received during the taxable year by individuals in an occupation that customarily and regularly received tips on or before December 31, 2024
- OBBBA added Section 225 to the IRC to provide an income tax deduction for “qualified overtime compensation,” defined as overtime compensation paid to an individual required under Section 7 of the FLSA that is in excess of the regular rate at which the individual is employed



Deduction for Tips

- Section 224(a) provides a deduction in an amount equal to the qualified tips received by an individual in a taxable year that are included on statements furnished to the individual pursuant to Section 6041(d)(3), Section 6041A(e)(3), Section 6050W(f)(2), or Section 6051(a)(18), or that are reported by the taxpayer on Form 4137 (or successor)
- Section 224(b)(1) limits the amount of the deduction to an amount not to exceed \$25,000 in a taxable year
- Section 224(b)(2) further limits the amount based on a taxpayer’s modified adjusted gross income (MAGI), which is a taxpayer’s AGI for the tax year increased by any amount excluded from gross income under Section 911, Section 931, or Section 933
- The deduction phases out for taxpayers with MAGI over \$150,000 (\$300,000 for joint filers)



Qualified Tips for the Self-employed

- Section 224(c) provides that, in the case of qualified tips received by an individual during any taxable year in the course of a trade or business (other than the trade or business of performing services as an employee) of such individual, such qualified tips are taken into account under Section 224(a) only to the extent that the gross income for the taxpayer from such trade or business for such taxable year (including such qualified tips) exceeds the sum of the deductions allocable to the trade or business in which such qualified tips are received by the individual for such taxable year



Qualified Tips

- Section 224(d)(1) defines “qualified tips” as cash tips received by an individual in an occupation that customarily and regularly received tips on or before December 31, 2024, as provided by the Secretary
- Section 224(d)(2) requires that qualified tips not include any amount received by an individual unless the amount:
 - Is paid voluntarily without any consequence in the event of nonpayment;
 - Is not the subject of negotiation, and is determined by the payor;
 - Is not received in the course of a trade or business that is a specified service trade or business; and
 - Satisfies such other requirements as may be established by the Secretary in regulations or other guidance



Qualified Tips

- The term “cash tips” includes tips received from customers that are paid in cash or charged and, in the case of an employee, tips received under any tip-sharing arrangement
- Section 224(e) provides that no deduction is allowed unless the taxpayer includes on the tax return for the taxable year such individual’s Social Security number
- If the taxpayer is a married individual, Section 224 applies only if the taxpayer and the taxpayer’s spouse file a joint return for the taxable year
- That is, the deduction is not available for a taxpayer who is married and files separately



Occupations That Customarily and Regularly Received Tips on or Before December 31, 2024,

- On September 19, 2025, a notice of proposed rulemaking (NPRM) (REG-110032-25) was published in the Federal Register (90 FR 45340) that includes a proposed list of occupations that customarily and regularly received tips on or before December 31, 2024, and a proposed definition of qualified tips for purposes of the income tax deduction for qualified tips
- Taxpayers may rely on the proposed regulations, including the proposed list of eligible occupations, for taxable years beginning after December 31, 2024, and on or before the date the regulations are published as final regulations in the Federal Register, provided that taxpayers follow the proposed regulations in their entirety and in a consistent manner



Information Reporting Requirements of the IRC for Employers and Other Payors Making Payments of Cash Tips

- A payor must include on the information return filed with the IRS a separate accounting of any such amounts reasonably designated as cash tips and the occupation described in Section 224(d)(1) of the person receiving such tips;
- In the case of compensation to non-employees, a payor is required to include on the written statement furnished to the payee the portion of payments reasonably designated as cash tips and the occupation described in Section 224(d)(1) of the person receiving such tips;
- Require a payor to include on the information return filed with the IRS a separate accounting of any such amounts reasonably designated as cash tips and the occupation described in Section 224(d)(1) of the person receiving such tips;
- Provide that, in the case of Section 6041A(a), a payor is required to include on the written statement furnished to the payee the portion of payments reasonably designated as cash tips and the occupation described in Section 224(d)(1) of the person receiving such tips;



Information Reporting Requirements of the IRC for Employers and Other Payors Making Payments of Cash Tips (Continued)

- Provide that, in the case of a third-party settlement organization (TPSO), the TPSO must include on the information return filed with the IRS the portion of reportable payment transactions that have been reasonably designated by payors as cash tips and the occupation described in Section 224(d)(1) of the person receiving such tips;
- Require a TPSO to include on the written statement furnished to the payee a separate accounting of any such amounts that have been reasonably designated by payors as cash tips and the occupation described in Section 224(d)(1) of the person receiving such tips; and
- Provide that an employer must include on the written statement furnished to the employee the total amount of cash tips reported by the employee under Section 6053(a) and the occupation described in Section 224(d)(1) of such person



Transition Rule for Persons Required To File Returns or Furnish Statements for Cash Tips Required To Be Reported for Periods Before January 1, 2026

- Those persons may approximate a separate accounting of amounts designated as cash tips by any reasonable method specified by the Secretary
- Every employee who, in the course of the employee's employment by an employer, receives in any calendar month tips that are wages for income tax withholding purposes to report all those tips in one or more written statements furnished to the employer on or before the tenth day of the following month
- The employee is to furnish the statements in the form and manner prescribed by the IRS



New § 224

- Section 224(b)(1) limits the tip deduction to an amount not to exceed \$25,000 in a taxable year
- Section 224(b)(2) further limits the amount of the deduction based on a taxpayer's MAGI, which is a taxpayer's AGI for the taxable year increased by any amount excluded from gross income under § 911, § 931 or § 933
- The \$25,000 tip deduction begins to phase-out for taxpayers with a MAGI over \$150,000 for single taxpayers or \$300,000 for married filing jointly
- For each \$1,000 above the threshold, the deduction is reduced by \$100
- The tips remain subject to payroll taxes and withholding taxes



Qualified Tips

- Cash tips received by an individual in an occupation that customarily and regularly received tips on or before December 31, 2024, as provided by the Secretary
- Qualified tips do not include any amount received by an individual unless the amount:
 - Is paid voluntarily without any consequence in the event of nonpayment, is not the subject of negotiation, and is determined by the payor;
 - Is not received in the course of a trade or business that is a SSTB; and
 - Satisfies such other requirements as may be established by the IRS in regulations or other guidance



Cash Tips

- Cash tips are tips received from customers or, in the case of an employee, through a mandatory or voluntary tip-sharing arrangement, such as a tip pool, that are paid in a cash medium of exchange, including by cash, check, credit card, debit card, gift card, tangible or intangible tokens that are readily exchangeable for a fixed amount in cash (such as casino chips), and any other form of electronic settlement or mobile payment application that is denominated in cash



Qualified Tips

- Cash tips do not include items paid in any medium other than cash or charge, such as event tickets, meals, services, or other assets that are not exchangeable for a fixed amount in cash (such as most digital assets)
- Tips are amounts paid by customers for services that are in excess of the amount agreed to, required, charged, or otherwise reasonably expected to have to be paid for the services in an arm's length transaction



Tip Payments Must Be Voluntary

- In Revenue Ruling 2012-18, the IRS applied similar factors in distinguishing tips from non-tip wages, specifically service charges, for FICA and income tax withholding purposes
- Revenue Ruling 2012-18 provided that the absence of any of the following factors creates a doubt as to whether a payment is a tip and indicates that the payment may be a service charge:
 - (1) The payment must be made free from compulsion,
 - (2) The customer must have the unrestricted right to determine the amount,
 - (3) The payment should not be the subject of negotiation or dictated by employer policy, and
 - (4) Generally, the customer has the right to determine who receives the payment



Example From Revenue Ruling 2012-18

- In Revenue Ruling 2012-18, the IRS concluded that an 18% charge automatically added to a bill for a large party was a service charge and not a tip because it was dictated by the employer and was not paid free from compulsion
- Consistent with both existing IRS guidance on tips and evolving practices concerning service charges, the proposed regulations under § 224 clarify that service charges, automatic gratuities, and other mandatory amounts automatically added to a customer's bill by the vendor or establishment, are not qualified tips unless the customer is expressly provided an option to disregard or modify it without consequence



Other Tip Deduction Requirements

- Qualified tips do not include amounts received by an individual unless such other requirements as may be established by the IRS in regulations or other guidance are satisfied
- Amounts received for services the performance of which is a felony or misdemeanor under applicable law are not qualified tips
- Amounts received for prostitution services and pornographic activity are not qualified tips
- To prevent reclassification of income as qualified tips, and to prevent abuse of the deduction, the proposed regulations would also provide that a payment is not a qualified tip if the tip recipient has an ownership interest in or is employed by the payor of the tip



Example – Qualified Tips

- Employee C works as a bartender but does not have the license or certification that is required based on the applicable laws
- These laws specify that serving alcohol without a license is a misdemeanor
- Employee C receives \$10,000 in tips during the year while serving alcohol at a bar
- “Bartender” is on the list of occupations that receive tips, but serving alcohol as a bartender without the proper license violates the applicable law
- Because the proposed regulations clarify that the definition of “qualified tips” excludes tips received while performing services that violate the applicable law, Employee C is aware that the \$10,000 in tips received while serving alcohol without a license are not qualified tips, and so Employee C does not claim the deduction for these tips



Social Security Numbers and Married Individuals

- The taxpayer must include on the tax return for the taxable year the SSN of the individual who has received the tips
- A taxpayer who is married must file a joint return with the taxpayer's spouse to claim the tip deduction
- Married taxpayers are only required to include the SSN of the taxpayer who has received the qualified tips to claim the deduction
- An SSN is required of both taxpayers only when both have qualified tips for which they are claiming a deduction
- The total amount of qualified tips that can be deducted on a return per calendar year is \$25,000 regardless of filing status
- After applying the \$25,000 limitation, the amount is subject to the phase-out based on the taxpayers' MAGI



Example – Hairstylist and Makeup Artist

- Employee A is a hairstylist and Employee B is a makeup artist, both are working at Beauty Salon 1
- Employee A and Employee B each receives \$10,000 in tips from customers at Beauty Salon 1
- The House Budget Committee report on the OBBBA, H. Rept. 119-106, at 1502 (2025) included hairstylists but not makeup artists in its examples of occupations that traditionally and customarily received tips on or before December 31, 2024
- Thus, prior to reading the guidance in the proposed regulations, Employee B might have been unsure whether her occupation as a makeup artist makes her eligible to claim the deduction for her qualified tips
- By enumerating this list, Employee A and Employee B have clarity that they are both eligible to use the \$10,000 in tips that they receive while working at Beauty Salon 1 for purposes of the tip deduction (assuming that all other requirements to claim the deduction are satisfied)



Example 1 – Calculating Tip Deduction

- Employee A satisfies all the requirements under § 224 and Employee A's filing status for 2025 is single
- A received \$26,000 in qualified tips in 2025
- Since this is greater than the \$25,000 limitation, the \$26,000 qualified tip amount is first reduced from \$26,000 to \$25,000
- A's MAGI for 2025 is \$200,000
- The qualified tip amount is further reduced (but not below zero) by \$100 for each \$1,000 by which A's MAGI exceeds \$150,000 (the threshold for a single filer)
- A's MAGI exceeds \$150,000 by \$50,000
- To calculate the deduction, A first divides \$50,000 by \$1,000 to get 50
- Thus, A's deduction is further reduced by \$5,000 ($\$100 \times 50$), from \$25,000 to \$20,000



Example 2 – Calculating Tip Deduction

- Employee K satisfies all the requirements under § 224 and Employee K's filing status for 2025 is single
- K received \$10,000 in qualified tips in 2025
- Since this amount is less than \$25,000, the limitation does not apply
- K's MAGI for 2025 is \$180,000
- K's deduction is reduced (but not below zero) by \$100 for each \$1,000 by which K's MAGI exceeds \$150,000 (the threshold for a single filer)
- K's MAGI exceeds \$150,000 by \$30,000
- To calculate the deduction, K first divides \$30,000 by \$1,000 to get 30
- Thus, K's deduction is reduced by \$3,000 ($\$100 \times 30$), from \$10,000 to \$7,000

No Tax on Overtime Under
Section 225



No Tax on Overtime

- Effective for 2025 through 2028, individuals who receive qualified overtime compensation may deduct the pay that exceeds their regular rate of pay — such as the “half” portion of “time-and-a-half” compensation — that is required by the Fair Labor Standards Act (FLSA) and that is reported on a Form W-2, Form 1099, or other specified statement furnished to the individual
- The provision is currently scheduled to expire after 2028
- The maximum annual deduction is \$12,500 (\$25,000 for joint filers)
- The overtime deduction also only applies to federal income taxes — federal payroll taxes are not affected
- OBBBA requires married couples to file jointly in order to qualify for the deduction
- The overtime deduction phases out at MAGI over \$150,000 for singles and at \$300,000 for joint filers



Example

- If a taxpayer earns \$20/hour regular pay:
 - Regular overtime rate: \$30/hour (1.5x)
 - Premium portion: \$10/hour (0.5x)
 - Only the \$10/hour premium is deductible



Single Filer

- Full deduction: MAGI up to \$150,000
- Phase-out: \$150,001 – \$275,000
- No deduction: MAGI above \$275,000
- The OT phase-out reduces the amount eligible for tax-free treatment by \$100 for every \$1000 of MAGI that exceeds the threshold



Joint Filer

- Full deduction: MAGI up to \$300,000
- Phase-out: \$300,001 – \$550,000
- No deduction: MAGI above \$550,000
- The OT phase-out reduces the amount eligible for tax-free treatment by \$100 for every \$1000 of MAGI that exceeds the threshold



No Tax on Overtime Under Section 225

- The overtime deduction applies to non-exempt workers under the Fair Labor Standards Act (FLSA)
- This covers those who work on non-professional jobs or are paid a salary but make less than \$35,568 a year, an amount last updated in 2019 and not adjusted for inflation



Taxpayer Eligibility for the Overtime Deduction

- The overtime deduction is available for both itemizing and non-itemizing taxpayers
- It is unclear if the overtime deduction is available to self-employed individuals — we are awaiting IRS guidance on this issue
- Coverage extends to FLSA-covered workers — independent contractors are not in that group
- It is expected that the IRS and the Treasury will eventually release guidance clarifying which types of workers, including nonemployee payees, are eligible to receive qualified overtime pay and, thus, claim the related deduction
- Taxpayers must:
 - Include their Social Security Number on the return and
 - File jointly, if married, to claim the deduction



Fair Labor Standards Act and the Minimum Wage

- The FLSA establishes minimum wage, overtime pay, recordkeeping, and youth employment standards affecting employees in the private sector and in federal, state, and local governments
- Covered nonexempt workers are entitled to a minimum wage of not less than \$7.25 per hour effective July 24, 2009
- Overtime pay at a rate not less than one and one-half times the regular rate of pay is required after 40 hours of work in a workweek



FLSA Overtime

- Covered nonexempt FLSA employees must receive overtime pay for hours worked over 40 per workweek (any fixed and regularly recurring period of 168 hours – seven consecutive 24-hour periods) at a rate not less than one and one-half times the regular rate of pay
- There is no limit on the number of hours employees 16 years or older may work in any workweek
- The FLSA does not require overtime pay for work on weekends, holidays, or regular days of rest, unless overtime is worked on such days
- Hours worked ordinarily include all the time during which an employee is required to be on the employer's premises, on duty, or at a prescribed workplace



Classes of Individual Exempt From Both the Minimum Wage and Overtime Pay Requirements Under the FLSA

- Executive, administrative, and professional employees (including teachers and academic administrative personnel in elementary and secondary schools), outside sales employees, and employees in certain computer-related occupations (as defined in DOL regulations);
- Employees of certain seasonal amusement or recreational establishments, employees of certain small newspapers, seamen employed on foreign vessels, employees engaged in fishing operations, and employees engaged in newspaper delivery;
- Farmworkers employed by anyone who used no more than 500 “man-days” of farm labor in any calendar quarter of the preceding calendar year;
- Casual babysitters and persons employed as companions to the elderly or infirm



Payment Method

- While often paid hourly, non-exempt employees can also be paid a fixed salary
- However, even if paid a salary, they are still entitled to overtime pay for hours worked over 40
- The overtime calculation for salaried non-exempt employees is based on their regular rate of pay, derived from their salary
- Employers are legally required to keep accurate records of the hours worked each day and week by non-exempt employees to ensure proper payment of wages and overtime



Guidance for Tax Year 2025

Determining the Amount of Qualified Tips Received by Employees

- An employee may deduct an amount equal to the qualified tips received during the taxable year and included on a statement furnished to the employee (a Form W-2) or reported by the employee on Form 4137, subject to certain limitations
- Employers must include the total amount of cash tips reported by the employee to the employer and the employee's occupation on the Form W-2
- Only cash tips separately accounted for on the Form W-2 or reported on the Form 4137 are included in calculating the deduction
- The 2025 Form W-2 has not been modified to account for the new tips reporting requirements
- As a result, employers are not required to separately account for cash tips on the written statements furnished to individuals for 2025



Guidance for Tax Year 2025

Determining the Amount of Qualified Tips Received by Employees

- For purposes of satisfying the requirements of Section 224(a) for tax year 2025, an employee may:
 - (1) Treat the requirement that qualified tips be included on a statement furnished to the employee as satisfied if the employee's cash tips are properly reported on the employee's Form W-2, without regard to the requirements to separately account for the total amount of cash tips reported by the employee under Section 6053(a)), and
 - (2) Calculate the amount of qualified tips (subject to the other limitations and requirements for qualified tips in Section 224) for tax year 2025 as follows



Guidance for Tax Year 2025

Determining the Amount of Qualified Tips Received by Employees

- 1) Use the total amount of Social Security tips reported in box 7 of the Form W-2;
- 2) Use the total amount of tips reported by the employee to the employer on all Forms 4070, *Employee's Report of Tips to Employer* (or any similar substitute form used to monthly report tips to the employer); or
- 3) If an employer voluntarily chooses to report the amount of an employee's cash tips in box 14 of Form W-2 (or on a separate statement), the employee may use this amount in determining the amount of qualified tips for tax year 2025
- 4) In addition to these three options, employees may also include any amount listed on line 4 of the 2025 Form 4137 filed with the employee's 2025 income tax return (and included as income on that return)



Guidance for Tax Year 2025

Determining the Amount of Qualified Tips Received by Employees

- Although the occupation of an employee receiving tips may not appear on the Form W-2 furnished to the employee in 2025, the employee is still responsible for determining whether the tips received by the employee were received in an occupation that customarily and regularly received tips on or before December 31, 2024
- Some employers may choose to provide information on an employee's occupation or other relevant information to employees using box 14 of Form W-2, in which case employees may rely on that information



Specified Service Trade or Business

- There will be a transition period for purposes of IRS enforcement and administration with regard to the specified service trade or business requirement
- Specifically, until January 1 of the first calendar year following the issuance of final regulations regarding the determination of whether a trade or business is a specified service trade or business for purposes of Section 224 and associated employer information reporting, the IRS will treat the employee as having received tips in the course of a trade or business that is not a specified service trade or business if the employee is in an occupation that customarily and regularly received tips on or before December 31, 2024, as provided by the Secretary



Determining Qualified Tips for Non-employees

- Under Section 224(a) an individual may deduct an amount equal to the qualified tips received as a non-employee during the taxable year and included on a statement furnished to the individual (a Form 1099-MISC, 1099-NEC, or 1099-K), subject to certain limitations
- Under Sections 6041(d)(3), 6041A(e)(3), and 6050W(f)(2), payors must include on the applicable Form 1099 the portion of (or a separate accounting of) payments that have been reasonably designated as cash tips and the occupation described in Section 224(d)(1) of the individual receiving the tips
- Only cash tips separately accounted for on the applicable Form 1099 are included in calculating the deduction
- However, for tax year 2025, a separate accounting of cash tips received by a non-employee will not appear on the Form 1099 furnished to the non-employee



Determining Qualified Tips for Non-employees

- A non-employee may:
 - (1) Treat the Section 224(a) requirement that qualified tips be included on a statement furnished pursuant to the requirements of Sections 6041(d)(3), 6041A(e)(3), or 6050W(f)(2) as satisfied if the non-employee's cash tips are included in the total amounts reported as other income on the Form 1099-MISC, nonemployee compensation on the Form 1099-NEC, or payment card/third-party network transactions on the Form 1099-K furnished to the non-employee, and
 - (2) Calculate the amount of qualified tips (subject to the other limitations and requirements for qualified tips under Section 224) using earnings statements or other documentation such as receipts, point-of-sale system reports, daily tip logs, third-party settlement organization records, or other documentary evidence that corroborates the calculation of the total amount of tips that are qualified tips for tax year 2025



Determining Qualified Tips for Non-employees

- For example, if a payor issues an earnings statement to contractors who provide services to the payor, the contractor may use the amount designated as tips by the payor on the earnings statement in determining the amount of qualified tips, provided the other limitations and requirements for qualified tips are satisfied, and provided the contractor maintains a copy of the earnings statement in accordance with IRS recordkeeping requirements
- Non-employee payees may also consult with the payor regarding any available information that may assist in determining and documenting the amount of qualified tips



Qualified Overtime Compensation

- Section 225(c) limits qualified overtime compensation to overtime compensation in excess of the individual's regular rate that is required and paid under 29 USC § 207
- In order for overtime to be required, it must be paid to an individual who is both covered by and not exempt from the FLSA (an FLSA-eligible employee)
- Thus, an individual who is ineligible for federal overtime (an FLSA-ineligible employee) will generally not be paid overtime
- However, some FLSA-ineligible employees are eligible for overtime under state law or are paid premium rates for certain work for other reasons
- Overtime compensation paid to FLSA-ineligible employees is not qualified overtime compensation within the meaning of Section 225(c) with respect to such employment, regardless of applicable state law provisions or other circumstances causing these amounts to be paid



Qualified Overtime Compensation

- Because employers and other payors will not be required to separately account for qualified overtime compensation, a separate accounting of qualified overtime compensation will not appear on written statements furnished to individuals for tax year 2025 absent an entry in box 14 of Form W-2 or a separate statement containing that information
- Consequently, individuals who are not furnished a separate accounting of qualified overtime compensation in box 14 of Form W-2 (or on a separate statement) must make a reasonable effort to determine whether they are considered FLSA-eligible employees, which may include asking their employers or other service recipients about their status under the FLSA



Qualified Overtime Compensation

- For tax year 2025, a separate accounting of qualified overtime compensation may not appear on the written statement furnished to the individual
- Some employers may choose to report the amount of qualified overtime compensation to employees using box 14 of Form W-2 or on a separate statement, in which case employees may treat the separate accounting requirement as satisfied for purposes of their eligibility for the deduction and use this amount for purposes of determining the deduction under Section 225
- If the amount of qualified overtime compensation is not provided by the employer in box 14 of the Form W-2 or on a separate statement, an FLSA-eligible employee may:
 - (1) Treat the separate accounting requirement as satisfied if the qualified overtime compensation is properly reported on the individual's Form W-2, Form 1099-NEC, or Form 1099-MISC, without regard to the requirements of Section 6051(a)(19) (to separately account for the amount of qualified overtime compensation), copies of which are furnished to the individual, and
 - (2) Base the determination of the amount of qualified overtime compensation (subject to the other limitations and requirements for qualified overtime compensation in Section 225 on other documentation such as earnings or pay statements, invoices, or similar statements that support the determination, using a reasonable method described below to determine the amount of the qualified overtime compensation



Qualified Overtime Compensation

- Individuals who had multiple employers during 2025 may use different methods for each employer



Individuals May Use Any of the Following Reasonable Methods for Purposes of Determining the Amount of Qualified Overtime Compensation Under Section 225(c) for Tax Year 2025

- (A) If the individual is paid overtime compensation at a rate of one and one-half times the individual's regular rate for hours worked in excess of 40 hours in a workweek, as generally required by 29 USC § 207(a), and receives a statement covering the entire 2025 tax year that separately accounts for the overtime premium, which is generally, the "half" portion of the "one and one-half times" amount (the FLSA Overtime Premium), the individual may use that separate amount
- See example 1
- (B) If the individual is paid overtime compensation at a rate of one and one-half times the individual's regular rate for hours worked in excess of 40 hours in a workweek, as generally required by 29 USC § 207(a), and receives a statement covering the entire 2025 tax year that does not separately account for the FLSA Overtime Premium, but does include an entry showing the aggregate dollar amount of the FLSA Overtime Premium combined with the portion of the individual's regular wages for the hours worked over 40 in a workweek, the individual may use one-third of that aggregate dollar amount
- See example 2



Individuals May Use Any of the Following Reasonable Methods for Purposes of Determining the Amount of Qualified Overtime Compensation Under Section 225(c) for Tax Year 2025

- (C) If the individual is paid overtime compensation at a rate in excess of one and one-half times the individual's regular rate for hours worked in excess of 40 hours in a workweek, as generally required by 29 USC § 207(a) (for example, two times the individual's regular rate), and receives a statement covering the entire 2025 tax year that separately accounts for the portion in excess of the employee's regular rate, the individual may multiply that separate amount by an appropriate fraction to approximate the FLSA Overtime Premium (for example, if overtime is paid at a rate of two times the regular rate, the appropriate fraction is one-half) and use the product
- See example 3



Individuals May Use Any of the Following Reasonable Methods for Purposes of Determining the Amount of Qualified Overtime Compensation Under Section 225(c) for Tax Year 2025

- (D) If the individual is paid overtime compensation at a rate in excess of one and one-half times the individual's regular rate for hours worked in excess of 40 hours in a workweek, as generally required by 29 USC § 207(a) (for example, two times the individual's regular rate), and receives a statement that does not separately account for the FLSA Overtime Premium but does include an entry showing the aggregate dollar amount of overtime compensation at that higher rate for the hours worked over 40 hours combined with the portion of the individual's regular wages for the hours worked over 40 in a workweek covering the entire 2025 tax year, then the individual may multiply the aggregate dollar amount by an appropriately smaller fraction (for example, if overtime is paid at a rate of two times the regular rate, the appropriate fraction is one-fourth) and use the product
- See example 4



Reporting Tip and Overtime Income – Schedule 1-A

- Schedule 1-A, not yet finalized, is a new tax form designed to calculate four new OBBBA-generated deductions
- Schedule 1-A consolidates them into a single entry on Form 1040
- Schedule 1-A will be filed with 2025 federal income tax returns that will be filled out next year to claim:
 - A deduction for qualified tip income
 - A deduction for qualified overtime pay
 - A deduction for car loan interest
 - The deduction for qualified seniors who are age 65 and older



Reporting Tip and Overtime Income

- These deductions include MAGI phase-out provisions, making the initial calculation of MAGI a crucial step
- Attach Schedule 1-A (Additional Deductions) to Form 1040 or 1040-SR
- Enter modified adjusted gross income (MAGI) in Part I
- Complete each section for the deductions the taxpayer qualifies for
- The total deduction amount will be entered on line 13b of Form 1040



Example 1

- Individual A has access to a payroll system that shows totals of amounts paid to Individual A in 2025, including the FLSA Overtime Premium paid during 2025
- In 2025, Individual A is last paid wages on December 22, 2025, for the payroll period beginning on November 30, 2025, and ending on December 13, 2025
- The payroll system shows \$5,000 as the “overtime premium” that Individual A was paid during 2025
- For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual A may include \$5,000 (the FLSA Overtime Premium)



Example 2

- Assume the same facts as in example 1 except that Individual A's pay stub, shows a total "overtime" amount of \$15,000 (which is the FLSA Overtime Premium combined with the portion of the individual's regular wages for the hours worked over 40 in a workweek)
- For purposes of determining the amount of qualified overtime compensation received in tax year 2025, the individual may include \$5,000 (the FLSA Overtime Premium, computed by dividing \$15,000 by 3)



Example 3

- Individual B's employer has a practice of paying overtime at a rate of two times an employee's regular rate of pay and Individual B was paid \$20,000 in overtime pay under that practice; although § 207 only requires Individual B's employer to pay at one and one-half times the employee's regular rate
- Individual B's last pay stub for 2025 shows "overtime premium" of \$10,000 paid in 2025 (which is Individual B's overtime premium paid at a rate of two times the individual's regular rate)
- For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual B may include \$5,000 (\$10,000 divided by 2)



Example 4

- Assume the same facts as in example 3 except that Individual B's pay stub shows a total "overtime" amount of \$20,000 (which is Individual B's overtime premium paid at a rate of two times the individual's regular rate of pay combined with the portion of the individual's regular wages for the hours worked over 40 in a workweek)
- For purposes of determining the amount of qualified overtime compensation received in tax year 2025, Individual B may include \$5,000 (the FLSA Overtime Premium, computed by dividing \$20,000 by 4)



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 the FLSA
- 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)



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 with respect to compensatory time off taken.
- 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

Thank You!
