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## How the One Big Beautiful Bill Act (OBBBA) affects overtime pay

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The federal One Big Beautiful Bill Act of 2025 introduced a new income tax deduction for employees who earn FLSA-qualified overtime pay. The key feature is that employees may deduct the “premium portion” of their FLSA overtime compensation from their federal taxable income—but not from FICA (Social Security or Medicare) taxes.

This provision is designed to reduce the federal income tax burden for hourly workers earning substantial overtime, without altering wage obligations under the **Fair Labor Standards Act (“FLSA”)** or state wage laws.

### **1. What Counts as “Qualified Overtime” that must be tracked**

To qualify for the federal deduction, the overtime pay must meet all three of these requirements:

- It is required under the FLSA – in other words, pay for hours worked over 40 in a workweek by a non-exempt employee.
- Only the premium portion of the overtime rate can be deducted – as an example, if an employee’s regular rate of pay is \$10 per hour, the employee would be paid \$15/hr. for all overtime worked. Out of this \$15, only \$5 would qualify for the deduction.
- It must be paid to an employee - independent contractors are not eligible.

Overtime required solely by state law, a collective bargaining agreement, or company policy does not qualify for this federal deduction.

### **2. Employer Payroll and Withholding Requirements**

Employers must maintain clear records distinguishing FLSA overtime hours from other types of premium pay. Payroll systems should:

- Identify which overtime hours are FLSA-mandated.
- Separate “qualified overtime pay” from total overtime pay.
- Retain detailed time and pay records to substantiate employee eligibility for IRS or DOL audits.

- For 2025, employers continue withholding income tax on full wages, including overtime.
- Employees will receive the benefit of the deduction when they file their individual tax returns for 2025.
- Beginning in 2026, the Treasury Department will adjust IRS Form W-4 and withholding tables to account for the new deduction.

### **3. Reporting requirements**

For the 2025 tax year, employers must report the amount of qualified overtime compensation separately. The IRS will issue formal guidance on where to report this amount, and employers may use an IRS-approved reasonable estimation method.