

FAQs

No Tax on OT and Tips

Our Compliance analysts answer questions about no tax on overtime and tips based on new IRS rules.



Overtime

- 1. For married couples filing jointly, is the \$25,000 limit for eligible overtime allowed for one person or is it split \$12,500 for each person?**

For the OT deduction, the cap is \$12,500 per individual. Filing status does not matter.

- 2. Do employers need to know the hours of overtime or the amount that is eligible for the refund for reporting purposes?**

The IRS has updated Form W-2 so that the total amount of qualified overtime compensation can be reported for taxpayers claiming the deduction. There is no indication on the form that hours would also be reported.

- 3. Is an employee that is classified as exempt but paid overtime eligible to take the deduction?**

Qualified overtime means the overtime paid to an individual as required under the Fair Labor Standards Act (FLSA). If an employee is classified as exempt from FLSA, then they typically are not eligible for overtime and, as such, would not qualify for the deduction.

- 4. What happens if you have overtime on several different rates like a skilled trades laborer?**

The deduction applies to the FLSA required premium portion only (the one-half – 0.5 – of time and a half), not the full overtime amount. It should be noted that double-time is treated the same way, so for federal tax purposes, only the FLSA premium portion is eligible.

- 5. What is considered a work week when it comes to computing overtime? Is it over 35 or 40 hours?**

Since FLSA establishes overtime as any hours worked beyond 40 per week, only the premium portion (the one-half of time and a half) is eligible on the hours worked beyond that threshold.

- 6. If an employee is "on call," do those hours qualify as overtime if they push the workweek beyond 40 hours?**

A variety of factors come into play in determining whether on-call time is considered time worked. Any time an employee is scheduled or permitted to work, including compensable time spent in an on-call capacity, the hours worked under FLSA could be considered for purposes of determining whether the employee worked qualified overtime.

- [USDOL Fact Sheet #22](#)

7. What if overtime is not on the W-2 in 2025, can an employee just reference another source to help them claim the deduction?

Individuals can use other sources, like their last paystub of 2025 which lists the overtime total. However, for 2026-2028 filings, employers have reporting requirements for overtime that include IRS forms W-2 and 1099.

8. Would prevailing wage rules be considered under the collective bargaining agreement exemption?

Prevailing wage is not automatically related to a collective bargaining agreement. They can, and frequently do, operate independently.

9. If an employee has 48 total hours consisting of 32 hours worked, 8 hours holiday or vacation or sick pay, and 8 hours of overtime, can they deduct overtime in a week when they have holiday pay?

The FLSA establishes that overtime happens after 40 hours worked in a workweek. Generally, holiday, vacation, and sick hours are not considered time worked.

10. If an employee is paid time-and-a-half for working on a holiday, but that doesn't enable the hours in the workweek to exceed 40, is that overtime eligible for the deduction?

If an employer elects to pay an employee premium pay for working a holiday, it is outside of what the FLSA has established as qualified overtime. The OBBBA provision only applies to the overtime required by the FLSA.

11. Are year-end bonuses included in OT calculations?

The FLSA specifically addresses how bonuses and commissions should be handled when determining the hourly rate for overtime calculation purposes.

- [FLSA Fact Sheet #56C](#)

12. Can an S corporation owner claim no tax on OT?

Only the FLSA overtime premium, meaning the 0.5 – “half-time” portion of time and a half – is eligible. The Department of Labor provides helpful tests, and IRS guidance includes examples for this rule.

- [IRS guidance on overtime qualifications \(assess eligibility\)](#)

Tips

13. If married filing jointly for the no tax on tips deduction, is the combined limit \$25,000?

Yes, the limit for deduction is \$25,000 per return regardless of whether it is single or married filed jointly.

14. Can a gift card given to an employee be considered a tip?

If a gift card is given voluntarily to an employee by a customer, it can qualify for the deduction. The IRS has ruled that gift cards can be considered cash tips.

15. Would a non-mandatory gratuity pool be eligible for the no tax on tips deduction? (e.g., If you are a restaurant worker sharing tips with the wait staff and that staff is eligible under the Treasury Tipped Occupation Code (TTOC)).

Yes, voluntary gratuities in a tip pool can be eligible for the deduction. In order for a tip pooling situation to be eligible for the deduction, there must not be any managers included in the pool, and all the tips must be given out to the employees by the employer.

16. If businesses collect tips for take-out sales and distribute them to line cooks and kitchen staff, do those individuals qualify to take the deduction?

It depends on whether they work in a qualified occupation.

- [Official Treasury Tipped Occupation Code \(TTOC\) list](#)

17. Any restrictions on claiming deduction for qualified tips if you are a dependent (e.g., college student working part-time at a restaurant)?

An individual claimed as a dependent on someone else's return can still be eligible for the deduction on qualified tips. They must meet all the eligibility requirements, and they must file their own tax return to be able to claim the deduction.

18. If I am a sole proprietor and receive tips, how do I report on 1040/Schedule C to be able to claim the no tax on tips deduction?

The no tax on tips deduction is calculated and reported on Form 1040 using Schedule 1-A.

19. If a business provides options for the percentage of tip to leave (e.g., 15%, 20%) on the credit card machine, would those be considered mandatory and disqualify the tips from consideration for the deduction?

The tip has to be voluntary to qualify for the individual to claim the deduction. So, unless there is an option to leave "no tip," then it is not considered voluntary.

Questions from Accountants

20. Is there a separate \$25,000 individual limit for tips and OT, or is it a combined limit? If they make \$20,000 in tips and \$10,000 in OT, would that push them over the cap?

No, the two deductions are separate. The deduction for OT is limited to \$12,500 per individual. The deduction for tips is limited to \$25,000 per return. Individuals with reported OT and tips are eligible to claim deductions in each category if they meet the criteria for both.

21. If individuals working jobs such as food delivery are paid a fee plus tips on weekly basis, and the 1099 groups the fee and the tips into Line 1 "Nonemployee Compensation", should the employer create a document that segregates both so the individual can claim the deduction on tips?

Yes, the best solution would be to separate out the tips and report them in the new box on the 1099. The worker will need to use their own records to differentiate any qualified tip amounts from what is reported on the 1099.

22. How do sole proprietors deduct tips if they don't receive a 1099 NEC or 1099-K?

As of publication of this PDF, the law and the 1040 instructions explicitly state that an individual needs to receive a 1099 to claim the deduction. They might need to use their own records to substantiate the tip portion of the compensation if it is not separated out on the form.

23. Will tips not reported on a W-2/1099 need to be reported on Form 4137 to be eligible for the no tax on tips deduction?

Yes, those are the only methods of receiving tip amounts that are referenced in IRS guidance to date.

24. If cash tips or OT is less than \$2,000 for 2026, will the employer be required to file a 1099NEC/MISC?

We can't answer this yet. Although the limit for compensation is increasing from \$600 to \$2,000, the IRS has not released the 1099 instructions for how this situation will be handled in 2026 and beyond.

25. Can unreported tips be declared on Schedule C so the filer can take the deduction?

Tips must be reported on W-2, 1099, or Form 4137 to be eligible for the deduction.

26. What if you work in a state that pays overtime differently than the federal standard under FLSA (e.g., California), does that pay qualify toward the no tax on OT deduction?

No. The overtime calculations in California are distinct from overtime calculations for FLSA. For the purposes of federal "no tax on overtime," it needs to be calculated on FLSA.

27. Which states have decoupled from the federal Internal Revenue Code in 2025, and does that make individuals ineligible from claiming the no taxes on tips and OT deduction on their federal returns?

This is not all-inclusive and is subject to change as more state legislatures address this. The following states and jurisdictions, as of publication, are decoupled from the Internal Revenue Code and jurisdictions: California, Colorado, District of Columbia, Illinois, Maine, Massachusetts, New York, and Rhode Island. Several other states, such as South Carolina, are in limbo as a bill that will conform with the IRS and allow S.C. residents to claim no tax on tips and overtime did not pass the legislature before the end of 2025. Employees in these states still will be able to claim the deduction on their federal tax returns but will not be able to take this deduction on state income tax returns.

28. Are tips received at a marijuana dispensary in a state where it is legal eligible for the deduction?

Each state may handle it differently, but these tips are not eligible for the federal deduction.

29. Is the IRS going to verify overtime amounts with a letter if it is not listed on the W-2?

If an employee claims the deduction on their 1040 but the OT amount is not listed on a W-2 or 1099, the employee might receive correspondence from the IRS asking them to substantiate the OT amounts they claimed.