"NO TAX" ON OVERTIME & TIPS

How the new federal deductions really work

THE MOST IMPORTANT POINT: "No tax" does not mean all overtime pay or all tip income disappears from your tax return. These are federal income-tax deductions, with specific eligibility rules and limits.

Beginning with tax year 2025 and continuing through 2028, eligible workers may claim new deductions for qualified tips and qualified overtime compensation. The deductions are available whether you itemize or take the standard deduction.

No Tax on Overtime: what is actually deductible?

For qualified overtime, the deduction generally applies only to the overtime premium - not the entire overtime paycheck. The overtime must be compensation required under Section 7 of the Fair Labor Standards Act (FLSA). Overtime that is paid only because of a union contract, employer policy, state rule, or other arrangement may not qualify if it is not required under the federal FLSA.

Example: A worker earns $20 per hour and receives time-and-a-half, or $30, for 10 overtime hours. Total overtime pay is $300. The regular-pay portion is $200; the extra "half-time" premium is $100. **Generally, the $100 premium - not the full $300 - is the amount that may qualify for the deduction.**

Annual limit: Up to $12,500 of qualified overtime compensation, or up to $25,000 on a married joint return.

Income phaseout: The deduction begins to phase out when modified adjusted gross income (MAGI) exceeds $150,000 for most filers or $300,000 for married couples filing jointly.

Does overtime become completely tax-free?

No. Qualified overtime compensation is still generally treated as wages and remains subject to Social Security and Medicare taxes. Federal income-tax withholding may also still occur during the year; the deduction reduces taxable income when properly claimed, although workers may be able to adjust withholding using Form W-4.

No Tax on Tips: who may qualify?

Eligible employees and self-employed individuals may deduct up to $25,000 of qualified tips each year. The tips must be received in an occupation the Treasury Department and IRS identify as one that customarily and regularly received tips on or before December 31, 2024.

Qualified tips generally include voluntary cash tips, charged tips, and - for employees - tips received through tip-sharing arrangements. Mandatory service charges are not qualified tips.

Example: An eligible worker receives and properly reports $18,000 of voluntary qualified tips during the year. Subject to the income limits and other rules, that worker may potentially deduct the $18,000 of qualified tips from federal taxable income.

Annual limit: Up to $25,000 of qualified tips per return. For a self-employed person, the deduction also cannot exceed net income from the trade or business in which the tips were earned.

Income phaseout: The deduction begins to phase out when MAGI exceeds $150,000, or $300,000 for married couples filing jointly.

Important rules for both deductions

- **They are temporary.** Under current federal law, the deductions apply for tax years 2025 through 2028.
- **Married taxpayers generally must file jointly.** A married taxpayer filing separately cannot claim these deductions.
- **A valid Social Security number is required.** The taxpayer claiming the deduction must meet the applicable SSN requirement.
- **Income must still be reported.** The law creates deductions; it does not authorize workers to omit qualified tips or overtime from required wage or income reporting.
- **Payroll taxes do not simply disappear.** Social Security and Medicare tax rules generally continue to apply.
- **State taxes may be different.** These are federal provisions. A taxpayer should check how his or her state treats the new deductions.

How do you claim the deductions?

The IRS uses Schedule 1-A, Additional Deductions, with Form 1040. For 2026 reporting, employers have new W-2 reporting requirements for qualified tips and qualified overtime. Tax year 2025 was a transition year, so workers filing or amending a 2025 return may need to use employer records and the special IRS instructions to determine the eligible amount.

The bottom line

The phrases "No Tax on Overtime" and "No Tax on Tips" are useful shorthand, but they can be misleading. The new law provides potentially valuable federal income-tax deductions - not a blanket exemption from every tax. The overtime deduction generally covers only the qualifying overtime premium, while the tip deduction is limited to qualified tips in eligible occupations. Both deductions have dollar limits, income phaseouts, reporting requirements, and other eligibility rules.

Trusted sources & more information

- IRS - No Tax on Overtime: What to Know
- IRS - No Tax on Tips: What It Means for You
- IRS - Qualified Overtime FAQs (FS-2026-13)
- IRS - List of Occupations That Receive Tips
- IRS - Schedule 1-A: Additional Deductions
- U.S. Department of Labor - Overtime Pay

Questions? We're here to help.

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