PAYROLL READINESS PACKET | JURISDICTION: FEDERAL | VERSION 2026.1

No-Tax-on-Overtime Reporting Readiness Packet

Get payroll ready for the overtime deduction: track the OT premium separately, map W-2 reporting, and fix regular-rate math first.

WHAT THIS HELPS YOU DO

Use this packet to prepare payroll for the federal 'no tax on overtime' deduction — isolating the FLSA overtime premium in your systems, confirming W-2 reporting, and pressure-testing the regular-rate calculations the premium depends on.

WHEN TO USE THIS DOCUMENT

- Before the next W-2 cycle, while payroll mapping can still change
- When choosing or reconfiguring a payroll vendor
- When employees ask why their 'tax-free overtime' was still withheld
- If bonuses, commissions, or differentials complicate your overtime math
- Before answering any employee tax question you're not sure about

WHAT THIS DOCUMENT HELPS PREVENT

- W-2s that can't report the qualified overtime amount the deduction requires
- Confusing the OT premium (deductible) with total OT pay (not)
- Regular-rate errors becoming visible on a federal tax document
- Employee relations damage from mismanaged expectations about withholding
- Vendor finger-pointing in January when the data isn't there

Faulkner HR Solutions focuses on the system behind the people problem. This tool is designed to help employers slow down the decision, identify the risk, and create proof before the issue becomes a claim, complaint, turnover event, or credibility problem.

BEFORE YOU START: READINESS CHECKLIST

Gather the following before working through this document. Incomplete inputs are one of the most common reasons employer decisions fail under later scrutiny.

Have it	Input	Notes / location
☐	Employee name and role	

Have it	Input	Notes / location
☐	Date of incident, request, or separation	
☐	Supervisor involved	
☐	Policy or handbook section that applies	
☐	Prior documentation on file	
☐	Pay records, if applicable	
☐	Relevant emails, texts, notes, or complaints	
☐	Decision-maker name	
☐	Deadline, if applicable	

REPORTING READINESS PACKET

The deduction applies to the premium portion of FLSA overtime — the extra 'half' in time-and-a-half — and employees claim it on their returns. The employer's job is accurate tracking and W-2 reporting. Start with the math underneath.

Part 1 — What Qualifies (orientation)

- Deductible amount: the FLSA overtime premium — the extra half-time above the regular rate, not the full overtime paycheck.
- The deduction is claimed by the employee on their federal return; income and payroll tax withholding largely continue as normal.
- Annual caps and income phase-outs apply — employees should not expect 'tax-free overtime' in each check.
- Overtime required only by contract or state rules beyond FLSA may not qualify — flag it for your tax advisor.

Part 2 — Payroll System Field Mapping

Data element	Where it lives in your system	Separately tracked?
Straight-time earnings		
Overtime hours		
Regular rate (per workweek, incl. bonuses/commissions)		
OT premium (0.5x portion) — the qualified amount		
Contractual/daily OT beyond FLSA (if any)		

Part 3 — W-2 Readiness

Done	W-2 step	Owner / date
☐	Confirm current-year W-2 reporting location for qualified overtime with your vendor	
☐	Verify the system can total the premium separately for the full tax year	
☐	Test with a sample employee: does the reported amount equal the 0.5x premium only?	
☐	Mid-year adoption: confirm retroactive premium totals can be reconstructed	
☐	Assign one owner for year-end reconciliation	

Part 4 — Regular Rate Pressure Test

The deduction inherits every flaw in your regular-rate math. If nondiscretionary bonuses, commissions, or differentials are excluded from the regular rate, both the paycheck and the W-2 number are wrong.

Verified	Regular-rate check	Findings
☐	Nondiscretionary bonuses flow back into the regular rate for OT weeks	
☐	Commissions and piece rates included in the rate calculation	
☐	Shift differentials and on-call pay included	
☐	Multiple-rate employees: weighted average or agreed rate applied correctly	
☐	Run the full Regular Rate of Pay Audit Checklist if any box is uncertain	

Part 5 — Vendor Questions

Asked	Question for your payroll vendor	Answer
☐	Where will qualified overtime appear on this year's W-2?	
☐	Is the 0.5x premium isolated automatically, or does it need a pay code?	
☐	How is the premium handled when bonuses retroactively raise the regular rate?	
☐	Can you produce a mid-year premium report for employee questions?	
☐	What is your deadline for configuration changes before W-2 processing?	

Part 6 — Employee Communication Plan

Key message: what the deduction is, what it is not, and that withholding continues	
Who answers employee tax questions (and where they stop: 'ask your tax advisor')	
Communication date and channel	

Role	Name / signature	Date
Payroll owner		
Reviewed by		

STOP AND REVIEW BEFORE ACTING

If any statement below is true, pause. Get the decision reviewed by HR, counsel, or Faulkner HR Solutions before you act.

- ☐ Your payroll system cannot separate the 0.5x premium from total overtime pay.
- ☐ Bonuses and differentials are excluded from the regular rate today.
- ☐ Employees believe overtime is now withholding-free and paychecks will prove otherwise.
- ☐ The vendor has no answer for where the amount lands on the W-2.
- ☐ Managers are answering employee tax questions ad hoc.

MINIMUM DOCUMENTATION STANDARD

Before this file is closed, the employer should be able to answer every question below and point to where the proof lives.

Question	Your answer / where the proof is stored
What happened?	
When did it happen?	
Who observed or reported it?	
What policy, standard, deadline, or expectation applies?	
What decision was made?	
Who had authority to make the decision?	
What alternatives were considered?	
What risk was reviewed?	
What follow-up is required?	
Where is the proof stored?	

COMMON MISTAKES

1. Reporting total overtime earnings instead of only the premium portion.
2. Letting the deduction expose years of regular-rate shortcuts on a federal form.
3. Stopping withholding on overtime because 'it's tax-free now.'
4. Waiting until January to ask the vendor configuration questions.
5. Promising employees a result on their tax return — that's their advisor's lane.
6. Ignoring contractual overtime that may not qualify under the federal definition.

WHAT TO DO NEXT

Fix any regular-rate findings first — they change paychecks, not just reporting. Then lock vendor configuration before the year-end freeze, brief employees with the communication plan, and calendar a year-end reconciliation of the premium totals against the W-2 output.

> **Before you terminate, deduct, discipline, classify, or respond, get the decision reviewed.**
> Call 210.446.8730 or email thomas@faulknerhrsolutions.info.

Before you process payroll, terminate, classify, deduct, or respond to a claim, get the decision reviewed.

Need help applying this to a real workplace decision?

Faulkner HR Solutions helps Texas employers, nonprofits, municipalities, and growing businesses fix the people systems behind recurring workplace problems.

If this document raised a risk flag, do not guess your way through the next step.

Call: **210.446.8730**
Email: thomas@faulknerhrsolutions.info
Website: faulknerhrsolutions.info

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