



INFO REPORT ON THE OVERTIME PAY TAX RELIEF ACT BILL

The SPRING Group

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1. Background

1.1 History of Overtime

Signed into law in 1938, the Fair Labor Standards Act (FLSA) formally created the concept of overtime pay. Prior to 1938, there were no federal laws regulating overtime pay, resulting in a scenario where workers would not receive additional pay for working increased hours. The FLSA established a standard 40-hour workweek, with overtime pay at a rate of at least 1.5 times the rate of regular pay.¹ Historically, overtime pay has been counted as taxable income in addition to wages.² Workers' earnings were added to their gross income, increasing the amount of taxable income, which would result in a higher marginal tax rate and tax bracket.

1.2 Effect of Labor Shortages on Overtime

Since 2018, the US labor workforce has experienced severe labor shortages predominantly in sectors such as healthcare, manufacturing, and hospitality. Typically, labor shortages occur when there are not enough unemployed workers in the market to meet the number of available job positions.³ As of May 2025, the number of unemployed persons per job opening is 0.9, indicating that there are fewer unemployed people than there are available positions.⁴ In the healthcare industry, the job opening rate is at 6.5%⁵, signifying that the demand for doctors and nurses significantly exceeds the supply. Additionally, in the hospitality industry, there is an even higher job opening rate of 6.8%⁶, reflecting the widespread openings in many roles. Workers are being forced to work more hours to make up for the available positions.⁷ While more hours can mean more money, this also increases the gross income, subjecting workers to a higher MTR or marginal tax rate. A higher tax rate would lead to a diminished after-tax return, thereby negating the primary benefit of overtime.

¹ [US Department of Labor](#), ND

² [Taylor](#), 2025

³ [Streets](#), 2023

⁴ [US Bureau of Labor Statistics](#), 2025

⁵ [US Bureau of Labor Statistics](#), 2025

⁶ [US Bureau of Labor Statistics](#), 2025

⁷ [Ferguson](#), 2025

2. Similar Legislation

2.1 No Tax On Overtime Act of 2025 (S.1046)

Introduced by Senator Josh Hawley [R - MO], the No Tax On Overtime Act of 2025 was read twice by the Senate and referred to the Committee on Finance on March 3, 2025, but never officially signed into law. One of the most significant provisions of this act is that it excludes overtime, hours worked over 40 as stated by the FLSA of 1938, entirely from federal income tax.⁸ This contrasts with the HR 651 bill, which only gives a partial deduction of up to 20% of regular wages.⁹ S.1046 adds these new provisions in section 139J of the Internal Revenue Code.

2.2 Alabama Act 2023-421

Act 2023-421 was a law in Alabama, first read on March 23, 2023, and signed into state law on June 8, 2023. The effort to pass this bill was led by Anthony Daniels [D], the minority leader in the State House of Representatives, and sponsored by representatives, including Nathaniel Ledbetter [R], Danny Garrett [R], and 21 more. This bill was referred to the House Ways and Means Education Committee before it was sent back to the State House of Representatives and passed with a unanimous vote of 105-0.¹⁰ Act 2023-421 amended Section 40-18-14 of the Code of Alabama 1975 to exclude overtime hours from gross income.¹¹ Criticism arose when a fiscal report estimated that the tax exemption would cost Alabama over \$230 million during 2024. For this reason, Alabama lawmakers chose not to renew the bill and allowed the act to expire on June 30, 2025.¹²

⁸ [Congress](#), 2025

⁹ [Congress](#), 2025

¹⁰ [Cason](#), 2023

¹¹ [State of Alabama](#), 2023

¹² [ITEP](#), 2025

3. Policy Analysis

3.1 Bill Overview

The Overtime Pay Tax Relief Act (H.R. 561) amends the Internal Revenue Code (IRC), the primary legislation governing U.S. tax law regulated by the Internal Revenue Service (IRS), by adding Section 224 to the code. The standard definition of “overtime compensation” accepted by the bill respects the definition presented in the Fair Labor Standards Act (FLSA), or, compensation paid at a rate of at least 1.5 times the regular rate of pay, where the employee subject to overtime works an exceeding number of hours specified by the employer (at least 40 hours in 7 days).¹³ Section 224 classifies overtime wages as tax-deductible, available regardless of whether taxpayers choose to itemize deductions or deduct specific eligible expenses from taxable income. For taxpayers who itemize deductions, deductions on overtime pay are excluded from itemization limits.¹⁴

There are several eligibility criteria to file for tax deductions under the bill. Eligible taxpayers may deduct only up to 20% of their standard income earned in overtime, complying with Section 7 of the FLSA. Deductions phase out at \$100,000 for individual taxpayers, \$150,000 for heads of household, and \$200,000 for joint taxpayers (such as married couples). Employees can deduct up to \$12,500 individually, and \$25,000 for joint filers. The bill includes a five-year sunset and mandated review until December 31, 2029. The bill is designed to provide targeted tax relief for working Americans and reward productivity (benefiting both parties in an employer-employee relationship). The bill is sponsored by Sen. Roger Marshall (R-KS), and later supported by members of the United States Senate, such as Sen. Tuberville (R-AL), Sen. Justice (R-WV), and Sen. Pete Ricketts (R-NE). These sponsors frame tax relief through H.R. 1 (OB BB), designed to support working American families through pro-growth reforms.

3.2 Stakeholder Analysis

3.2.1 Employees

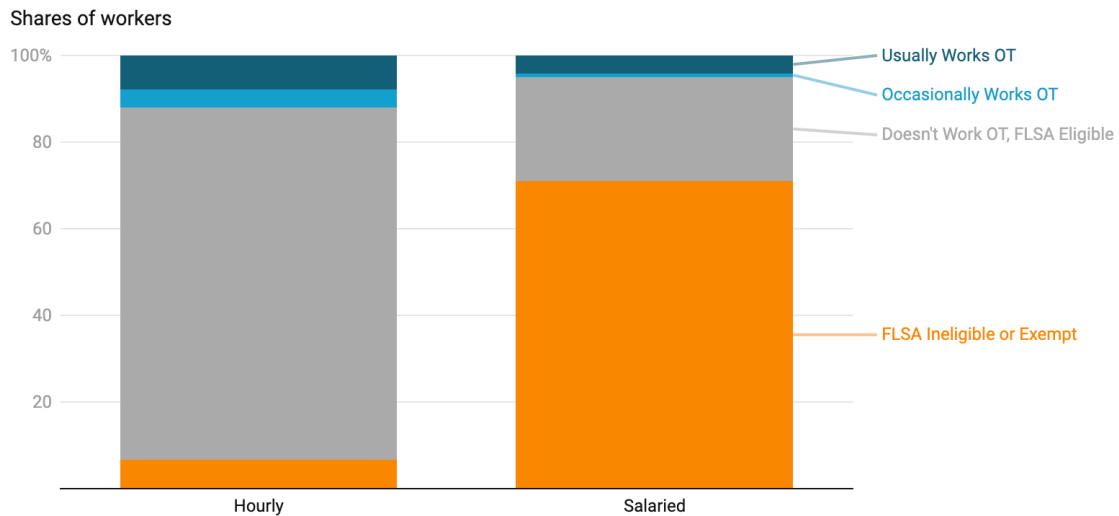
The Overtime Pay Tax Relief Act reshapes incentives across the market, differing based on income levels, business size, and employment type. There are multiple distinctions to be drawn between employees affected by the provision. Hourly employees tend to gain more from overtime benefits, with about 8% of eligible hourly workers earning overtime regularly, as opposed to just 4% of salaried workers (See Fig. 1). 93% of hourly

¹³ [US Department of Labor](#), ND

¹⁴ [Congress](#), 2025

workers qualified for overtime, contrasting the mere 29% of salaried workers.¹⁵ Lower-income workers receive a full benefit (annual income ~\$100,000), while the deduction phases out at higher thresholds (annual income ~\$150,000). The deduction is above the line, again accessible to non-itemizers. Additionally, since deduction is limited to FLSA-required overtime, bonuses that are negotiated within unions do not apply. The effects of this classification offer two possibilities. The distinction between bonuses and premiums negotiated within unions and overtime tax deductions could either bolster working class momentum and boost union legitimacy, or it could disincentivize broad wage increases given the option of another avenue for additional take-home.

Figure 1. Civilian Employment in 2023, by FLSA Eligibility & Overtime Utilization.



Source: The Budget Lab analysis of DOL, EPI, and BLS Data.

3.2.2 Employers

Employers are affected differently by the bill depending on size and capacity. Businesses will likely benefit from the bill, but some risks are inevitable. Increased take-home pay for workers might incentivize voluntary overtime participation, boosting productivity with extra monetary compensation at no significant direct financial risk to the employer. However, labor costs might rise, especially for sectors that already experience extreme numbers of employees working overtime hours, such as healthcare.¹⁶ Additionally, with the addition of tax-deductible overtime, employers must

¹⁵ [NFORUM](#), 2025

¹⁶ [Watson](#), 2024

separately track and report qualified overtime premiums on W-2 forms, which may require payroll system updates and administrative work on the front end that might pose stress on small businesses.¹⁷ Large employers likely will adapt to this change well. Additionally, the risk of tax fraud or noncompliance might increase, with reclassifications of regular salary to nonexempt, posing increased administrative work for auditors to sort through.¹⁸

3.2.3 Bureaucracy

The Internal Revenue Service (IRS) and the U.S. Treasury will be responsible for federal oversight over the bill's implementation, and will require the relevant updates to protocol given the IRC amendment to comply with new Section 224. This includes, but is not limited to, an outline of how W-2 forms should be filed, and setting new audit standards. Additionally, the Congressional Budget Office (CBO) will have to evaluate and regulate federal revenue loss. This could add additional coordination costs across agencies.

3.3 What Works

3.3.1 Increased Take-Home & Potential Bottom-Up Growth

Workers retain more of what they earn when overtime wages are tax-deductible, yielding savings over \$1000 annually, and could improve their financial stability.¹⁹ Additionally, the bill's amendments to the IRC detail that withholding should be updated such that workers observe a tax benefit in each paycheck, rather than in annual refunds when filing taxes. This ensures that workers feel the effects of the bill quickly and can soon engage in spending. The non-itemized nature of the deduction also makes it more accessible to newer taxpayers, often the ones spending the most and earning the least. This promotes economic growth from the bottom up. Taxpayers are likely to spend extra portions of their paycheck rather than save, funneling more dollars into the economy and boosting consumption-driven growth. This would theoretically put money directly in the hands of growing businesses (instead of tax cuts for larger corporations), and can have broad ripple effects across the economy.

Economists, however, present a more moderate outlook for growth in the short term. Some estimate that the bill will grow the economy about 0.4% in the first year, considered modest growth, generating about 190,000 new jobs.²⁰

¹⁷ [Paycom](#), 2025

¹⁸ [Durbin](#), 2025

¹⁹ [Durbin](#), 2025

²⁰ [Davidson](#), 2025

3.3.2 Workforce Shortages

Industries with chronic staffing shortages oftentimes overlap with industries with excessive overtime work (healthcare, emergency services, manufacturing). Tax deductions on overtime boost productivity by supporting a rewards-based incentive, potentially relieving staffing shortages in these critical sectors. In the United States, a projected shortage of 139,000 physicians by 2033 can be pinned down to a lack of labor rights and overstaffed hospitals.²¹ 94% of the 2,600 emergency medical service reports underscore major staffing issues and overworked employees.²² These are just examples of a broadly overstretched workforce across the nation, which the bill attempts to remedy.

3.4 Concerns and Limitations

3.4.1 Reduces Federal Revenue

A static budget cost for the new tax deductions estimate that total overtime pay in 2025 among FLSA-eligible taxpayers will reach \$335 billion, which is 3% of all waged reported on tax returns, and 1.1% of total U.S. GDP.²³ This massive amount poses a serious risk for federal spending, but can be effectively regulated through bureaucratic agencies. Additionally, the deduction would cost the federal government an estimated \$866 billion over 10 years if the sunset is waived and the provisions extended.²⁴ If workers do not earn enough to pay income tax, but do pay payroll tax, and exemptions are extended to payroll taxes (which is likely), then static costs total about \$1.3 trillion, trading off massively with Social Security spending, and increasing interest rates by rising national debt.²⁵ It is worthwhile to note that these costs are “static” estimates, and do not assume fluctuations in worker productivity and subsequently wages, which alter income and payroll tax rates.

3.4.2 Complexity

Provisions would increase tax code complexity, potentially increasing the administrative burden for small businesses, and require increased IRS funding to bolster its auditing capacity to assess new claims. Increased complexity in tax code could also create incentives to inflate overtime reports, which may lead to tax abuse and evasion (increasing the need for proper auditing systems from the IRS). Additionally, since the deduction requires detailed tracking of overtime wages, several mechanisms must be

²¹ [AAMC](#), 2020

²² [NAEMT](#), 2025

²³ [The Budget Lab](#), 2024

²⁴ [The Budget Lab](#), 2024

²⁵ [FiscalData](#), 2025

monitored. Overtime wages must be calculated separately from base pay, be reflected on W-2 forms, and follow stringent phase-out and deduction caps. Employers will have to spend funding on updating payroll and educating workers on new laws, creating the need for potential external legal support, causing strain in the short term.

3.4.3 Inequity

The bill excludes workers who do not work overtime, but work multiple paid jobs, and provides no mechanisms to safeguard workers whose employers fail to classify overtime correctly and decrease wages.²⁶ Additionally, it strategically favors certain sectors, such as healthcare or public safety, but does not provide much support for other sectors with weaker labor rights, such as education and retail. This selective support could deepen existing inter-sectoral wage disparities, concentrating spending power in higher-income groups, reducing aggregate demand, and limiting the productive potential of the workforce.²⁷

Additionally, the bill could disrupt horizontal equity among taxpayers. Horizontal equity refers to the principle that individuals receiving the same income should be subject to equal taxation. The provisions within this bill could disrupt this. The Budget Lab at Yale University provides an example.

- Imagine a hotel worker with an hourly wage of \$16, working 45 hours a week (~\$39,500 a year) including overtime. Consider another worker who works at a car dealership earning \$19 hourly working 40 hours a week, earning the same annually. The hotel worker would have a lower tax burden in a world of overtime tax relief, given that the hotel worker's income is partially composed of overtime wages, which would be eligible for a tax deduction under the overtime tax relief policy. Since the dealership worker's income is entirely composed of standard wages and not eligible for the deduction, their taxable income remains higher even though both workers earn the same annual amount.²⁸

²⁶ [JDSUPRA](#), 2025

²⁷ [Schmidt and Juijn](#), 2021

²⁸ [The Yale Budget Lab](#), 2024

4. Recommendations

4.1 Graduated Deduction

Replacing the current \$150,000 cutoff for deduction eligibility with a graduated phase-out structure and establishing a cap on the minimum amount of deductible pay could potentially resolve concerns surrounding over-subsidization of higher earners and control revenue loss. This could take the form of scaling percent deductibles to household size, local median wages, and overall income, ensuring that there are not large sectoral gaps in income (given geographic redistribution), and promotes equity for the lowest earners who work the most overtime. Additionally, a capped deduction would limit fiscal cost, petering out the amount of federal revenue required to fund the highest earners among the eligible taxpayers. Our recommendations ensure the progressive structure of the bill remains, but incorporates sustainable fiscal policy into the equation.

4.2 Wage Distortion Mitigation

To mitigate the effects of wage distortion, we propose requiring the Department of the Treasury and the IRS to issue formal guidance clarifying how overtime wages should be audited. This includes standardizing W-2 form documentation with specific definitions of overtime and safeguards against the misclassification of overtime by employers defined by the standards set in the FLSA. Specifically, the IRS could require employers to report compensation as a distinct item to help track overtime premium amount.²⁹

Additionally, to resolve risk of employers lowering wages in response to increased take-home, we recommend an additional clause to the deductible that conditions it upon base pay continuity. This disincentivizes employers to decrease wages, as they still want to preserve the boost in productivity from overtime pay tax relief.

Implementing a compliance credit for accurate overtime reporting could push businesses (especially small businesses) to develop the infrastructure necessary to adapt to tax rules.³⁰ For example, the credit could be available to employers who submit required attestation that their payroll complies with FLSA rules, and maintain accurate reporting of overtime on W-2 forms. It could ensure *proactive* compliance with new tax rules, rather than waiting for audits or penalties, adding the additional perk of relieving regulatory stress from the IRS.

²⁹ [Pritchard et al](#), 2025

³⁰ [Elite Tax](#), ND