



Insight

No Tax on Overtime: Winners and Losers

EMMET BOWLING | APRIL 29, 2025

Executive Summary

- President Trump's call to alter federal tax law to exempt overtime compensation from taxation has gained steam: several bills have been introduced in Congress and the proposal may be included in the upcoming reconciliation bill.
- While this policy would put more money into the pockets of workers who regularly work overtime, it would also create unintended consequences that could affect roughly 97.7 million overtime-eligible workers—including changes in employer and employee behavior that would result in decreased average wages in affected markets and create winners and losers.
- Instead, Congress should look to design tax policy that is pro-growth, minimizes market distortions, and does not penalize nor give preferential treatment to certain types of work.

Introduction

In recent months, the call to alter tax law to exempt overtime compensation from taxation has gained steam: President Trump first endorsed such a policy on the [campaign trail](#), and has continued to push the idea since taking office; several bills have been proposed in Congress, including the [KEEP Act](#), the [Overtime Pay Relief Act of 2025](#), and the [No Tax On Overtime Act](#); and the proposal may be included in the upcoming reconciliation bill. [Several states](#) are also considering the idea. While this policy would put more money into the pockets of workers who regularly work overtime, it would also create unintended consequences that could affect roughly [97.7 million](#) overtime-eligible workers—including changes in employer and employee behavior that would result in decreased average market wages in affected markets and create winners and losers.

Under static economic conditions, where economic behavior is held constant, nobody is made worse off by a tax exemption on overtime. The workers who regularly work overtime would benefit from the tax exemption by receiving more net compensation, while the workers who do not regularly work overtime would not see any impact to their paycheck. When individuals adapt to the policy, however, the tax exemption would cause the supply of labor to increase in affected markets, which would decrease the average market wage and negatively affect the net compensation of workers who do not regularly work overtime. Therefore, a “no-tax-on-overtime” policy would make some workers better off to the detriment of other workers.

Furthermore, insights from France indicate that higher-skilled workers with a greater degree of autonomy—those with more freedom to make decisions about how they complete their tasks and manage their work—are more likely to benefit from the tax exemption, while less-skilled and less autonomous workers are likely to be negatively affected by the tax exemption.

This insight examines the unintended consequences of a “no-tax-on-overtime” policy, including shifts in labor supply, changes in employer and employee behavior, and resulting wage distortions that create winners and losers.

Overview of a No-tax-on-overtime Policy

What Compensation Would Be Exempted, and From Which Taxes?

The bills in Congress to enact a “no-tax-on-overtime” policy – such as the KEEP Act, the Overtime Pay Relief Act of 2025, and the No Tax on Overtime Act – would exempt only overtime compensation subject to Fair Labor Standards Act (FLSA) [eligibility requirements](#) from the federal income tax. FLSA eligible overtime compensation is pay derived from work performed by an individual beyond 40 hours in a workweek. This overtime pay must be at least 150 percent of the worker’s regular rate of pay. Under these bills, overtime compensation would still be subject to other taxes, such as payroll taxes.

How Many Workers Would Be Directly Affected?

Under static conditions, any kind of “no-tax-on-overtime” policy would only directly affect non-exempt workers under the FLSA. According to the Department of Labor, there were about [97.7 million workers](#) who were eligible for overtime protections under the FLSA in 2023, [82.1 million](#) of whom were paid by the hour and 15.5 million of whom were salaried. While about 93 percent of hourly workers were eligible for overtime protections, only about 29 percent of salaried workers were eligible, as current FLSA overtime protections apply only to salaried workers who earn less than \$684 per week.

Although these workers qualify for FLSA overtime protections, most eligible workers work fewer than 40 hours per workweek, and would thus not normally be affected by this policy under static conditions. About 8 percent of eligible hourly workers and 4 percent of eligible salaried workers usually work overtime, while 4 percent of hourly workers and 1 percent of eligible salaried workers occasionally work overtime hours. All told, around 13.14 million workers would be directly affected by a “no-tax-on-overtime” policy.

How Much Money Will Workers Save?

According to Yale Budget Lab, these eligible workers would earn a collective total of [\\$335 billion](#) in overtime compensation in 2025 under static conditions. Under its model, the affected workers would save roughly \$48 billion in taxes in 2025 and about \$866 billion over the course of 10 years.

Policy Effects: Increase in Overtime Take-home Pay, Decrease in Regular Wages

Under static economic conditions, exempting overtime pay from income taxation would only affect eligible workers who clock in more than 40 hours per workweek. These workers would receive greater net compensation due to the deduction, while those who work regular hours would earn the same net compensation, since their income would not be subject to the tax exemption. Therefore, when economic behavior is held constant, a “no-tax-on-overtime” policy appears to only have an upside and no downside: The workers who normally work overtime are made better off because of the tax exemption, but the other workers are not made any worse off.

When economic behavior is factored in, however, the dynamic effects of a “no-tax-on-overtime” policy come to light, and regular-hour workers would be negatively affected by a tax exemption on overtime. As tax burdens are lifted from overtime compensation, net compensation for overtime hours increases. When net compensation for overtime hours increases, more workers are incentivized to enter positions and work hours that are eligible to receive the deduction. As more workers enter these affected markets, average wages decrease.

This decrease in average wages negatively affects workers who, for whatever reason, do not regularly work overtime hours. Not only would these workers not benefit from the tax exemption, but they would also receive lower wages for the same amount of work, resulting in a decrease in take-home pay. Meanwhile, the workers who regularly work overtime would likely still be able to increase their net compensation due to the tax deduction. Consequently, a “no-tax-on-overtime” policy simultaneously increases net compensation for some while decreasing net compensation for others, bifurcating workers into two

categories: winners and losers.

Winners

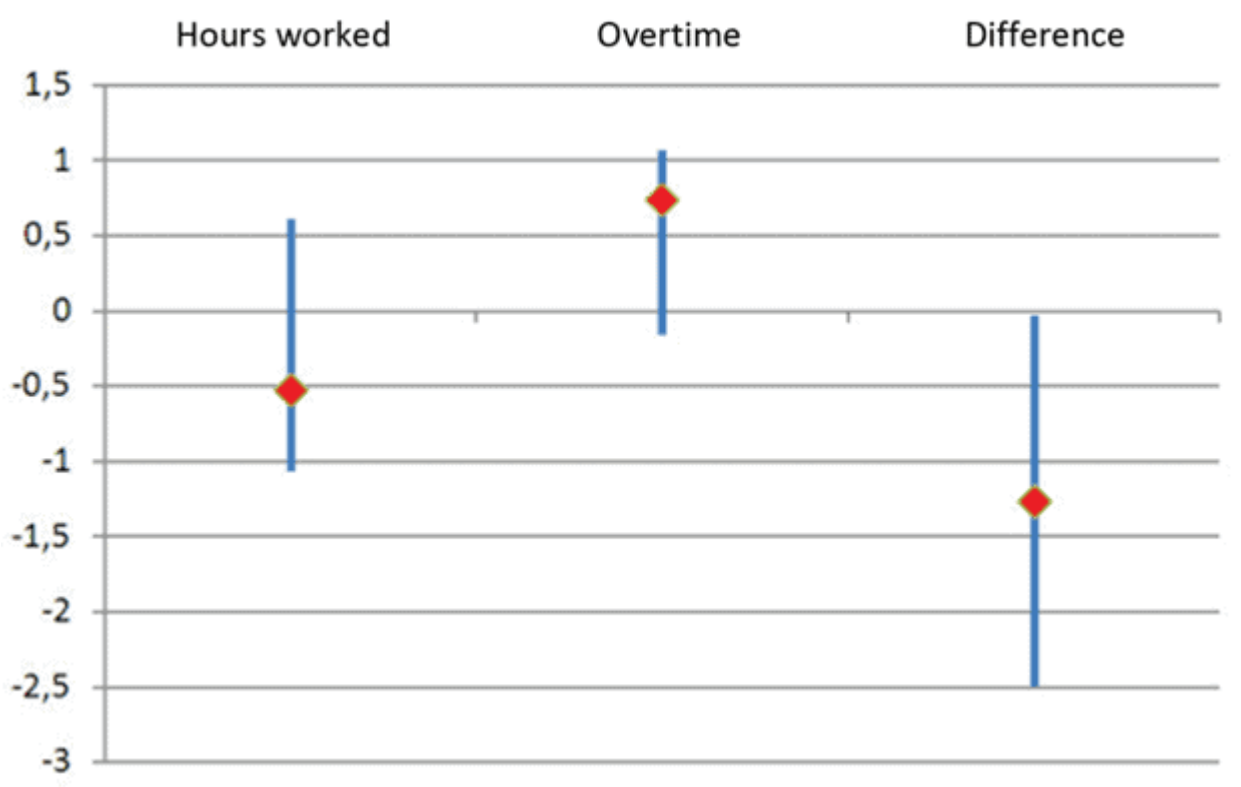
The winners of a tax exemption on overtime compensation would be, unsurprisingly, workers who regularly work overtime. More specifically, they would be workers who earn enough untaxed overtime compensation to offset any wage reductions this tax exemption may cause.

Furthermore, workers who regularly work overtime are more likely to already possess certain characteristics that predispose them to higher earning potential, as overtime workers are [more likely](#) to be male, middle-age, have higher levels of education, and are more skilled than their regular-hour counterparts.

Evidence from France's "Law for the promotion of labor, employment and purchasing power" (TEPA law), which exempted overtime compensation from taxation from 2007-2012, supports the notion that the winners of such a policy would be those workers who are already more skilled and have a greater degree of autonomy over the organization of their work. According to one [study](#), the law had no significant effect on the number of hours worked, but did result in a rise in the number of overtime hours declared by highly skilled employees, such as managers, technicians, and intellectual artists. These workers, according to the authors, "have opportunities to manipulate the overtime hours they declare in order to optimize their tax situation since the hours they work are difficult to verify."

As seen in the graph below, the authors estimate that these skilled French workers were able to increase the amount of overtime hours declared by 0.7 hours per week, while the total number of hours they declared decreased by about 0.5 hours per week.

Impact of French TEPA Law on Working Hours for Skilled Employees



Source: [Institut des Politiques Publiques](#)

This simultaneous increase in overtime hours and decrease in total hours is in part due to the fact, the authors suggest, that these workers were able to exercise their work autonomy to strategically allocate their work schedule in a manner that would maximize the amount of overtime hours, while also managing to work the same or fewer total hours.

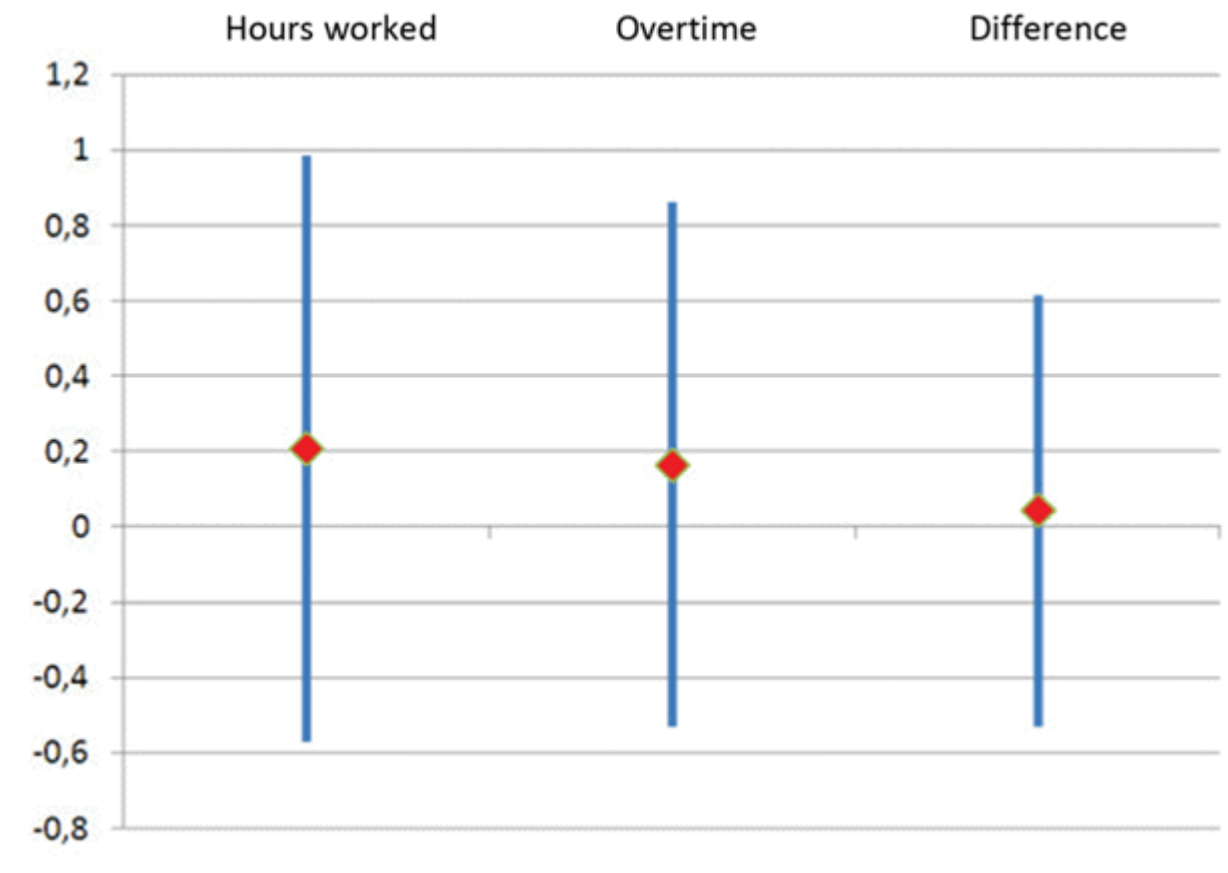
Losers

The losers from a tax exemption on overtime hours policy would be those workers who normally do not work overtime, as they would gain no benefit from the tax exemption and receive lower wages due to the labor supply increase. These workers are more likely to be female, not middle age, less educated, and less skilled. In other words, the workers who would be hurt the most from this policy are those who are less able to work more than 40 hours per week or have other responsibilities, such as family obligations, that prevent them from working overtime.

Furthermore, evidence from the French TEPA law demonstrates that less-skilled, less-autonomous workers would likely not see a significant increase in overtime hours. As shown in the graph below, less-skilled workers did not have any significant increase in the amount of overtime worked after the law's implementation, with an increase of only about 0.16

overtime hours per week.

Impact of French TEPA Law on Working Hours for Low or Unskilled Employees



Source: Institut des Politiques Publiques

Although this 0.16-hour increase in overtime hours per week may appear to benefit less-skilled workers, albeit to a small degree, these workers would receive a lower average wage due to the aforementioned labor supply increase. Thus, these workers would benefit from the overtime tax exemption only if they were able to earn enough net pay from overtime to offset the decrease in regular wages, which the above data suggest is unlikely to happen.

This lack of significant increase in overtime hours worked is likely due to, as the authors explain, the fact that these workers have less autonomy over the organization of their work. After all, employers still have an incentive to prevent their employees from working excess overtime hours to avoid paying them overtime premiums, despite the tax deduction.

How This Policy Affects Firm Behavior

While a “no-tax-on-overtime” policy produces a set of winners and losers for workers, it may

have more complicated effects on firms. On the one hand, since the tax exemption reduces market wages, firms might be able to save on payroll because they would be able to pay their workers less for the same amount of work. Furthermore, the increased attractiveness of overtime work may [fit well](#) for some employers' operations, as firms may be able to alter their payroll structure in a way that increases worker efficiency and productivity.

On the other hand, a "no-tax-on-overtime" policy may negatively impact firms due to the increased compliance costs and other costs associated with preventing their workers from claiming excessive overtime hours. Since this tax exemption would encourage more employees to work (or simply declare) overtime hours, firms would have to find more ways to prevent their employees from clocking in more overtime than necessary to avoid paying them the overtime premium of 150 percent of their regular pay. While workers have a greater incentive to work overtime hours, employers may have to spend more time and resources to prevent them from doing so.

Conclusion

When holding economic behavior constant, it appears that a "no-tax-on-overtime" policy benefits overtime workers at no cost to other workers. A more dynamic analysis of the policy, one that accounts for economic behavior, however, shows that the tax deduction would result in a decrease in the average market wage, making some workers - most often higher-skilled and more autonomous - better off and others - most often less skilled and less autonomous - worse off.

In sum, while a "no-tax-on-overtime" policy is intended to give hard-working individuals tax relief, it would create unintended consequences that incentivize certain economic behaviors that distort labor markets and create winners and losers.

Congress should instead look to design tax policy that is pro-growth, minimizes market distortions, and does not penalize nor give preferential treatment to certain types of work.

