

STATE CONTROLLER'S OFFICE
PERSONNEL AND PAYROLL SERVICES DIVISION
P.O. BOX 942850
SACRAMENTO, CA 94250-5878

DATE: February 17, 2026

PAYROLL LETTER #26-003

TO: All Agencies/Campuses in the Uniform State Payroll System

FROM: Lisa Dean, Chief
Personnel and Payroll Services Division

RE: OVERTIME INSTRUCTIONS FOR ONE BIG BEAUTIFUL BILL ACT

On July 4, 2025, the President signed H.R.1 into law [Pub. L. 119-21], known as the [One Big Beautiful Bill Act \(OBBBA\)](#). The One Big Beautiful Bill Act provides a temporary exemption of the overtime premium from federal income taxation of overtime pay when the employee files their income taxes. For tax year 2025, the State Controller's Office (SCO) reported the Qualified Overtime Compensation amounts in Box 14 of Form W-2. Under the OBBBA, Qualified Overtime Compensation means overtime compensation paid to an individual required under [Section 7 of the Fair Labor Standards Act \(FLSA\) of 1938](#) that is in excess of the regular rate (as used in such section) at which such individual is employed.

Example – Qualifying Overtime:

If an employee works 50 hours in a work week at a regular rate of \$20 per hour, the amount of Qualified Overtime Compensation that can be reported is \$100. This is calculated as follows:

0.5 (the overtime increment) \times $\$20$ (the regular rate of pay) \times 10 (the hours of overtime) = $\$100$.

The reported amount does not include the straight-time portion of the overtime hours ($\$20$ regular rate \times 10 hours).

Example – Overtime that Does Not Qualify:

If an employee is compensated for 48 hours in a work week but used 8 hours of a leave benefit (resulting in physical hours of regular hours worked not exceeding 40 hours). Although the employee is paid 8 hours of overtime, 8 hours do not qualify for reporting as Qualified Overtime Compensation.

It's important to note that overtime compensation required by state law, or a Memorandum of Understanding (MOU) and not by the FLSA does not qualify to be reported as Qualified Overtime Compensation.

Therefore, the State Controller's Office must report only overtime payments that meet the FLSA criteria as Qualified Overtime Compensation. The overtime code field on the overtime payment is the key attribute used to include or exclude the amounts for reporting.

- Overtime code = blank or "2," it will be excluded from the reporting.

- For a list of Overtime codes, please refer to the [Payroll Procedures Manual \(PPM\)](#) Section B 014.1.

Processing Payments

Agencies and campuses must use special processing for employees whose MOU overtime provisions differ from the FLSA requirements.

Example:

If an employee is compensated for 50 hours in a work week, used 8 hours of a leave, and did not physically work more than 40 hours. Due to the MOU provision, all 10 hours of overtime are paid at 1.5 overtime factor, but only 2 hours qualify for reporting.

In this scenario, pay must be processed using the following transactions:

- 2 hours paid with 1.5 overtime factor (Overtime code 1)
- 8 hours paid with 1.0 overtime factor (Overtime code blank)
- 8 hours paid with 0.5 overtime factor (Overtime code 2)

This ensures that only the 2 hours of qualifying hours are captured and reported as Qualified Overtime Compensation in accordance with the reporting requirements.

Important Reminders

If payments are not processed using the correct overtime factor, the total Qualified Overtime Compensation reported on employees' Form W-2s will be incorrect.

Employees should work with the department/campus for supplemental documentation if their Qualified Overtime Compensation were captured incorrectly on their Form W-2s, as no corrected Form W-2s will be provided by SCO.

Employees should consult with their tax advisor on what to claim when filing their taxes.

To avoid reporting errors from occurring, be sure to do the following:

- Use the special processing instructions above
- Use the correct earnings identifier when processing via Payroll Input Process (PIP).
- Use the correct earnings identifier and overtime factor when processing via the [File Transfer Protocol](#) (FTP). Do not leave the required field blank.

PPSD and CSU Contact Information:

- [PPSD Contacts and Additional Information](#)
- [Campus Information Retrieval System \(CIRS\) | Contact Email](#)

Web Resources:

- [For HR Personnel](#)
- [For State Employees](#)