



## Bill Analysis

Author: Macedo

Sponsor:

Bill Number: AB 2336

Related Bills: See Legislative  
History

Introduced: February 19, 2026

### SUBJECT

Gross Income Exclusion for Overtime Pay and Pension Distributions

### SUMMARY

This bill would, under the Personal Income Tax Law (PITL), for taxable years beginning on or after January 1, 2026, and before January 1, 2031, provide a gross income exclusion for (1) overtime pay and (2) proceeds from a defined benefit plan, not to exceed \$25,000 for each exclusion.

### RECOMMENDATION

No position—The three-member Franchise Tax Board has not formally voted or taken a position on this bill.

### SUMMARY OF AMENDMENTS

Not applicable.

### REASON FOR THE BILL

The reason for the bill is to provide financial support to both working and retired Californians.

### ANALYSIS

This bill would, under the PITL, for taxable years beginning on or after January 1, 2026, and before January 1, 2031, provide a gross income exclusion for the following:

- The first \$25,000 of overtime pay received during the taxable year.
- The first \$25,000 received by a taxpayer as proceeds from a defined benefit plan (Pension plan) as specified in Section 414(j) of the Internal Revenue Code (IRC), which means any plan that is not a defined contribution plan, during the taxable year.

Lastly, the bill includes language to comply with Revenue and Taxation Code section 41, which states the goal of the gross income exclusions is to give financial support to those working extra hours to afford increasing costs and those on limited retirement income. The Legislature would find and declare that there is no available data to collect or report with respect to the exclusion.

#### *Effective/Operative Date*

As a tax levy, this bill would be effective immediately upon enactment and both the gross income exclusion for overtime pay and proceeds from a defined benefit plan, would be specifically operative for taxable years beginning on or after January 1, 2026, and before January 1, 2031.

#### *Federal/State Law*

Federal and state laws provide that gross income includes all income from whatever source derived, including compensation for services, business income, gains from property, interest, dividends, rents, and royalties, unless specifically excluded. Types of income currently excluded include amounts received as a gift or inheritance, certain compensation for injuries and sickness, educational assistance programs, foster care payments, interest received on certain state or federal obligations, and qualified scholarships.

#### *Overtime pay*

Current federal law allows a deduction of an amount equal to qualified overtime compensation received during the taxable year, not to exceed \$12,500 (\$25,000 for married filing joint), for taxable years beginning on or after December 31, 2024, and before January 1, 2029. Qualified overtime must be reported on information returns and statements furnished to the taxpayer. The deduction is reduced by \$100 for each \$1,000 by which the taxpayer's modified adjusted gross income exceeds \$150,000 (\$300,000 in the case of a joint return). This deduction is available as an itemized deduction or in addition to the standard deduction for taxpayers who do not itemize. "Qualified overtime compensation" is defined as overtime compensation paid to an individual as required under section 7 of the Fair Labor Standards Act of 1938 that exceeds the regular rate of pay to the employed individual. Qualified overtime compensation does not include any qualified tips. Federal law also requires a valid Social Security Number (SSN) to be provided on the tax return to claim the deduction. An omission of the correct SSN on the return is treated as a math or clerical error. Additionally, in the case of a married individual, they must file a joint return to claim the deduction.

## Employer-sponsored retirement plans

Under federal and state law, the most common type of tax-favored employer-sponsored retirement plan is a qualified retirement plan, which may be a defined benefit plan or a defined contribution plan. A defined benefit plan is an employer-sponsored plan that the employer funds and manages, and an employee must work for a set period. This is commonly known as a pension plan.

A defined contribution plan is an employer sponsored retirement plan where both the employer and employee can make regular contributions into an individual account. A defined contribution plan may include a qualified cash or deferred arrangement under which employees may elect to make plan contributions (elective deferrals). The maximum annual dollar amount of elective deferrals that can be made by an employee for a year is \$24,500 (for 2026). For an employee who attains age 50 by the end of the year, the dollar limit on elective deferrals is \$32,500 (for 2026), which includes an additional \$8,000 in catch-up contributions. An employee's elective deferrals must be fully vested. A defined contribution plan includes IRC 401(k), IRC 403(b), IRC 457(b) and Simplified Employee Pension (SEP) Individual Retirement Account (IRA), Simple IRA, profit sharing plans and Thrift Savings Plans.

California automatically conforms to deferred compensation, consisting of IRC sections 401 through 420, without regard to taxable year to the same extent as applicable for federal income tax purposes.

## Section 41

Under existing state law, legislation that would create a new tax expenditure, which includes a credit, deduction, exemption, or any other tax benefit as provided for by the state, is required to include specific goals, purposes, objectives, detailed performance indicators and data collection requirements measures to allow the Legislature to evaluate the effectiveness of the tax benefit. Legislation that would create an income exclusion would not require detailed performance indicators and data collection requirements performance measures if the Legislature determines there is no available data to collect and report.

### *Implementation Considerations*

The Franchise Tax Board (FTB) has identified the following implementation considerations and is available to work with the author's office to resolve these and other considerations that may be identified.

The bill uses the term "overtime pay". However, the bill does not define the term, and this could lead to taxpayer confusion. For clarity, the author may wish to amend the bill to define this term.

### *Technical Considerations*

For consistency and clarity, it is recommended in Sections 17147(b) and 17147.1(b), to replace "operative only until January 1, 2031," with "in effect only until December 1, 2031".

### *Policy Considerations*

The bill would allow gross income exclusions without an income limitation. If this is contrary to the author's intent, the author may wish to amend the bill to add an income limitation.

## **LEGISLATIVE HISTORY**

AB 1550 (Sanchez, 2025/2026) would, under the PITL, for taxable years beginning on or after January 1, 2026, and before January 1, 2029, conform, with modifications, to the federal law that allows a deduction for qualified tips and overtime compensation. AB 1550 is currently in the Assembly Committee process.

SB 17 (Ochoa Bogh, et al., 2025/2026), would have, under the PITL, for taxable years beginning on or after January 1, 2026, treated tips as gifts that would be excluded from gross income. Under the Administration of Franchise and Income Tax Laws this bill would have excluded tips from supplemental wages subject to withholding for purposes of the wage withholding tables that are prepared by the FTB. Under the Unemployment Insurance Code, this bill would have excluded tips from wages for unemployment purposes. The bill would have also made changes to other related provisions. SB 17 did not pass out of Assembly Revenue and Taxation Committee by the required deadline.

## **PROGRAM BACKGROUND**

None noted.

## **OTHER STATES' INFORMATION**

None noted.

## **FISCAL IMPACT**

The FTB's costs to implement this bill have yet to be determined. As the bill moves through the legislative process, costs will be determined.

**ECONOMIC IMPACT**

*Revenue Estimate*

This bill would result in the following revenue loss:

Estimated Revenue Impact of AB 2336 as Introduced January 19, 2026  
 Assumed Enactment after June 30, 2026

(\$ in Millions)

<b>Fiscal Year</b>	<b>Revenue</b>
2026-2027	-\$5,500
2027-2028	-\$3,700
2028-2029	-\$3,800

This analysis does not account for changes in employment, personal income, or gross state product that could result from this bill or for the net final payment method of accrual.

*Revenue Discussion*

The overtime exclusion estimate is based upon a proration of the Joint Committee on Taxation (JCT) federal tax expenditure estimate for deductions of overtime compensation. In July 2025, the JCT estimated the federal revenue impact of the overtime compensation deduction to be \$33 billion in the 2025-26 fiscal year. The combined corresponding loss to California, after adjusting for the differences between the federal law and the exclusion proposal provided for in this bill, is estimated to be \$2 billion in the 2026 taxable year.

Based on data from the US Bureau of Labor Statistics and the National Institute on Retirement Security, it is estimated that there will be 2.8 million defined benefit plan recipients who would be eligible to claim the exclusion. After applying the exclusion limit, there will be an estimated \$64 billion defined benefit payments excluded in the 2026 taxable year. After applying an average tax rate of 3 percent, the revenue impact is estimated to be \$1.6 billion in the 2026 taxable year.

The tax year estimates are converted to fiscal year estimates, combined, and then rounded to arrive at the amounts reflected in the above table.

**LEGAL IMPACT**

None noted.

**EQUITY IMPACT**

None noted.

**APPOINTMENTS**

None noted.

**SUPPORT/OPPOSITION**

To be determined.

**ARGUMENTS**

To be determined.

**LEGISLATIVE CONTACT**

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