



Indiana Department of Revenue

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Income Tax Information Bulletin #128

Subject: Deductions for Tips, Overtime, and Vehicle Loan Interest

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Introduction

In 2026, the Indiana General Assembly enacted IC 6-3-2-31, IC 6-3-2-32, and IC 6-3-2-33, which created new deductions for tips, overtime compensation, and qualified passenger vehicle loan interest. However, these deductions are in place only for the 2026 tax year.

Definitions and Applicable Rules

For purposes of this bulletin, except where the context clearly indicates otherwise, “qualified tips” has the same meaning provided in IRC § 224(d).

“Qualified overtime compensation” has the same meaning provided in IRC § 225(c).

“Qualified passenger vehicle loan interest” has the same meaning provided in IRC § 163(h)(4)(B).

“Exemption” means a provision under IC 6-3 or IC 6-3.6 that treats income as not subject to tax for purposes of the relevant tax. Exemptions include but are not limited to:

- The deduction under IC 6-3-2-27.5 for compensation earned by nonresidents working in Indiana for 30 days or fewer.
- The exemption under IC 6-3-5 for compensation earned by residents of Kentucky, Michigan, Ohio, Pennsylvania, and Wisconsin.
- The exclusion for nonresidents under IC 6-3.6-2-2(1) for income derived from counties other than the taxpayer’s principal place of business or employment.
- The exclusion for Perry County residents for income derived from certain Kentucky localities under IC 6-3.6-8-7.

The term “exemption” does not include the personal exemptions, dependent exemptions, and other exemptions allowable under IC 6-3-1-3.5(a)(3), (a)(4), and (a)(5). An exemption also does not include the deductions provided under IC 6-3-2-31 and IC 6-3-2-32.

Any reference to a form and/or line number relates to the 2025 version of the forms. If the relevant federal form and/or line numbers change after publication of this bulletin, use the federal form and/or line numbers applicable to 2026.

If federal regulations have been adopted or are adopted to further refine or clarify the terms defined above, Indiana will follow the terms as modified by the federal regulations.

Treatment of Qualified Tips

For 2026, Indiana allows a deduction in determining Indiana adjusted gross income for qualified tips. The Indiana deduction begins with the amount of qualified tips allowable as a deduction for federal income tax purposes, including income phaseouts and disallowances for married individuals filing separate returns. This is the amount reported as a deduction on line 13 of Schedule 1-A (Form 1040). The Indiana deduction cannot exceed the deduction allowable in determining a taxpayer’s federal taxable income.

If an exemption applies, the deduction is equal to the federal deduction multiplied by the ratio of:

- Qualified tips subject to Indiana state or local tax after the application of exemptions but before the deductions allowable under IC 6-3-2-31 and IC 6-3-2-32, over
- Qualified tips included in federal adjusted gross income.

If an exemption results in a different amount of qualified tips included in adjusted gross income for state purposes and for local income tax purposes, the formula above is to be applied separately for determining the state adjusted gross income tax deduction and the local adjusted gross income tax deduction.

Example #1: In 2026, Gina resides in Illinois and has a principal place of work in Lake County, Indiana as of January 1, 2026. Gina also worked briefly in Porter County, Indiana, and Cook County, Illinois. Gina received \$30,000 in qualified tips. Of the \$30,000 in tips, \$21,000 were from Lake County, Indiana, \$6,000 from Porter County, Indiana, and \$3,000 from Cook County, Illinois. Gina claimed \$25,000 as a deduction for qualified tips on her 2026 Form 1040, Schedule 1-A.

For state adjusted gross income tax purposes, \$27,000 of qualified tips were included in her state adjusted gross income. Her deduction allowable for state purposes is \$22,500 (\$25,000 times \$27,000 divided by \$30,000, or 90%). For determining her Lake County income tax, only \$21,000 of qualified tips is included in her adjusted gross income. Her deduction for local income tax purposes is \$17,500 (\$25,000 times \$21,000 divided by \$30,000, or 70%). The portion of tips attributable to Porter County or Cook County, Illinois are not allowed for local income tax purposes.

Example #2: In 2026, Gina resides in Illinois and has a principal place of work in Illinois on January 1, 2026. Gina worked in Indiana for 25 days total and was eligible to claim the exemption for compensation under IC 6-3-2-27.5. Gina received \$30,000 in qualified tips. Of the \$30,000 in tips, \$3,000 were from Indiana and \$27,000 from Cook County, Illinois. Gina also received \$30,000 in hourly compensation, allocated in the same proportion as qualified tips and \$20,000 in gambling income from Indiana. Gina claimed \$25,000 as a deduction for qualified tips on her 2026 Form 1040, Schedule 1-A.

Gina was able to claim an exemption—the deduction provided under IC 6-3-2-27.5—for all of her qualified tips. She may not claim an additional deduction for qualified tip income.

Example #3: In 2026, Gina resides in Michigan and has a principal place of work in St. Joseph County, Indiana on January 1, 2026. Gina received \$30,000 in qualified tips, all from St. Joseph County. Gina claimed \$25,000 as a deduction for qualified tips on her 2026 Form 1040, Schedule 1-A.

Gina was able to claim an exemption—the reciprocal-state income exemption provided under IC 6-3-5—for all of her qualified tips. She may not claim an additional deduction for qualified tip income for state income tax purposes. However, for determining her St. Joseph County income tax, Gina may deduct the entire \$25,000 allowable deduction in determining her income subject to St. Joseph County income tax.

For married individuals filing a joint return, the proration of qualified tips and allocation of the Indiana deduction shall be applied in a manner that the individuals determine based on their circumstances, including counties of residence or principal work and exemptions. However, married individuals may not allocate the deduction in a manner that results in one spouse claiming a deduction in excess of their qualified tips otherwise allowable as a deduction as if the spouse was not married. In addition, if married individuals are subject to local income tax in different counties, their allocation carries over to local income tax.

Example 4: Phil and Susan are a married couple filing jointly for 2026. Phil and Susan are residents of another state. Phil has a principal place of employment in Porter County, Indiana and Susan has a principal place of employment in Lake County, Indiana for local income tax purposes. Phil received \$20,000 in tip income, \$15,000 from Porter County, Indiana and \$5,000 from another state. Susan received \$30,000 in tip income, \$12,000 from Lake County, Indiana and \$18,000 from another state. Phil and Susan claimed a \$25,000 qualified tip deduction for federal purposes. Assume no exemptions apply to the qualified tips.

If Phil was single, Phil would have been permitted a maximum \$15,000 Indiana deduction. If Susan was single, Susan would have been permitted a maximum \$10,000 Indiana deduction (\$25,000 times \$12,000 divided by \$30,000, or 40%).

Phil and Susan's deduction is determined by using the following steps:

Step 1: Allocate the federal deduction between Phil and Susan. No set allocation is required except that, under the facts presented, Phil cannot be allocated more than \$20,000 in tips.

Step 2: Determine Phil's deduction by taking the federal deduction allocated to Phil and multiplying that by 75% (\$15,000 divided by \$20,000).

Step 3: Determine Susan's deduction by taking the federal deduction allocated to Susan and multiplying that by 40% (\$12,000 divided by \$30,000).

The state deduction is the sum of the second and third steps unless an exemption applies. If Phil and/or Susan have exemptions that apply, those deductions are also applied to state and local income tax as otherwise provided above in examples 1 through 3 above. The portion of the deduction allowable for county income tax purposes is determined in the same manner. However, the allocation used in the first step must also be used for local income tax purposes.

For Indiana residents, the deduction for state adjusted gross income tax is the same amount allowable in determining federal taxable income. For local income tax purposes, the deduction also is the same as the federal deduction except in isolated cases of Perry County residents and individuals domiciled in Indiana but residing outside Indiana.

Qualified Overtime Compensation Deduction

For 2026, Indiana allows a deduction in determining Indiana adjusted gross income for qualified overtime compensation. The Indiana deduction begins with the amount of qualified overtime compensation allowable as a deduction for federal income tax purposes. This is the amount reported as a deduction on line 21 of IRS Schedule 1-A (Form 1040), including income phaseouts and disallowances for married individuals filing separate returns. The Indiana deduction cannot exceed the deduction allowable in determining a taxpayer's federal taxable income.

If an exemption applies, the deduction is equal to the federal deduction multiplied by the ratio of:

- Qualified overtime compensation subject to Indiana state or local tax after the application of exemptions but before the deductions allowable under IC 6-3-2-31 and IC 6-3-2-32, over
- Qualified overtime compensation included in federal adjusted gross income.

If an exemption results in a different amount of qualified overtime compensation included in adjusted gross income for state purposes and for local income tax purposes, the formula above is to be applied separately for determining the state adjusted gross income tax deduction and the local adjusted gross income tax deduction.

For married individuals filing a joint return, the proration of qualified overtime compensation and allocation of the Indiana deduction shall be applied in a manner that the individuals determine based on their circumstances, including counties of residence or principal work and exemptions. However, married individuals may not allocate the deduction in a manner that results in one spouse claiming a deduction in excess of their qualified overtime compensation otherwise allowable as a deduction as if the spouse was not married. In addition, if married individuals are subject to local income tax in different counties, their allocation carries over to local income tax.

The examples in the section above related to qualified tips also relate to qualified overtime compensation.

Deduction for Qualified Passenger Vehicle Loan Interest

For 2026, Indiana allows a deduction for individuals in determining Indiana adjusted gross income for qualified passenger vehicle loan interest. The Indiana deduction begins with the amount of qualified overtime compensation allowable as a deduction for federal income tax purposes. This is the amount reported as a deduction on line 30 of IRS Schedule 1-A (Form 1040), including income phaseouts. The Indiana deduction cannot exceed the deduction allowable in determining a taxpayer's federal taxable income.

For full-year Indiana residents, the deduction is equal to the federal deduction. If the taxpayer claiming the deduction is a resident of Indiana for only a portion of the year, the deduction is limited to the interest paid while an Indiana resident. If the taxpayer is a married couple filing jointly, the allowable interest shall be determined separately for each individual. Individuals may allocate the allowable Indiana deduction among themselves, provided that the individuals do not allocate a deduction to an individual larger than the amount that would have been allowable to the individual had the individual filed separately.

For local income tax purposes, a non-resident individual may claim the deduction only to the extent that other non-employment deductions such as the renter's deduction are allowable.

For purposes of this deduction, the location and registration of the vehicle are not determinative to the allowance of the deduction. For example, an Indiana resident may register and keep a vehicle in Florida and still qualify for the deduction. Conversely, a Florida resident who registers and keeps a car in Indiana does not qualify for the deduction.

Example #5: In 2026, Tom lived in Illinois on January 1, 2026 and becomes an Indiana resident on July 15, 2026 through the remainder of 2026. Tom purchased multiple vehicles and paid \$25,000 in qualifying passenger vehicle loan interest in 2026. Of the \$25,000 in interest, Tom paid \$13,000 while an Illinois resident and \$12,000 while an Indiana resident. Tom claimed a \$10,000 federal qualified passenger vehicle loan interest deduction. Tom can claim the lesser of the \$10,000 federal deduction or \$12,000 deduction for interest paid while an Indiana resident. Thus, Tom can claim an Indiana deduction of \$10,000.

Example #6: Same facts as Example 5 except that of the \$25,000 in interest, Tom paid \$16,000 while an Illinois resident and \$9,000 while an Indiana resident. Tom claimed a \$10,000 federal qualified passenger vehicle loan interest deduction. Tom can claim the lesser of the \$10,000 federal deduction or \$9,000 deduction for interest paid while an Indiana resident. Thus, Tom can claim an Indiana deduction of \$9,000.

Example #7: Same facts as Example 5 except that Tom claimed an \$8,000 federal qualified passenger vehicle loan interest deduction due to an income phaseout. Tom can claim the lesser of the \$8,000 federal deduction or \$12,000 deduction for interest paid while an Indiana resident. Thus, Tom can claim an Indiana deduction of \$8,000.

Example #8: In 2026, Jack lived in Indiana for the entire year. Diane lived in Illinois from January 1, 2026 through July 31, 2026, and Indiana for the remainder of the year. Jack and Diane filed a joint tax return for state and federal purposes for 2026. Jack incurred \$6,000 in qualified passenger vehicle loan interest while Diane incurred \$7,000. Of Diane's interest, \$4,000 was incurred while Diane was an Illinois resident and \$3,000 was incurred while Diane was an Indiana resident. Jack and Diane claimed a \$10,000 federal deduction for qualified passenger vehicle loan interest. Jack and Diane are permitted a \$9,000 state income tax deduction for the interest because \$9,000 was incurred while they were Indiana residents. However, for purposes of local income tax, Jack is limited to a \$6,000 deduction while Diane is limited to a \$3,000 deduction due to their respective shares of the Indiana deduction.

Example #9: In 2026, Jack lived in Indiana for the entire year. Diane lived in Illinois from January 1, 2026 through July 31, 2026, and Indiana for the remainder of the year. Jack and Diane filed a joint tax return for state and federal purposes for 2026. Jack incurred \$6,000 in qualified passenger vehicle loan interest while Diane incurred \$17,000. Of Diane's interest, \$10,000 was incurred while Diane was an Illinois resident and \$7,000 was incurred while Diane was an Indiana resident. Jack and Diane claimed a \$10,000 federal deduction for qualified passenger vehicle loan interest. Jack and Diane are permitted a \$10,000 state income tax deduction for the interest because \$13,000 was incurred while they were Indiana residents. The \$13,000 is limited to \$10,000 because of the federal deduction limitation.

However, for purposes of local income tax, Jack's deduction is limited to \$6,000 while Diane's deduction is limited to a \$7,000 deduction. They may allocate an aggregate \$10,000 deduction within these limitations.

Example #10: In 2026, Jack and Diane lived in Indiana for the entire year. On January 1, 2026, Jack was a Marion County resident while Diane was a Hamilton County resident. Jack and Diane filed a joint tax return for state and federal purposes for 2026. Jack incurred \$11,000 in qualified passenger vehicle loan interest while Diane incurred \$11,000. Jack and Diane claimed a \$10,000 federal deduction for qualified passenger vehicle loan interest. Jack and Diane are permitted a \$10,000 state income tax deduction for the interest because \$22,000 was incurred while they were Indiana residents. The \$22,000 interest deduction is limited to \$10,000 because of the federal deduction limitation.

However, for purposes of local income tax, Jack and Diane must allocate the \$10,000 deduction between themselves.

State and Local Tax Credits for Qualified Tips and Qualified Overtime Compensation

For purposes of determining the credits for taxes paid to other states or local jurisdictions paid in other states, the following apply:

1. For Indiana state and local taxes, the amount paid to Indiana (or an Indiana county) on qualified tips and qualified overtime compensation subject to tax is computed after the Indiana-specific deductions allowable against the income.
2. Any out-of-state taxes allowable as a credit is determined after any deductions allowable by the other state (or locality in another state) against qualified tips or qualified overtime compensation in determining the tax imposed by that other state.

Example #11: In 2026, Tom is an Indiana resident but worked in Illinois. Tom earned \$10,000 in qualified overtime compensation, \$50,000 in other compensation from Illinois sources, and \$5,000 in interest attributable solely to Indiana. Illinois does not permit a deduction or exclusion for qualified overtime compensation. Tom reported \$60,000 on his Illinois income tax return and paid \$2,840 in tax to Illinois. Tom claimed the \$10,000 qualified overtime compensation deduction on his IT-40. If his income from Illinois is disregarded, his Indiana adjusted gross income is reduced by \$50,000 (\$60,000 total compensation minus \$10,000 Indiana deduction against such income). Assuming no other Indiana tax credits, Tom's Indiana tax liability on the qualified overtime compensation is \$50,000 times .0295, or \$1,475. Tom's credit for out of state taxes is \$1,475.

Example #12: In 2026, Gina is a Ripley County, Indiana resident working in Cincinnati, Ohio. Gina earns \$30,000 in tips, \$40,000 in regular compensation from Ohio, and \$5,000 in interest attributable solely to Indiana. Gina's tips are permitted the Indiana-specific \$25,000 deduction but are not subject to a similar deduction for Cincinnati local income tax. Gina has no other local income tax credits available for Indiana. Gina's Cincinnati local income tax liability is \$1,260 (\$70,000 times 1.8%). Gina's liability to Ripley County on her compensation is \$1,071 (\$45,000, her compensation after the tips deduction, times 2.38%). Gina's Indiana credit for local income taxes is the lesser of \$1,260 due to Cincinnati and \$1,071 on the post-deduction compensation subject to Ripley County income tax, or \$1,071.

If you have any questions concerning this bulletin, contact the Tax Policy Division at taxpolicy@dor.in.gov.



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