2026

PAYROLL

EXECUTIVE BRIEF

MIDYEAR UPDATE

What every CEO, CFO, CHRO, and payroll leader needs to know now

Federal reporting changes. Wage-and-hour risk. AI-enabled payroll. Second-half action plan.

$184,500	$684/week	$16.90	$70,304
2026 Social Security wage base [1]	Federal EAP salary threshold [2]	California minimum wage [3]	California exempt salary floor [4]

THE EXECUTIVE TAKEAWAY

The biggest 2026 payroll risk is not a single tax rate. It is whether payroll, time, HR, and vendor systems can produce defensible data for new W-2 reporting while leaders continue adopting AI-enabled automation. The organizations that test now will avoid a year-end scramble. The organizations that wait will discover their data gaps when correction time is most expensive.

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01 Executive Summary

The six issues that deserve leadership attention in the second half of 2026

1 2026 W-2 redesign

The 2026 Form W-2 adds reporting for cash tips, qualified overtime, tipped occupation codes, and certain employer contributions. Map earning codes and validate source data now. [5]

2 Overtime rule reset

DOL restored the 2019 federal thresholds: $684 per week for most EAP exemptions and $107,432 for certain highly compensated employees. State rules may be higher. [2]

3 California wage pressure

California's statewide minimum wage is $16.90 per hour, driving a general exempt salary floor of $70,304. Local and industry-specific rates may be higher. [3][4]

4 Higher Social Security base

The 2026 OASDI wage base is $184,500, making the maximum employee Social Security withholding $11,439. [1][6]

5 AI moves from assist to act

Workday, ADP, and UKG are expanding payroll agents and AI-enabled compliance capabilities. Define approval, audit-log, and segregation-of-duties controls. [11][12][13]

6 Continuity is enterprise risk

Complex reporting, vendor changes, thin teams, and leadership vacancies create operational fragility. Treat payroll continuity as an enterprise discipline, not merely staffing.

LEADERSHIP QUESTION

Can your organization explain exactly where the data for every employee's 2026 W-2 came from - including the earning code, time source, calculation rule, manual adjustment, approval, and final tax treatment? If the answer is not immediate, the control environment needs work.

02 Federal Payroll Tax and W-2 Changes

The new reporting burden is a system-design issue, not a year-end form issue

The 2026 Form W-2 is materially different. Box 14 is split into box 14a and new box 14b. New box 12 codes include TP for cash tips, TT for qualified overtime compensation, and TA for qualifying employer contributions to Trump Accounts. Box 14b is used for Treasury tipped occupation codes. [5]

What payroll must distinguish

- Qualified tips versus mandatory service charges. Mandatory service charges are not qualified tips. Tips remain generally subject to federal income tax withholding and Social Security and Medicare taxes. [7]
- Qualified overtime versus total overtime paid. Code TT applies to the premium amount above the regular rate that is required under FLSA section 7 - generally the "half" portion of time-and-a-half. [5][7]
- Federal FLSA overtime versus state-only or contractual overtime. California daily overtime, double time, union premiums, and company-policy overtime may not all qualify for the federal deduction. Systems should not assume every overtime earning code belongs in code TT.
- Tipped occupation codes. Employers reporting cash tips under code TP must also report qualifying occupation codes in box 14b. [5]
- Employer contributions beginning July 4, 2026. Qualifying employer contributions to Trump Accounts are reported using code TA. [5]

DO NOT MISCOMMUNICATE "NO TAX ON TIPS/OVERTIME"

These provisions are individual income-tax deductions. Qualified tips and overtime generally remain subject to payroll withholding and employment taxes. Employees may update Form W-4 or use the IRS withholding estimator, but payroll should not simply stop taxing these earnings. [7][8]

Other 2026 federal items

- The Social Security wage base increased to $184,500; maximum employee Social Security tax is $11,439. [1][6]
- The wage reporting threshold increased from $600 to $2,000 for certain wages where no federal income, Social Security, or Medicare tax was withheld. [5][9]
- The IRS now allows direct deposit for employment tax refunds. Employers may still elect to apply an overpayment to a future return. [9]
- The 2026 W-2 filing and employee-furnishing deadline is February 1, 2027. [10]

03 Wage-and-Hour and Classification

Federal rules reset, but state and local requirements continue to drive risk

Federal white-collar exemptions

On May 14, 2026, the U.S. Department of Labor restored the operative 2019 regulations after the 2024 rule was judicially vacated. Most executive, administrative, and professional employees must be paid at least $684 per week, and the highly compensated employee threshold is $107,432. Duties tests and salary-basis requirements still apply. [2]

California 2026 thresholds

$16.90	$70,304	$58.85/hr	$107.17/hr
State minimum wage	General exempt salary floor	Computer software hourly exemption	Physician/surgeon hourly exemption

California's statewide minimum wage is $16.90 per hour for all employers, with higher rates for covered fast-food and health-care workers and potentially higher local rates. The general salary floor for executive, administrative, and professional exemptions is $70,304. [3][4][14][15]

Independent contractor classification

On February 26, 2026, the Department of Labor proposed rescinding the 2024 independent-contractor rule and returning to an analysis similar to the 2021 approach. This remains a proposed rule, not a final standard. Organizations should continue following applicable current law and monitor the rulemaking rather than changing classifications prematurely. [16]

PAYROLL CONTROL

Build a jurisdiction matrix that ties each employee to the correct minimum wage, overtime rule, exempt threshold, pay-frequency rule, and local tax setup. Do not rely on a single "state" field when city, county, worksite, remote-work location, union agreement, or industry coverage changes the result.

04 AI in Payroll

Agentic payroll is arriving faster than most control frameworks

Major payroll platforms are moving beyond chat and recommendations toward agents that monitor data, identify anomalies, automate multi-step work, and help resolve issues before payroll finalization. Workday describes a Payroll Agent that monitors data health and streamlines payroll input; ADP has launched AI agents and expanded SmartCompliance; UKG introduced Pro Pay with Workforce AI to detect, analyze, and resolve potential payroll issues in real time. [11][12][13][17]

Minimum governance standard for payroll AI

Control	Required practice
Human approval	No AI agent should independently release payroll, transmit tax files, change bank details, alter tax setup, or modify an employee’s classification without defined human approval.
Auditability	Retain prompts, recommendations, actions taken, source data, approver identity, timestamp, and before/after values.
Access and segregation	Separate the ability to identify an issue, edit the data, approve the correction, and release funds.
Data protection	Know what employee data leaves the platform, how it is used for model training, where it is stored, and how long it is retained.
Exception thresholds	Define which dollar amounts, employee populations, and change types require escalation.
Fallback procedures	Maintain documented manual processes for payroll completion if an AI service or integration fails.

THE RIGHT QUESTION

Do not ask only, “Is the AI accurate?” Ask, “Can we prove what it did, why it did it, who approved it, and how we would recover if it were wrong?”

05 Top Payroll Risks for 2026

Where costly failures are most likely to emerge

1. W-2 mapping failure	New tip, overtime, occupation-code, and contribution fields are not mapped or tested across time, payroll, HRIS, and year-end vendors.	**Complete a data dictionary and trace each field from source to W-2 output.**
2. Overtime qualification errors	All overtime earnings are treated as qualified federal overtime, even when amounts arise from state law, union rules, shift premiums, or company policy.	**Create separate earning codes and document federal eligibility logic.**
3. Jurisdiction mismatch	Remote or mobile employees are taxed or paid using the home-office location instead of the work location.	**Perform work-location validation and local-rate audits.**
4. AI without controls	Agents can recommend or execute changes without clear approval, audit logs, or segregation of duties.	**Adopt payroll-specific AI governance before enabling autonomous actions.**
5. Reconciliation weakness	W-2, W-3, Form 941, general ledger, benefit, and third-party sick-pay totals are not reconciled early enough.	**Run quarterly and pre-year-end reconciliations, not only January clean-up.**
6. Leadership and key-person dependency	Critical knowledge exists in one leader's inbox, memory, or spreadsheet.	**Document decision rights, calendars, vendor contacts, and emergency payroll procedures.**
7. Worker classification exposure	Contractor, exempt/nonexempt, and statutory employee classifications drift from actual work.	**Use periodic cross-functional classification reviews.**

06 Second-Half 2026 Action Timeline

A practical sequence for getting ahead of year-end

JULY Lock the design

Inventory all tip and overtime earning codes. Confirm vendor readiness for 2026 W-2 codes TP, TT, TA and box 14b. Review July 1 local wage changes. File Q2 Form 941 by July 31. [5][18]

AUGUST Trace the data

Document source-to-output lineage for tips, overtime premiums, occupation codes, manual checks, retro pay, and third-party sick pay. Identify state-only and contractual overtime.

SEPTEMBER Test before quarter-end

Run a mock 2026 W-2 file for a representative employee population. Validate high earners reaching the $184,500 wage base. Confirm Social Security withholding caps. [1][6]

OCTOBER Reconcile and govern

Complete Q3 reconciliation and prepare Form 941, due November 2 because October 31 falls on a Saturday. Finalize payroll AI approval and fallback controls. [19]

NOVEMBER Run the full dress rehearsal

Reconcile payroll register, Forms 941, general ledger, benefit files, stock compensation, third-party sick pay, and year-end W-2 output. Resolve exceptions before the final payroll.

DECEMBER Control the close

Freeze year-end mappings, restrict manual adjustments, confirm off-cycle approval rules, communicate employee deadlines, and validate final payroll calendar and banking cutoffs.

JAN-FEB 2027 File cleanly

Complete final W-2/W-3 reconciliation. Furnish and file 2026 Forms W-2 by February 1, 2027. [10]

07 Executive Readiness Checklist

Use this to assign ownership and force decisions before year-end

Done	Control	Owner	Target
☐	W-2 reporting owner named	**Payroll / Tax**	**July**
☐	2026 W-2 field mapping completed	**Payroll Systems**	**August**
☐	FLSA-qualified overtime logic documented	**Payroll + Legal**	**August**
☐	Tipped occupation population validated	**Payroll + HR**	**August**
☐	Mock W-2 file tested	**Payroll + Vendor**	**September**
☐	Federal/state/local wage matrix reviewed	**HR Compliance**	**Quarterly**
☐	AI approval and audit controls approved	**Payroll + IT + Internal Audit**	**October**
☐	Emergency payroll continuity plan tested	**Payroll Leadership**	**October**
☐	941-to-W-2-to-GL reconciliation completed	**Payroll Accounting**	**November**
☐	Final year-end go/no-go review held	**CFO / CHRO / Payroll**	**December**

WHEN TO BRING IN HELP

Bring in outside payroll continuity support when the payroll leader role is vacant, year-end readiness is behind, the team cannot explain new reporting logic, a platform change is underway, reconciliations are unresolved, or critical knowledge lives with one person. The goal is not to replace the team. It is to stabilize decisions, expose risk, and keep payroll moving.

08 Sources and Verification Notes

Official sources used for this July 10, 2026 midyear update

[1] Social Security Administration - Contribution and Benefit Base Determination
[2] U.S. Department of Labor - May 14, 2026 technical amendment restoring 2019 exemption thresholds
[3] California Department of Industrial Relations - 2026 minimum wage
[4] California DIR - 2026 minimum wage and exempt salary threshold announcement
[5] IRS - General Instructions for Forms W-2 and W-3 (2026)
[6] IRS - 2026 Form W-2 instructions and Social Security withholding limit
[7] IRS - Publication 15-T (2026), qualified tips and overtime withholding
[8] IRS - Updated Tax Withholding Estimator reflects new deductions
[9] IRS - Payroll Professionals Tax Center, 2026 reporting and refund updates
[10] IRS - 2026 Forms W-2/W-3 filing deadline
[11] Workday Marketplace - Payroll Agent
[12] ADP - AI agents for workforce challenges, January 28, 2026
[13] UKG - Pro Pay with Workforce AI, May 11, 2026
[14] California DIR - Computer software employee exemption rates for 2026
[15] California DIR - Licensed physician and surgeon exemption rate for 2026
[16] U.S. Department of Labor - February 26, 2026 independent contractor proposed rule
[17] ADP - SmartCompliance AI enhancements, June 3, 2026
[18] IRS - Third quarter 2026 tax calendar
[19] IRS - Employment tax due dates

IMPORTANT

This brief is an executive operational overview, not legal or tax advice. Federal, state, local, industry, union, and employee-specific rules can differ. Confirm implementation decisions with qualified legal or tax counsel and your payroll vendor.