



State of North Carolina

Office of the State Controller

Michael F. Easley, Governor

Robert L. Powell, State Controller

January 24, 2007

MEMORANDUM NO. PYR2007-001

TO: All Agencies and Universities Served by the Office of the State Controller Central Payroll Section

FROM: Edith Cannady
Office of the State Controller – Central Payroll Section

SUBJECT: Refunds of Prior Year Pre-Tax and Income Tax Deferred Deductions

The Central Payroll System has been modified to reject any refund that would create a negative year-to-date balance on the system for any deductions that impact the W-2 forms generated at year-end. This change prevents the accidental keying of refunds to non-eligible deduction codes and the improper alteration of year-to-date tax data.

Beginning January 2007, prior year refunds for the deduction codes listed in this memorandum will no longer be processed in their original form through the Central Payroll System. The method by which prior year refunds are to be handled depends on the type of refund due to the employee.

Pre-Tax Deductions

Pre-tax deductions impact an employee's income tax and FICA subject wages. A refund of a prior year pre-tax deduction requires that earnings be reported on the employee's W-2 for the year in which the refund is processed. Pre-tax deductions processed on the Central Payroll System include the following:

Deduction Code	Description of Deduction
094	Institution Parking (Pre-Tax)
098	Department of Administration Parking (Pre-Tax)
400	NC Health Benefit Plan
401	NC Health Benefit Plan – Medicare Recipient
403	NC Health Benefit Plan – Non-Contributory
404	NC Health Benefit Plan – Prepayment
405	TriCare Hospitalization Plan
407	TriCare Hospitalization Plan – Non-Contributory
408	TriCare Hospitalization Plan - Prepayment
410	NC PPO Health Plan
411	NC PPO Health Plan – Medicare Recipient

MAILING ADDRESS
1410 Mail Service Center
Raleigh, NC 27699-1410

Telephone: (919) 981-5454
Fax Number: (919) 981-5567
State Courier: 56-50-10
Website: www.ncosc.net

LOCATION
3512 Bush Street
Raleigh, NC

412	NC PPO Health Plan – Non-Contributory
413	NC PPO Health Plan - Prepayment
445	NCFlex – Dependent Care Plan (Pre-Tax)
446	NCFlex – Health Care Plan (Pre-Tax)
448	NCFlex – Dental Plan (Pre-Tax)
449	NCFlex – Unum AD&D Plan (Pre-Tax)
450	NCFlex – Superior Vision Plan (Pre-Tax)
451	NCFlex – Health Care Plus Plan (Pre-Tax)
452	NCFlex – ING Term Life Plan (Pre-Tax)
454	NCFlex – Allstate Cancer Plan (Pre-Tax)

All prior year refunds of pre-tax deductions are now required to be processed as earnings on the payroll system in the current year. Eligible refunds are keyed as gross pay and are not subject to retirement (**retirement code 5** – subject to both FICA and income taxation). The appropriate payment cycle depends on the timing of the refund:

Type of Employee	Timing of Refund	Correct Payment Cycle
Inactive Employee	Not applicable	Q Cycle (flat tax rate)
Active Employee	Processed separately from the employee's regular payment cycle	Q Cycle (flat tax rate)
	Processed as a split on the employee's regular payment cycle (Pay Type must be RZ for the system to automatically delete the split before the next payroll run)	Split keyed on the employee's record (uses the withholding elections)

The account that should be keyed on the payroll system subhead is 531673, Refund of Prior Year Deduction Clearing. Employer FICA costs generated by the NCAS Payroll Interface will post to account 531513, Social Security Contributions – Undesignated. NCAS agencies will need to reclassify the 531513 entry to the appropriate account, as necessary.

Required Documentation and Reimbursements

Agencies and universities must submit to Central Payroll proper documentation to support prior year pre-tax refunds for the following deductions:

Deduction Code(s)	Description of Deduction	Documentation Required
098	Department of Administration (DOA) Parking	DOA Facility Management Monthly Refunds Due Report
445-452 454	NCFlex Plans	NCFlex Plan Administrator Authorization Form

Payments by the Central Payroll Section to the Department of Administration and applicable NCFlex vendors will be adjusted based on receipt of the appropriate documentation. Refunds of Pre-Tax DOA parking will be processed based on Facility Management's "Monthly Refunds Due Report." All other refunds must be supported by authorization from the appropriate NCFlex vendor.

The adjustment amount will be remitted back to the agency or university by Central Payroll. Agencies and universities should record the deposit of the refund against the same account keyed into the payroll

system, 531673, Refund of Prior Year Deduction Clearing. This account balance should be zero after the payment is recorded and **must always** be zero at the fiscal year end (June 29).

Pre-Tax Health Insurance Refunds

Prior year refunds of pre-tax health insurance premiums for the State Health Plan (indemnity and PPO plans) and the TriCare Hospitalization Plan are not remitted by Central Payroll back to the employing agency or university. Agency and university staff must manually adjust the health insurance billing to accommodate the refund. The adjustment amount attributable to the refund should be recorded against account 531673, Refund of Prior Year Deduction Clearing, when the payment made to the vendor. Once again, this account balance should be zero after the payment is recorded and **must always** be zero at the fiscal year end (June 29).

Institution Pre-Tax Parking Fees

Prior year refunds related to institution pre-tax parking refunds are not remitted to the individual universities by Central Payroll. It is the responsibility of each university to properly account for third party payments related to these types of refunds.

Income Tax Deferred Deductions

Deferred deductions do not impact FICA subject wages, but do reduce the wages reported as subject to federal and state income tax. Wage deferral deductions include the following:

Deduction Code	Description of Deduction
001	Perquisite – Board (Tax Deferred)
002	Perquisite – Dormitory (Tax Deferred)
003	Perquisite – Rent (Tax Deferred)
004	Perquisite – Utilities (Tax Deferred)
200	403(b) Annuity Plans (Tax Deferred)
225	401(k) Plans (Tax Deferred)
249	457(b) Plan (Tax Deferred)

Third Party Administrator (Vendor) Refunds of Prior Year Deductions

Annuities, tax deferred savings plans, and the 401(k) Roth savings plans are administered by third party vendors and include the following:

Deduction Code	Description of Deduction
200	403(b) Annuity Plans (Tax Deferred)
225	401(k) Plans (Tax Deferred)
249	457(b) Plan (Tax Deferred)
591	Roth 401(k) Plan (Post-Tax)

While the Roth plan is not a tax deferred savings plan, it is reported on an employee's W-2 form in much the same manner as the other annuities and savings plans. Refunds of prior year deductions cannot be processed on the Central Payroll System. The third party administrator is responsible for issuing directly to the employee any refund of a prior year deduction and generating a 1099-R form for that employee for the year in which the refund is processed.

Agency and University Refunds of Prior Year Deductions

Prior year tax deferred employee refunds that are the responsibility of the employing state agency or university include:

Deduction Code	Description of Deduction
001	Perquisite – Board (Tax Deferred)
002	Perquisite – Dormitory (Tax Deferred)

003	Perquisite – Rent (Tax Deferred)
004	Perquisite – Utilities (Tax Deferred)

Employees that are due a prior year refund for the deductions listed above are to be reimbursed in the same manner as prior year pre-tax refunds except that the appropriate retirement code is different. Prior year refunds of perquisites are required to be processed as earnings on the payroll system in the current year. Eligible refunds are keyed as gross pay and are not subject to retirement (**retirement code 6** – subject only to income taxation). The appropriate payment cycle depends on the timing of the refund:

Type of Employee	Timing of Refund	Correct Payment Cycle
Inactive Employee	Not applicable	Q Cycle (flat tax rate)
Active Employee	Processed separately from the employee's regular payment cycle	Q Cycle (flat tax rate)
	Processed as a split on the employee's regular payment cycle (must be manually removed after the payroll cycle is run)	Split keyed on the employee's record (uses the withholding elections)

The account that should be keyed on the payroll system subhead is 531673, Refund of Prior Year Deduction Clearing. Employer FICA costs are not generated for this type of refund.

Prior year refunds related to perquisites are not remitted to the individual agencies or universities by Central Payroll. It is the responsibility of each entity to properly account for third party payments related to these types of refunds.

Prior Year Refunds of Retirement Contributions

Employee retirement contributions are processed on the Central Payroll System as deferred tax deductions. If prior year corrections to retirement contributions cannot be adjusted in the current calendar year, then retirement refunds are processed through the payroll system in the same manner as perquisites. While the Retirement System will allow the refund of prior year employee contributions, employer contributions are non-refundable.

IMPORTANT NOTE: PRIOR YEAR RETIREMENT REFUNDS CANNOT BE REFUNDED TO THE EMPLOYEE UNTIL THE AGENCY OR UNIVERSITY HAS RECEIVED APPROVAL FROM CENTRAL PAYROLL (T&SE AND POA PLANS) OR REIMBURSEMENT FROM THE APPROPRIATE THIRD PARTY RETIREMENT VENDOR (OPTIONAL RETIREMENT PLANS).

Teachers' and State Employees' (T&SE) Retirement System and Power of Arrest (POA) Retirement Refunds

To request a refund of prior year T&SE or POA retirement contributions, agencies must complete the attachment to this letter, Form CPRET01, Prior Year Refund Request for TS&E or POA Retirement Contributions. Refunds collected by the Central Payroll Section from the Retirement System or the POA third party administrator will be remitted back to the agency or university.

Agencies or universities will process employee refunds through the payroll system using the same procedures identified in the section titled, *Agency and University Refunds of Prior Year Deductions*. However, refunds **cannot be processed on the payroll system until after** reimbursement has been received from Central Payroll.

Optional Retirement Plans

All universities that offer optional retirement plans must process employee refunds through the payroll system in the same manner as T&SE and POA retirement refunds. However, prior year optional retirement plan refunds are not remitted to the individual universities by Central Payroll. Each agency or university is responsible for contacting the retirement plan administrator to request refunds and is individually responsible for the proper accounting of amounts received.

Post-Tax Refunds for Prior Years

All other deductions processed on the Central Payroll System are post-tax deductions and require no special accounting.

A table summarizing the requirements for processing prior year refunds on the Central Payroll System follows:

Information Related to Processing Deduction Refunds Reported on Employee W-2 Forms in a Previous Year				
Deduction Code	Description of Deduction	Payroll System Refund Retirement Code	Agency/University Reimbursement from Central Payroll	Tax Status
001 – 004	Perquisites	Code 6	No	Tax Deferred
094	Institution Parking	Code 5	No	Pre-Tax
098	DOA Parking	Code 5	Yes	Pre-Tax
200	403(b) Annuities	N/A – Refunded to employee by administrator	N/A	Tax Deferred
225	401(k) Plans	N/A – Refunded to employee by administrator	N/A	Tax Deferred
249	457(b) Plan	N/A – Refunded to employee by administrator	N/A	Tax Deferred
400 - 413	State Health Plans	Code 5	No	Pre-Tax
445-452 454	NCFlex Plans	Code 5	Yes	Pre-Tax
591	Roth 401(k) Plan	N/A – Refunded to employee by administrator	N/A	Post-Tax
N/A	T&SE Retirement	Code 6	Yes	Tax Deferred
N/A	POA Retirement	Code 6	Yes	Tax Deferred
N/A	Optional Retirement	Code 6	No	Tax Deferred

The procedural modifications identified in this memorandum are effective immediately. Please refer all questions regarding these changes to your OSC Central Payroll contact.

Attachment

- Cc: Tim Bryan, Prudential Investment Management Services LLC
 Doreen Vitiello, Prudential Investment Management Services LLC
 Jennah Yerby, Orchard Trust Company LLC
 Cindy Novak, Orchard Trust Company LLC
 Patricia Eckstein, Orchard Trust Company LLC
 John Morgan, OSC

Central Payroll Staff