



# State of North Carolina

## Office of the State Controller

**DAVID T. MCCOY**  
**STATE CONTROLLER**

January 26, 2009

**MEMORANDUM NO. 2009-002**

**TO:** Payroll Offices Served by Central Payroll Operations

**FROM:** Central Payroll Operations

**SUBJECT:** Refunds of Prior Year Deductions

The Central Payroll System programmatically rejects any refund that would create a negative year-to-date balance on the system. This restriction prevents the accidental keying of refunds to non-eligible deduction codes and the improper alteration of year-to-date tax data.

Prior year refunds for the deduction codes listed in this memorandum are not usually 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. If there is not sufficient current year-to-date balance accumulated in a deduction code for an employee, then 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 Fees
410	NC PPO Health Plan
411	NC PPO Health Plan – Medicare Recipient
412	NC PPO Health Plan – Non-Contributory
413	NC PPO Health Plan - Prepayment
445	NC Flex Dependent Care Plan
446	NC Flex FSA – Health Care Spending Account
447	NC Flex - Critical Illness Plan
448	NC Flex – Dental Plan
449	NC Flex – AD&D Plan
450	NC Flex – Vision Plan
452	NC Flex – Term Life Plan
454	NC Flex – Cancer Plan

Prior year refunds of pre-tax deductions that are processed as earnings on the payroll system in the current year 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)

When processing prior year pre-tax refunds as income, the appropriate account to key is 531673, Refund of Prior Year Deduction Clearing.

The methodology for recoupment of prior year refunds keyed as employee income in the current year follow:

Institution Pre-Tax Parking Fees

It is the responsibility of each university to manually adjust their monthly parking fee payment to Parking Services by the amount of any refund keyed as income in the Central Payroll System. Refunds keyed as income will not show on the deduction report generated at month end.

Pre-Tax NC Flex Plan Refunds

Universities must submit a "NC Flex Plan Administrator Authorization Form" to Central Payroll Operations as documentation in support of a prior year refund. The adjustment amount will be remitted back to the appropriate university as part of the month end process.

Pre-Tax Health Insurance Refunds

Pre-Tax Health Insurance refunds are processed in the Central Payroll System in the same manner as refunds for NC Flex Plans. However, the university must recoup the refund from the vendor by manually reducing their health insurance billing to accommodate the refund. The adjustment amount attributable to the refund should be recorded against account 531673 as an accounts payable credit memo when the invoice is paid to the vendor.

**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
003	Perquisite – Rent
200	NC 403(b) Annuity Plan – Fidelity
201	NC 403(b) Annuity Plan – TIAA-CREF
225	NC 401(k) Plan - Prudential
249	457(b) Plan - Prudential
N/A	All mandatory retirement contributions (e.g., T&SE or Optional Plans)

Refunds of Prior Year Perquisites

Perquisites are normally processed under one of the following deduction codes:

Deduction Code	Description of Deduction
001	Perquisite – Board
003	Perquisite – Rent

Employees that are due a prior year refund for perquisites are to be reimbursed in the same manner as prior year pre-tax refunds (see previous section) 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, not FICA). An adjustment to 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. Universities must collect amounts to be refunded from the appropriate university department or service group. It is the responsibility of each university to properly account for third party payments related to these types of refunds.

Third Party Administrator (Vendor) Refunds of Prior Year Deductions

Tax deferred savings and Roth plans are administered by third party vendors and include the following:

Deduction Code	Description of Deduction
200	403(b) Annuity Plan – Fidelity
201	403(b) Annuity Plan – TIAA-CREF
225	401(k) Plans - Prudential
249	457(b) Plan (Deferred Comp) - Prudential
020	Roth 403(b) Plan – Fidelity
021	Roth 403(b) Plan – TIAA-CREF
591	Roth 401(k) Plan - Prudential

While the Roth plans are not tax deferred savings plan, they are reported on an employee's W-2 form in much the same manner as the other annuities and savings plans. Refunds of these 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. If the refund is for a tax deferred plan, then the vendor must generate a 1099-R form for that employee for the year in which the refund occurs.

Prior Year Refunds of Retirement Contributions

Employee retirement contributions are tax deferred deductions. Corrections to prior year retirement contributions cannot be adjusted through the Central Payroll System. Universities must contact the ORBIT system to record prior year refunds or adjustments to service time. While the Retirement System will allow the refund of prior year employee contributions, employer contributions are non-refundable after January 31.

In addition to correcting an employee's service in the ORBIT system, prior year refunds for Optional retirement plans (VALIC, Lincoln, TIAA-CREF, and Fidelity) are handled in the same manner as elective annuity refunds (see above). Each university is responsible for contacting the appropriate 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 cannot be keyed into the Central Payroll System if the refund causes a negative year-to-date balance for the deduction. Prior year refunds must be authorized by the vendor and are treated as credit memos against the vendor invoice. The credit memo amounts are refunded to the employer, who is responsible for remitting the refund amount directly to the employee through accounts payable.

Please refer all questions regarding this memorandum to [edith.cannady@osc.nc.gov](mailto:edith.cannady@osc.nc.gov).

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