



Office of the State Controller
Military Differential Payments Procedures and Communications

Internal Revenue Service tax law revised in 2001 specifies that certain military personnel who are called to active duty, and thereby qualify for differential pay, be exempted from Social Security (FICA) payments while on duty. To accommodate this law, North Carolina House Bill 231, Sections 23.(a) and 23.(b) rewrote GS.127A-116 to provide leave without loss of pay, time or efficiency rating for federal military duty or special emergency management services retroactive to September 1, 2001.

To better assist the agencies in administering the FICA changes, the Office of the State Controller has created this Military Differential Payment Procedure and Communication packet for Agency use. All questions regarding these procedures can be directed to Roger Farmer.

As a reminder, differential pay is not subject to State Retirement. A Reservist must be allowed to buy back time. Differential pay can be used for Section 125 Cafeteria Plan deductions such as health insurance and NC Flex Plan deductions.

Future Payroll Processing – Effective Immediately

Beginning immediately, Agencies should become familiar with the following military differential pay procedures.

- Identify all employees in your Agency who are eligible for military differential pay.
- For all employees identified as eligible, all payments of the military differential pay should be made under the “S” cycle.
- To ensure that Retirement and Social Security are not withheld from the payment, Agencies should use the retirement code “6” for the employee deduction and retirement code “6” as the matching deduction. These codes should be effective for payments made beginning in September and thereafter.
- University Optional Retirement Plan participants should code their military differential pay using the codes listed below:

PLAN	EMP DED	MAT DED
TIAA	B	B
Lincoln	M	M
Valic	T	T
Fidelity	X	X

- When identified employees are no longer eligible for military differential pay, the pay cycle should resume under the regular pay cycles.

Correcting 2004 Calendar Year Payments

Central Payroll will correct payments of Social Security previously withheld in the 2004 calendar year. Over-withheld FICA will be directly refunded to the employee. Differential pay will be



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reported on Form W-2 as Federal and State taxable wages. The FICA and Medicare wage amounts will be zero.

Agency assistance is needed in order to refund affected employees. Please complete the following process before September 30, 2004:

1. Identify all impacted employees in your Agency by searching records for differential wage payments made this year.
2. Create a recap listing of affected employees. The listing must have the following specifications listed below:
 - a. The recap file should be in Microsoft Excel and titled:
 <Your Agency Name>_2004 Military FICA Refunds.xls
 - b. The listing must follow the format below:

MILITARY DIFFERENTIAL PAYMENTS – 2004 Calendar Year					
SOCIAL SECURITY REFUND REQUESTS					
EMPLOYEE	SOCIAL SECURITY NUMBER	WAGES SUBJECT		TAX WITHHELD	
		OASDI	HI	OASDI	HI
Employee Name #1	123-45-6789	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00
Employee Name #2	987-65-4321	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00
Total		\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00

3. Forward the following to OSC (Attention: Roger Farmer) by September 30, 2004:
 - o Recap Listing
 - o A copy of the payroll register, attached to the Recap Listing. The payroll register should support the information in the Recap List.
4. Send a communication by October 31, 2004 to affected employees in your agency letting them know of their refund. The communication should also provide information on how the refunds will affect their tax forms. A sample communication is provided in the back of this document for your convenience.

After forwarding the information specified above, all Agencies should see a refund on the payroll register during the month of November.

Correcting 2001-2003 Calendar Year Payments

Central Payroll will process corrections of Social Security previously withheld in years 2001-2003. Agency assistance is needed in order to correct the payments to affected employees. Please complete the following process before December 30, 2004:

1. Identify all impacted individuals in your agency by searching records for differential wage payments made from 2001 through 2003. Identify all impacted employees by November 1, 2004.



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2. From the identified employees, create recap listings of the affected employees. The listings must have the following specifications:
 - a. For each calendar year, create a separate recap listing. Create each listing as one tab in a Microsoft Excel Workbook. (See Microsoft Spreadsheet example from notification e-mail)
 - b. Within each calendar year recap listing, break out the employees into quarters.
 - c. For the recap listings, follow a similar format as 2004 Calendar Year procedures
 - The recap file should be in Microsoft Excel and titled:
 <Your Agency Name>_ Military FICA Refunds.xls
 - Follow the format below and add additional quarters, as needed, to your spreadsheet:

Employee	SS#	Quarter 1				Total (All 4 Quarters)			
		WAGES SUBJECT		TAX WITHHELD		WAGES SUBJECT		TAX WITHHELD	
		OASDI	HI	OASDI	HI	OASDI	HI	OASDI	HI
Employee Name #1	123-45-6789	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00
Employee Name #2	987-65-4321	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00
Total		\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00	\$0,000.00

3. Send a communication and the Social Security Waiver to the affected employees advising them of the current process. The Social Security Waiver confirms that the employee will not attempt to obtain a refund of the over-withheld FICA. This form must be signed and returned before Central Payroll can process any FICA Military changes.
4. Forward the following to OSC (Attention: Roger Farmer) by December 30, 2004:
 - o Recap listings from 2001-2003 broken down by quarter.
 - o A copy of the payroll register, attached to the Recap Listing. The payroll register should support each Recap List.
 - o The signed Social Security Waiver forms by affected employees.

All Agencies will be sent refund checks for their employees during the first quarter of 2005.



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Communication Sample – Impacted Employee Communication

MEMORANDUM

To: Active Military Personnel since 2001

From: <Insert Agency Contact Name>

Subject: Military Differential Payments

Internal Revenue Service tax law revised in 2001 specifies that certain military personnel who are called to active duty, and thereby qualify for differential pay, be exempted from Social Security (FICA) payments while on duty. To accommodate this law, North Carolina House Bill 231, Sections 23.(a) and 23.(b) rewrote GS.127A-116 to provide leave without loss of pay, time or efficiency rating for federal military duty or special emergency management services retroactive to September 1, 2001.

Central Payroll is currently in the process of identifying those individuals that are currently impacted by the revised law specified above. You have been identified as an impacted individual. Below is a summary of the impacts to your paycheck and how Central Payroll will resolve those changes:

- Calendar Year 2004: Central Payroll will correct payments of Social Security previously withheld from your paycheck this calendar year. Payroll registers will be directly corrected with your Agency.

The differential pay you receive for this year will be reported on Form W-2 as Federal and State taxable wages. However, since this compensation is exempted from Social Security, your FICA and Medicare wage amounts on Form W-2 for 2004 will be reduced to reflect the refund.

Your Assistance: No action is needed on your part to correct the withholding for calendar year 2004.

- Calendar years 2001-2003: Central Payroll will correct payments of Social Security previously withheld during active military time retroactive to 2001. Over-withheld FICA will be directly refunded to you by check during the first quarter of 2005. For calendar years 2001-2003 in which FICA was withheld from your paycheck, a W-2C Form will be issued to you. The tax refund and issued W-2C Form will correct your tax returns; no additional filing will be needed.

Your Assistance: A signed Social Security Waiver will be required from you before the State can issue you a refund or Form W-2C. This specified waiver is attached to this memo. Please promptly sign this form and return it to <insert Agency contact> by <insert Agency specific date>. By signing the Social Security Waiver, you are confirming that you will not attempt to obtain a refund of the over-withheld FICA.

All questions regarding these procedures can be directed to <Insert Agency contact>.

Attachment: Social Security Waiver