



STATE OF ILLINOIS  
COMPTROLLER  
JUDY BAAR TOPINKA

# PAYROLL BULLETIN

---

To: All State Agencies, Boards, and Commissions  
From: Steven L. Valasek, Assistant Comptroller - Operations  
Date: May 22, 2013  
Subject: Payroll Reversals of Federal and State Taxes  
Number: 2 – 13

The United States Department of the Treasury – Internal Revenue Service (IRS)  
Publication 15 (Circular E) under the Subject “Wage Repayment” states:

“The wages paid in error in the prior year remain taxable to the employee for that year.”

In the past the IRS has allowed the State of Illinois to process prior year reversals for Federal Taxes. The IRS has since notified the Illinois Office of the Comptroller (IOC) that prior year reversals will only be processed if the employee did not receive the wages. Therefore, the IOC is implementing the following policy changes related to salary reversals.

- Agencies are encouraged to use gross payroll adjustments on future payrolls to correct errors when the employee is still on the State payroll for the subsequent pay period. Example: If John Doe was overpaid by \$150.00 during the current pay period, a payroll reversal should not be completed. Instead, John Doe’s payroll check for the next pay period should be reduced by the overpayment of \$150.00.

NOTE: Agencies must contact the respective retirement system and/or Central Management Service – Group Insurance to determine if additional information will be needed to ensure there is no impact on retirement earnings or insurance.

- The IOC will treat retirement overpayment refunds as current year transactions, even if the refund is from a prior calendar year.
- The IOC will treat Deferred Compensation over deferral refunds as current year transactions, even if the refund is from a prior calendar year.

The IOC is implementing the following procedural changes related to salary reversals.

**Current calendar year reversals:**

1. Employees currently on state payroll:
  - 1.1 Agencies should adjust future earnings using a gross payroll adjustment on future payrolls.
  - 1.2 Agencies may petition the IOC to process a current year reversal when there are extraordinary circumstances. If approved, agencies must follow the new current year reversal rules (see attachment 1).
2. Employees no longer on state payroll:
  - 2.1 A gross salary adjustment is not an option; therefore, agencies should follow step 1.2.

**Prior calendar year reversals:**

3. Employees currently on state payroll:
  - 3.1 Agencies should adjust future earnings using a gross payroll adjustment on future payrolls.
  - 3.2 Agencies may petition the IOC to process a prior year reversal when the net warrant or net deposit was received by the employee and there are extraordinary circumstances. If approved, the agency must follow the new prior year reversal rules - Option 1 (see attachment 2).
  - 3.3 Agencies may petition the IOC to process a prior year reversal when the "hard copy" net warrant was NOT received by the employee. If approved, the agencies must follow the new prior year reversal rules - Option 2 (see attachment 3).
4. Employee no longer on state payroll:
  - 4.1 A gross salary adjustment is not an option: therefore, the agency should follow step 3.2 or 3.3.

A follow up meeting with Payroll Officers and/or Fiscal Officers that have outstanding questions relating to this bulletin is scheduled for 1:30 – 3:00 PM on May 29, 2013 at the Capital City Training Center, 130 W. Mason Street, Springfield, IL 62702. Agencies should contact Ellen Curtin at 217-558-3359 to make a reservation. Questions should be forwarded to Nancy Smith at [nsmith@mail.ioc.state.il.us](mailto:nsmith@mail.ioc.state.il.us).

Agencies may access this and other Payroll, SAMS and Accounting Bulletins on the Comptroller's website at [www.ioc.state.il.us](http://www.ioc.state.il.us) under Resource Library.

If you have any questions regarding this bulletin, please contact the IOC payroll office at (217) 782-4758.

## **Attachment 1**

### **New Current Year Reversal Rules:**

1. Agencies must request approval to initiate a salary reversal from the IOC. A sample "Petition to Process Salary Reversal" form is available from the IOC Payroll Office.
2. The request must include a detailed justification for the reversal.
3. If the request is approved, the IOC will notify the agency to submit the C-65 along with all money instruments not included on the reversal.
4. When the completed C-65 and the associated money instruments are received, the IOC will review and determine whether to authorize the agency to complete the salary reversal on a specified pay period. This reversal will include the Federal and State Taxes.
5. The IOC will retrieve the salary reversal warrant and process the C-65.
6. If the salary reversal is not completed on the specified pay period, the agency must request in writing a future pay period to process the reversal.
7. If the salary reversal is not completed by November 15, the agency must follow prior year reversal rules (Attachments 2 or 3) including requesting approval again.

## Attachment 2

### New Prior Year Reversal Rules - Option 1:

1. Agencies must obtain a letter from the employee stating that they have not, and will not, request a claim for FICA and Medicare.
2. Agencies must request approval to initiate a salary reversal from the IOC. A sample "Petition to Process Salary Reversal" form is available from the IOC Payroll Office.
3. The request must include a detailed justification for the reversal.
4. If the request is approved, the IOC will notify the agency to submit the C-65 along with all money instruments not included on the reversal.
5. When the completed C-65 and the associated money instruments are received, the IOC will review and determine whether to authorize the agency to complete the salary reversal on a specified pay period. This reversal will **not** include the Federal and State Taxes.
6. The C-65 instructions are modified to address the processing of a salary reversal without the Federal and State Taxes as follows:
  - Mark the top of the C-65 as "PRIOR YEAR".
  - Do not complete lines 16 or 18.
  - On the "Comments" line enter "Note Prior Year Reversal no Federal or State withholding allowed".
7. The IOC will retrieve the salary reversal warrant and process the C-65.
8. The IOC will file a W-2C form. Boxes 1 and 2 will not be changed. Boxes 3, 4, 5 and 6 will be adjusted for the reversal.
  - If the agency wants to recoup the Federal and State taxes, they must get the funds from the employee (voluntarily or non-voluntarily).
  - Once the agency receives the funds (Federal and State Taxes) from the employee, the agency should process an Expenditure Adjustment Transmittal (EAT).
  - The agency should then issue the employee a letter stating that the employee has reimbursed the agency for the taxes.
  - The employee can follow IRS guidelines to reduce their gross income on their tax return.
9. If the salary reversal is not completed on the specified pay period, the agency must request in writing a future pay period to process the reversal.

### **Attachment 3**

#### **New Prior Year Reversal Rules - Option 2:**

1. Option 2 is limited to situations where the “hard copy” net warrant was not received by the employee and the employee has stated in writing that they have not, and will not, request a claim for the associated taxes.
2. Agencies must request approval to initiate a salary reversal from the IOC. A sample “Petition to Process Salary Reversal” form is available from the IOC Payroll Office.
3. The request must include a detailed justification for the reversal.
4. If the request is approved, the IOC will notify the agency to submit the C-65 along with all money instruments not included on the reversal.
5. When the completed C-65 and the associated money instruments are received, the IOC will review and determine whether to authorize the agency to complete the salary reversal on a specified pay period. This reversal will include the reversal of Federal and State Taxes.
6. The IOC will retrieve the salary reversal warrant and process the C-65.
7. The IOC will file a W-2C form and all boxes, including boxes 1 and 2, will be adjusted for the reversal.
8. If the salary reversal is not completed on the specified pay period, the agency must request in writing a future pay period to process the reversal.