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MEMORANDUM

TO: All Agency Accounting, Human Resource, & Payroll Managers

FROM: D. Clark Partridge, State Comptroller

DATE: February 25, 2008

SUBJECT: Military Differential Pay

The IRS has determined that Military Differential Pay is not "wages" for services performed in the "employment" of a company. The IRS has defined military differential pay as payments made voluntarily by an employer to represent the difference between the regular salary of an employee called to military active duty and the amount being paid by the military, if the regular salary was higher. For federal tax purposes, the employment relationship between the employee and the company was terminated when the employee was called for active military service. Therefore, the military differential pay is not considered wages. As a result, Federal taxes, State taxes, FICA, and Medicare taxes are not to be withheld from such pay. Additionally, employee-related benefits should not be deducted. The military differential pay is to be reported on a Form 1099 MISC.

Effective immediately, the HRIS system will no longer be used to process military differential payments. Military differential payments are to be paid using AFIS. A new technical bulletin (TB) will be issued to replace the current TB (#05-9) on this subject. Until such time as the new TB is published, this memorandum should be followed. Once the amount of military differential pay due to the employee is calculated, a claim must be prepared (using transaction code TC222 or TC225 as appropriate) and entered into AFIS. The expenditure must be charged to comptroller object (COBJ) 6292. You should contact your AFIS liaison if you need assistance with this transaction.

Form GAO-42 (Military Emergency Activation Differential Pay Computation Worksheet) may still be used to assist in the calculation for differential pay due. Also, Form GAO-43 (Reconciliation of Military Emergency Activation Differential Pay Upon Discharge or Death) should continue to be used for those situations. Any military differential pay already processed in HRIS during 2008 will be corrected by the GAO and all taxes deducted will be refunded to the employee.