



July 20, 2023

CIRCULAR LETTER TO ALL MEMBER COMPANIES

RE: Workers Compensation Insurance: Updates to Payroll Inclusions and Exclusions

**WC2023-01:** Revisions to Manual Rules Related to Payroll Inclusions and Exclusions  
(Comparable to NCCI Item B-1448)

**WC2023-02:** Revisions to Manual Rules Related to Service Charges and Automatic  
Gratuities (Comparable to NCCI Item B-1449)

The North Carolina Rate Bureau (Bureau) has filed and the North Carolina Commissioner of Insurance has approved revisions to the state-specific North Carolina Basic Manual for Workers Compensation and Employers Liability (*Basic Manual*). The approved revisions are related to changes being made by way of NCRB items WC2023-01 and WC2023-02. The approved changes become effective for all new and renewal policies with effective dates on and after January 1, 2024.

These manual changes clarify and enhance rules relative to payroll inclusions and exclusions, expense allowances, service charges and automatic gratuities.

Complete copies of Filing Memorandums WC2023-01 and WC2023-02 and exhibits outlining all changes are included for your review.

If you have any questions, contact Regulatory Manager, Jodi Webb at 919-719-3028 or via email at [JLW@ncrb.org](mailto:JLW@ncrb.org).

Sincerely,

Jarred Chappell  
Chief Operating Officer

JC:ko  
Attachments  
C-23-6

**North Carolina Rate Bureau  
Filing Memorandum  
WC2023-01**

**Revisions to Basic Manual Rules Related to Payroll Inclusions and Payroll Exclusions**

**PURPOSE**

The purpose of this filing is to:

- Clarify and enhance North Carolina's Basic Manual for Workers Compensation and Employers Liability Insurance (**NC Basic Manual**) rules related to payroll inclusions and payroll exclusions.

**BACKGROUND**

**Compensation Plans:** North Carolina participated in multi-jurisdictional discussions on treating payroll for employee-elected salary reductions to fund various compensation plans. Based on this research, it was determined that additional rules are needed in the **NC Basic Manual** related to payroll inclusions and payroll exclusions. As a result, NCRB has proposed rules to clarify how to treat payroll for these unique compensation plans and support consistent and uniform application of payroll.

**Expense Allowances:** A review was also completed to address concerns related to expense allowances. In 2017, NCRB issued Circular C-17-6 - Revisions to Basic Manual Rule 1 – Classification Assignment and Rule 2 – Premium Basis and Payroll Allocation to increase the maximum amount for expense reimbursements without verifiable receipts from \$30 to \$75 per day effective 10/1/17. Since implementation, there have been many inquiries and requests for clarification. Based on the inquiries and requests received, NCRB has recommended revisions to the **NC Basic Manual** rules relative to payroll inclusions and payroll exclusions to clarify that:

- The employer's expense receipts must be verifiable, and
- Allowable expenses must be paid in addition to, not in lieu of, wages earned by the employee, to exclude such expenses from payroll.

Additionally, NCRB has proposed revisions to all the rules related to the inclusion or exclusion of expense allowances to ensure clarity and consistency between rules in a form consistent with the North Carolina Basic Manual.

**North Carolina Rate Bureau  
Filing Memorandum  
WC2023-01**

**Revisions to Basic Manual Rules Related to Payroll Inclusions and Payroll Exclusions**

**PROPOSAL**

This item will:

- Revise the payroll inclusions rules
  - Rules for including wages and salaries in payroll, to remove the reference to retroactive wages or salaries and add newly established rules related to retroactive wages or salaries.
  - Rules for including employee-authorized reductions from gross pay in payroll, to update the content for consistency and add related references, and
  - Rules for including expense reimbursements in payroll, to clarify that employer records must be verifiable and update the content for consistency between the rules.
- Revise payroll exclusion rules for excluding from the audit reimbursed expenses and flat expense allowances, to clarify that expense allowances must be paid in addition to, not in lieu of, wages and update the content for consistency between the rules.
- Eliminate rules for excluding from payroll expense reimbursements, to reduce redundancy and ensure consistency between the rules.
- Establish new rules for excluding from payroll a maximum daily expense allowance for nonverified expenses incurred on overnight business, for clarity and consistency between the rules.
- Establish additional payroll inclusion rules to address the treatment of
  - Employee-authorized reductions for purchasing stock options or stock purchase plans
  - Employer contributions to the cashless exercise of stock options
  - The value of equity-based compensation plans
  - Deferred compensation payments to current employees
  - Employee-authorized reductions to fund deferred compensation plans, and
  - Retroactive wages or salaries paid to a current employee
- Establish additional payroll exclusion rules to address the treatment of
  - Deferred compensation payments to retired or terminated employees
  - Employer contributions to stock purchase plans
  - Employer contributions to the exercise of stock options
  - Employer contributions to the deferred compensation plans
  - The difference earned from purchasing discounted stocks
  - The market value of equity-based compensation plans, and
  - Retroactive wages or salaries paid to a retired or terminated employee

Exhibits showing revisions to the **NC Basic Manual** follow this filing memorandum.

**North Carolina Rate Bureau  
Filing Memorandum  
WC2023-01**

**Revisions to Basic Manual Rules Related to Payroll Inclusions and Payroll Exclusions**

**IMPACT**

**Payroll Inclusions and Payroll Exclusions**

An employer may see an increase or decrease in premium dependent on whether the payroll inclusion or payroll exclusion rules being implemented and/or clarified are different from how the policy is currently being written.

**Expense Allowances**

An employer may see an increase in premium if the employer's payroll increases because of the expense allowance revisions. Statewide premium impact is not quantifiable but is expected to be negligible.

**IMPLEMENTATION**

This filing proposes to clarify and enhance the North Carolina Basic Manual rules related to payroll inclusions, payroll exclusions and expense allowances. It is applicable to new and renewal policies with effective dates on or after 12:01 am on January 1, 2024.

**North Carolina Rate Bureau  
Filing Memorandum  
Filing WC2023-02**

**Revisions to Basic Manual Rules Related to Service Charges and Automatic Gratuities**

**PURPOSE**

The purpose of this filing is to:

- Revise payroll rules related to service charges and automatic gratuities in the NC Basic Manual for Workers Compensation and Employers Liability (NC Basic Manual).

**BACKGROUND**

North Carolina participated in a comprehensive review of NC Basic Manual rules related to payroll inclusions and payroll exclusions to determine the appropriate treatment for service charges, automatic gratuities and tips. The NC Basic Manual rule that excludes tips and gratuities does not address whether the intent of the rule is meant to exclude only tips and gratuities that are given voluntarily. Banquet halls, country clubs and private clubs traditionally add a service charge to food and beverage sales. In some cases, members or patrons can adjust the service charge; in others, the amount is a set percentage in place of a tip or gratuity. Additionally, many restaurants have changed their business models to include service charges. These service charges can be in place of, or in addition to a tip. Key points are this research are:

- Tips are “discretionary” payments by a customer that employees receive from customers
- Service charges are “forced” fees added by the employer through a bill or contract
- The Internal Revenue Service’s (IRS) Publication 15, Employers Tax Guide states “Service charges aren’t tips; therefore, withhold taxes on service charges as you would on regular wages.”

Bureau staff has created proposed revisions to the **NC Basic Manual** to define service charges and automatic gratuities and established a rule stating that service charges and automatic gratuities are included in payroll.

**PROPOSAL**

This item will:

- Establish a new rule “Rules for including service charges and automatic gratuities in payroll” to specify that service charges and automatic gratuities are included in payroll when the customer does not:
  - Determine the amount of the payment
  - Determine who receives the payment, and
  - Have the ability to reduce the payment amount below the set percentage or fee
- Revise the rule “Rules for excluding from payroll tips or gratuities” to add definition for tips and other gratuities.

Exhibits showing revisions to the **NC Basic Manual** follow this filing memorandum.

**North Carolina Rate Bureau  
Filing Memorandum  
Filing WC2023-02**

**Revisions to Basic Manual Rules Related to Service Charges and Automatic Gratuities**

**IMPACT**

An employer may see an increase in premium, dependent on whether the newly established rule related to payroll service charges and automatic gratuities is different from how the policy is currently being written.

**IMPLEMENTATION**

This filing proposes to revise rules in the North Carolina Basic Manual rules related to payroll service charges and automatic gratuities. It is applicable to new and renewal policies with effective dates on or after 12:01 am on January 1, 2024.

Premium is calculated on the basis of the total payroll paid or payable by the insured for services of employees who are eligible to receive workers compensation benefits for work-related injuries as provided by the policy. Some classifications may have a different premium basis. See example below:

**Example:**

Premium is calculated for domestic workers on a per capita basis instead of payroll. Domestic workers are employees who perform household duties. See [Rule 3-C](#) for additional information.

A per capita classification uses the number of workers rather than payroll to measure exposure.

**B. Payroll**

For purposes of this manual, the terms "payroll" and "remuneration" mean money or substitutes for money.

**1. Includes:**

- a. Current wages or salaries paid during the current policy period. ~~salary or wages.~~
- b. Total pay received by an employee for commissions and draws against commissions.
- c. Service charges and automatic gratuities received by employees. Service charges and automatic gratuities are set percentages or fees added to a bill or contract where the customer does not: determine the amount of percentage or fee; determine who receives the percentage or fee, and; have the ability to reduce the payment amount below the set percentage or fee.
- d. Bonuses and stock bonus plans. See [Rule 2-D](#).
- e. Extra pay for overtime work except as provided in [Rule 2-C-2](#).
- f. Pay for holidays, sick leave, or vacations. See [Rule 2-G-3](#) for allocation of payroll for employees subject to more than one classification code.
- g. Employer payments withheld from employees to meet statutory obligations for insurance and/or pension plans, such as the Federal Social Security Act or Medicare.
- h. Payment to employees on any basis other than time worked, such as piecework, profit sharing, or incentive

plans.

i. (RESERVED FOR FUTURE USE)

- j. The rental value of a house or apartment provided to an employee based on comparable accommodations.
- k. The value of lodging, other than an apartment or house, received by an employee as part of their pay as shown in the insured's records.
- l. The value of meals received by employees as part of their pay as shown in the insured's records.
- m. The value of store certificates, credits, merchandise, or any other substitute for money received by employees as part of their pay.
- n. Payment for retirement or cafeteria plans (Internal Revenue Code 125), health savings accounts (HSAs), flexible spending accounts (FSAs), employee savings plans, or salary reduction that is made through employee-authorized salary reductions from the employee's gross pay.

o. Employee-authorized reductions from an employee's gross pay for purchasing stock options or qualified or nonqualified employee stock purchase plans (ESPP) in payroll. The salary reduction amounts are included in payroll for the policy year in effect when the salary reduction was made, even when the plan is a portion of a cafeteria plan.

p. Employer contributions to an employee's cashless exercise of stock options in payroll.

Exception: Exclude from payroll employer contributions to the exercise of stock options except for employer contributions to an employee's cashless exercise of stock options.

q. The value of equity-based compensation plans, other than stock options and stock purchase plans, at the time of vesting in payroll. This applies when vesting is on a scheduled or annual basis such as grade vesting, scheduled cliff vesting, performance goals vesting and



milestones anniversaries vesting.

Equity based compensation plans, other than stock options and stock purchase plans include stock transfers, stock warrants, restricted stock, restricted stock units, phantom stock plans and stock appreciation rights.

- r. Deferred compensation distribution payments made to current employees from an employer's contributions to previously deferred wages in payroll. This applies to amounts paid during the policy period.
- s. The amount by which an employee's salary is reduced from gross pay to fund an employee- authorized deferred compensation plan in payroll. The salary reduction amounts are included in payroll for the policy year in effect when the salary reduction was made, even when the plan is a portion of a cafeteria plan. Employee-authorized deferred compensation plans include pension plans, equity-based compensation plans and other deferral plans.
- t. Payroll retroactive wages or salaries paid to a current employee when the payment is within the three-year audit period of the policy, and the employee was actively employed by the employer at the time wages were paid, or during any portion of the current policy period.
- u. ~~n.~~ Davis-Bacon Act wages (A federal law that establishes the requirement for paying the local prevailing wages on public works projects) or wages from similar prevailing wage laws.
- v. ~~o.~~ Annuity plans.
- w. ~~p.~~ Expense reimbursements to employees if the employer's records do not confirm that the expense was incurred as a valid business expense. Refer to [Rule 2-B-2-h](#) for contractual allowable travel expenses. Expense reimbursements and flat expense allowances paid to employees in payroll when the employer's verifiable records do not confirm that the employee expense or allowance was incurred as a valid business expense.

**-Exception:**

~~When it can be verified that the employee was away from home overnight on business for the employer, but no verifiable receipts for incurred expenses have been retained, a reasonable expense allowance, also known as a per diem, is permitted to be excluded. The allowance is limited to a maximum of \$75 per day. The remaining non-verifiable expenses are included as payroll.~~

~~X.9.~~ Payment for filming commercials for the insured, excluding subsequent residuals that are earned by the commercial's participant(s) each time the commercial appears in any type of media.

**2. Excludes:**

- a. Tips or gratuities received by employees. Tips or other gratuities are optional payments added to a bill or contract where the customer: determines the amount of payment; determines that the employees receive the payment for services provided, and: has the option to not add a payment to the bill or contract.
- b. Group insurance or group pension payments made by an employer for employees, other than those covered by [Rule 2-B-1-f](#) and [Rule 2-B-1-m](#).
- c. Payments by an employer into third-party trusts for the Davis-Bacon Act or similar prevailing wage laws, provided the pension trust is qualified under the Internal Revenue Code, Sections 401(a) and 501(a).
- d. The value of special rewards for individual invention or discovery.
- e. Payments for dismissal or severance except for time worked or vacation accrued.
- f. Payments for active military duty.
- g. Employee discounts on goods purchased from the employee's employer.
- h. Expense reimbursements to employees if the employer's records confirm that the expense ~~was incurred as a valid business expense.~~

and flat expense allowances and reimbursed expenses paid to employees may be excluded from the audit if all only when all of these three of the following conditions are met:

- 1) The employer's verifiable records confirm that the expenses or allowances are incurred as a valid for the business expense. of the employer
- 2) The amount of each employee's expense or allowance is shown separately in the records of the employer.
- 3) The amount of the expense or allowance approximates the actual expense incurred by the employee in the conduct of their work.

4). The expense reimbursement and/or flat expense allowances paid to the employee must be in addition to, not in lieu of, the wages earned by the employee.

**NOTE:** ~~If an employer did not maintain verifiable receipts for incurred expenses for an employee that was away from home overnight on the business of an employer a maximum expense allowance is permitted to be excluded. Refer to Rule 2-B-1-p exception for the maximum employee expense allowance.~~

i. A maximum expense allowance of \$75 per day when:

- 1). It can be verified that the employee was away from home overnight on business for the employer.
- 2). The employer did not maintain verifiable records for the employee's daily incurred business expenses and
- 3). The daily expense allowance paid to the employee is in addition to, not in lieu of, the wages earned by the employee.

Include the remaining nonverified daily business expense in excess of \$75 per day in payroll.

Allowable travel expenses permitted by any contract with a federal, state, or local government entity, including, but not limited to, a city, borough, or village, are excluded from payroll. In lieu of verifiable receipts for incurred expenses, the employer must produce a copy of the contract provision

permitting the travel expenses at audit. The allowable travel expenses must be in addition to the current wage of the employee.

**Example of payroll exclusions:**

*Consider an employer that allows a \$0.55 per mile reimbursement for an employee that uses a personal vehicle for company business. The employer considers the \$0.55 per mile reimbursement a fair estimate of actual incurred expenses. The employee drives 100 miles in a personal vehicle for the company. The \$55.00 reimbursement (100 miles x \$0.55) is a fair estimate and is excluded from payroll.*

i.j Meal money for late work

j.k Work uniform allowance

k.l Disability income benefits paid to an employee by a third party such as an insured's group insurance carrier

l. m Employer-provided perks including, but not limited to:

- 1) Use of company car
- 2) Airplane flights
- 3) Incentive vacations (e.g., contest winners)
- 4) Discounts on property or services
- 5) Club memberships
- 6) Tickets to entertainment events
- 7) Educational assistance
- 8) Relocation and moving expenses

m. n Employer contributions to employee benefit plans such as:

- 1) Employee savings plans
- 2) Retirement plans
- 3) Cafeteria plans (Internal Revenue Code 125)

- 4) Health savings accounts
- 5) Flexible spending accounts

These include any contributions made by the employer, at the employer's expense, which are based upon the amount contributed by the employee.

- o. Deferred compensation payments to retired or terminated employees during the current policy period, when the employee is not employed at the time of distribution, and records are maintained to separate these payments.
- p. Employer contributions to qualified or nonqualified employee stock purchase plans.
- q. Employer contributions to the exercise of stock options except for employer contributions to an employee's cashless exercise of stock options.

Exception: Include employer contributions to the cashless exercise of stock options in payroll.

- r. Employer contributions to deferred compensation plans.
- s. The difference between the market price of stock and any discounted price paid by the employee to purchase the stock.
- t. The market value of equity-based compensation plans. This applies when accelerated cliff vesting is triggered by an Initial Public Offering (IPO) of stock, or a change in majority ownership where the owner or owners before the change own less than one-half interest after the change.
- u. Retroactive wages or salaries paid to retired or terminated employees when:
  - The payment is within the three-year audit period of the policy
  - The employee was retired or terminated at the time wages or salaries were paid and
  - The employer maintains records that separate such payments.