



# Pensions briefing — ten things you should know about overpayments

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## Briefing

September 2016

## Introduction

Given the often complex nature of pension benefit calculations, it is not uncommon for mistakes to occur, including making overpayments to pension scheme members and other beneficiaries. This briefing looks at some of the issues on benefit overpayments and how HM Revenue & Customs (HMRC) treats overpayments made by registered pension schemes.

### 01 | **Do trustees have to recover overpayments?**

Trustees have a duty to act in accordance with the governing documentation of their pension schemes. By making a payment from the pension scheme to a member that is not permitted by the scheme's rules, trustees are in breach of that duty. When trustees become aware that benefits are being paid incorrectly, they must take action to rectify the situation and ensure that future payments are correct. Where an overpayment has been made, trustees should take action to recover it.

### 02 | **Can trustees demand repayment of the overpaid amounts?**

Broadly, there are two ways trustees can seek to recover overpayments. They can demand repayment of the overpaid amount from the member. Trustees are entitled to recover the money and take legal action against the recipient to recover the overpayment. However, the costs involved in bringing legal action could outweigh the overpaid amount. In addition, trustees may feel uncomfortable bringing legal action against individuals who are potentially elderly or suffering from ill health.

### 03 | **Can trustees reduce future benefit payments to recoup overpayments?**

Alternatively, trustees may reduce the amount of future benefit payments. This method of recovery is likely to be less expensive and avoids many of the difficult issues that may arise from demanding immediate repayment from an individual.

Trustees should agree the reduction and the recovery period with the member and the rate of the recoupment should be affordable and fair.

The Pensions Ombudsman (TPO) has stated that trustees should not seek to recover an overpayment over a period shorter than the period during which the overpayment had been undetected. TPO has also indicated that future benefit payments should not be reduced whilst there are any outstanding disputes between the trustees and the member in relation to the existence or amount of the overpayment.

### 04 | **How long do trustees have to recover overpayments?**

Recipients of overpayments may claim that the trustees are prevented under the Limitation Act 1980 from recovering historic overpayments. Broadly, trustees will be unable to recover overpayments that were made more than six years before repayment is sought. However, it may be possible for trustees to recover overpayments made more than six years ago if they were made as a result of a mistake (which is most often the case in relation to overpayments) and that mistake is not detected until more recently.

### 05 | **Do members have any other defences against recovery?**

A member may be able to claim in defence that he has changed his position on the basis of the overpayment. The member must be able to show that he received the overpayments in good faith in the belief that they were correct, and he must have entered into an irreversible financial commitment that he would not otherwise have undertaken. For example, TPO has found that spending the overpayment on an improved lifestyle or making charitable gifts are sufficient to permit this defence. However, the purchase of assets that retain or increase in value or the making of gifts to family members may not be sufficient.

Trustees can also be prevented from recovering overpayments if a court finds that they are estopped from making a claim against the member. The requirements for estoppel are similar to the change of position defence. However, the member must also demonstrate that either the change of position resulted:

- from an incorrect statement made by the trustees or
- from facts or law assumed to be correct by the trustees and the member, but which are actually incorrect.

Given the additional requirements, it may be simpler for a member to raise the change of position defence rather than estoppel. However, the change of position defence is potentially more limited, as it may prevent recovery of only a proportion of the overpayment, depending on how the member has spent the overpayments.

### 06 | **When is an overpayment an unauthorised payment?**

Registered pension schemes can make specified authorised payments to members and employers without incurring tax charges. These payments are set out in the Finance Act 2004 (the Act) and the Registered Pension Schemes (Authorised Payments) Regulations 2009 (the Regulations). Any payments that are not “authorised payments” under either the Act or the Regulations are likely to be unauthorised payments. If an overpayment does not fall within the authorised payment requirements, it is likely to be unauthorised and tax charges may apply.

### 07 | What are the tax consequences of an overpayment being an unauthorised payment?

If an overpayment is an unauthorised member payment, the following tax charges may apply:

- an unauthorised payments charge of 40 per cent of the overpayment, payable by the member
- (depending on the extent of the overpayment) an unauthorised payments surcharge of 15 per cent of the overpayment, payable by the member and
- a scheme sanction charge of 40 per cent of the overpayment, payable by the trustees (reduced by up to 25 per cent if the member has paid the unauthorised payments charge). The trustees can apply to HMRC to be discharged from the scheme sanction charge where it would not be just and reasonable for them to pay the charge, but there is no discharge available for members.

### 08 | In what circumstances can an overpayment still be an authorised payment?

Notwithstanding the trustees' duty to pay benefits in accordance with the scheme rules, there are two ways in which an overpayment may still be treated by HMRC as an authorised payment:

- if the overpayment is made in "genuine error" and meets the requirements set out in HMRC's Pensions Tax Manual or
- if the overpayment meets the criteria for one of the types of payment specified in the Regulations.

### 09 | When will an overpayment be considered to have been a "genuine error"?

Broadly, if an overpayment is made in genuine error and the error is spotted and rectified as soon as reasonably possible, the overpayment will not be an unauthorised payment. In practice, the requirement for the overpayment to be repaid as soon as reasonably possible may present difficulties for trustees.

In addition, HMRC states that it will not pursue overpayments which are less than £250. The overpayment would still technically be unauthorised, but the overpayment would not have to be reported to HMRC as an unauthorised payment. In practice, this provision may not be useful, as £250 is a very low threshold.

### 10 | When will an overpayment be authorised under the Regulations?

The Regulations set out certain types of erroneous pension payments which will be treated as authorised payments if they meet specified criteria. Depending on the precise circumstances, these types of payment include:

- pensions paid in error, provided that the payer believed the recipient was entitled to the payment
- pensions paid after the discovery of the error, provided that certain requirements are met (including where the payer took reasonable steps to stop the payment being made)
- pensions paid up to six months after the death of a member and
- arrears of pension paid after the death of a member.

## Contacts

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