

Talking points - Taxing overpayments of income and PCLS

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There has been much talk in the press regarding tax of overpayments of benefits to pension members made by pension schemes.

The charges are draconian but overpayments are possible and in certain circumstances even likely.

The rules, however penal, do give certainty and although the overpayments may have been made by the scheme, there is still much that an adviser can do to help reduce the risk of tax charges.

The background

HMRC has issued guidance that states unless schemes act to claw back inadvertent payouts over £250 they will be treated as unauthorised payments. Unauthorised payments attract tax charges both on the pension member and the scheme – which will impair the pension fund. The pension member could be liable personally up to 55% of the value of the payment and the scheme could be liable up to a further charge of up to 40% of the value (reduced to 15% where the pension member has paid tax). Please note that if the payout is refunded then in most circumstances no tax charges apply.

How could the overpayments arise?

Overpayments are most likely to arise during a transitional stage of the pension, such as the five yearly income limit review or conversion to ASP, and are most likely to affect those at or near to the maximum income limit. For instance, if there is a significant decline in fund value, due to a bear market or indeed a dramatic fall in interest rates, there could be a fall in maximum income at the five year review. This is most likely to impact pension members that are taking the income quarterly, six monthly or yearly in advance such that the payment is made prior to the full review being carried out.

Overpayments may also arise on the death of a pension member where regular income payments are made. It is likely that the pension provider will not be at the forefront of the deceased family's mind. Payments may continue for sometime and are therefore likely to exceed the *de minimis* limit.

What can you do to help your client?

You can help your clients by letting them know when a review is due and what could happen to the income limits. This way, they should be prepared if an overpayment arises. Rough calculations on an un-audited fund value can also be used with the right caveats to give an estimation of possible reductions in income.

Similarly when a client dies you can help the family by informing them of the impact on the pension and also promptly informing the pension provider of the death so that the payments can be stopped.

Our view

Although a limit as small as £250 may seem unreasonable it is useful to have some guidance on the matter. We believe pension members would rather be forewarned of the consequences than blindly assuming nothing will happen if repayments are not made.