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ADVISER GUIDE

Contribution refunds

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Overview

The basic principle when it comes to pension contributions is that once the money has gone in, it cannot be withdrawn until retirement age is reached (or earlier ill health or death). There are very few circumstances when exceptions can be made, and if a refund is made other than as permitted by HMRC, then it would be classed as an unauthorised payment, with tax charges that could potentially be as high as 70% of the amount refunded.

This guide looks at the exceptions that are permitted under HMRC's rules.

Cancellation rights

If the pension scheme arrangement has been set up recently and the member is within their cancellation period (typically 30 days for pensions), then they can still exercise their right to cancel. This would allow them to have a refund of any contributions made, but the arrangement would have to be closed and it would be as if the application had never been made. It would not be possible to have a refund of contributions and leave the scheme open.

Occupational schemes can also make short service refunds if the relevant criteria are met – the main one is usually having less than two years' service for a defined benefit scheme, or 30 days for money purchase schemes.

Excess contributions

The clearest reason for a refund is when it meets the 'excess contribution' condition. This can only apply to personal contributions: refunds not only can but must be made where the member has made contributions in excess of their UK relevant earnings for the tax year.

UK relevant earnings include:

- employment income, such as wages, bonus, overtime or commission, including:
    - redundancy payments above the £30,000 tax-exempt threshold;
    - taxable benefits in kind;
    - profit-related pay;
- income from a trade, profession or vocation (either as an individual or as a partner acting personally in a partnership);
- income from a UK/EEA furnished holiday lettings business; or
- patent income.

Pension payments/income, rental income from properties (other than furnished holiday lettings), the first £30,000 of redundancy pay and investment income do not count as relevant earnings.

The full definition can be found here.

Excess contributions can stem from having fluctuating income, such as for the self-employed, or anyone who makes a contribution towards the start of the year based on their projected earnings but later gets made redundant, so earnings are lower than anticipated. Refunds can only be made once the tax year has ended and the scheme administrator will need to see evidence of earnings for the tax year concerned.

Evidence of earnings could be in the form of a P60, a completed self-assessment for the tax year, week 52 payslip or a signed letter from an accountant confirming total UK relevant earnings for the year. Where the member has no earnings in the tax year, then they will need to make a declaration confirming this. In this instance, any contributions above the £3,600 (£2,880 net) basic amount would be classed as excess.

The tax relief on any excess contribution must go back to HMRC, but it is down to the administrator whether the net contribution goes back to the member, or remains in the pension scheme.

Excess contribution case study – Tom

- Paid £28,500 net contribution to his SIPP; and
- relevant UK earnings at end of year were £26,000 gross.

£28,500 net contribution/80% = £35,625 gross contribution

The excess contribution is the amount of gross contribution above relevant UK earnings, i.e. £35,625 - £26,000 = £9,625.

The tax relief on the excess contribution would be £9,625 x 20% = £1,925.

Therefore £1,925 must be returned to HMRC by the scheme administrator.

The corresponding net amount of £7,700 (£9,625 x 80%) can be returned to the member, or may be retained in the scheme if the scheme administrator allows.

It is important to note that exceeding the annual allowance is not a permitted reason for a refund. 'Excess' refers to contributions that are not entitled to tax relief, not to contributions in excess of the available annual allowance.

Technically speaking, members can make personal contributions up to 100% of UK relevant earnings and receive tax relief – even if their earnings were £1 million. What the annual allowance charge does is cancel out that relief on the amount above the available allowance, but the tax relief should always be claimed.

Genuine errors

HMRC also allow refunds in very limited circumstances when a 'genuine error' has occurred. This is only possible where there was no intention to make a contribution, or the member was not entitled to the contribution.

Examples of this would include where the member instructs their bank to cancel a Direct Debit but the bank fails to act on this, or where an employee has left service but the employer contribution was not immediately stopped.

In the first example, the contribution made to the scheme was never intended to be made, so the return of the inadvertent payment would not be unauthorised. There would need to be clear evidence of the instruction to the bank to cancel, and that this was before the bank's relevant deadline.

In the second example, if the member is no longer an employee, then there is no basis to accept the former employer contributions, so these may be returned.

If a contribution was made deliberately, but later information came to light that meant the member would not have chosen to make that level of contribution, this does not make it a genuine error and such contributions cannot be refunded.

Where a member makes a personal contribution, the following are not 'genuine errors' under HMRC rules and are therefore not grounds for a refund:

- member has exceeded any applicable annual allowance;
- adviser miscalculated available annual allowance (whether by error on their part, or due to incomplete or inaccurate information from the member), and member was following advice;
- member holds fixed or enhanced protection, and the contribution breaks that protection; or
- member was unaware of annual allowance rules.

HMRC is clear that if any contributions paid under 'bad advice' are refunded, these would be unauthorised payments.

Reporting refunds and repaying tax relief claimed

When we process any refund of member contributions, we have to report this to HMRC and repay the tax relief that has been claimed.

The information we have to provide to HMRC in relation to the reclaim is comprehensive and must be submitted within 90 days of discovering the error or excess contribution.

The information includes the member's personal details, including NI number, date and amount of contribution, and when the excess relief was claimed. Importantly, it also includes the reason the excess relief was claimed. This means that it would be very easy for HMRC to challenge any refunds made under the 'genuine error' rules, especially if providers were seen to be making them too often.

Where the member has made an excess contribution and informs the scheme administrator of this before the tax year end, the condition is not met until 6 April, and this is when the 90 days will start.

Once the clock has started ticking, it is important to get the evidence required to the scheme administrator as soon as possible – preferably at the same time as the initial notification. If, for any reason, the scheme administrator is not able to repay HMRC the tax relief claimed within 90 days of discovery, then the member will be charged late payment interest.

The interest will be calculated from the date the scheme received the excess tax relief into the pension scheme (so could potentially go back a number of years) until the date it is paid. Current late payment rates can be found here: HMRC interest rates for late and early payments - GOV.UK (www.gov.uk)

This information is based on current understanding of HMRC tax rules. Tax treatment, including tax relief, depends on your individual circumstances and rules may change.