CASE STUDY

REFUND OF EXCESS CONTRIBUTIONS LUMP SUM

APPROVED FOR CLIENT USE | MARCH 2024

Furlough and redundancy cause problems for a contribution made based on assumed earnings.

The Challenges

Eloise is 39 and earned £35,000 a year as a manager in a small factory manufacturing furniture. Her grandmother passed away in January 2020, leaving Eloise £75,000 which she received at the beginning of March.

Eloise only began saving into a pension a few years ago when she was auto-enrolled for the first time with a previous employer. She hadn't really given retirement saving much thought before then, but read a little about pensions at the time to understand what she was saving into. Eloise learned enough to know that she would probably need to contribute more than the auto-enrolment minimum in the future in order to save enough for her retirement. However, at the time she was prioritising saving for a house deposit and didn't have enough money spare to increase her contributions.

Eloise bought her house last year but still hadn't got around to increasing her pension contributions, although the factory paid a little more than the minimum required under auto-enrolment. When she received the money from her grandmother, Eloise decided she would like to pay most of it into her pension.

The Actions

Eloise remembered reading that the most a person can contribute each year while claiming tax relief is based on their earnings for the year. She also remembered reading about the annual allowance, but a quick check showed her that the annual allowance is higher than her earnings, so she didn't really need to worry about it. Eloise decided that in order to make the most of the tax relief available, she would make two contributions to her pension from the inherited money: one payment before 6 April 2020 for the 2019/20 tax year, and one after that for 2020/21.

In mid-March Eloise worked out how much her auto-enrolment contributions would total for the 2019/20 tax year, then called her provider and arranged to make a one-off contribution to make up the difference, allowing for the fact that her provider would reclaim tax relief on the amount she sent to them. In early April, at the beginning of the new tax year, Eloise arranged a second payment.

Only a couple of weeks later Eloise was furloughed; she was told that a lot of the factory's customers were hotels and restaurants, and demand plummeted due to the coronavirus lockdown. In mid-May, Eloise was informed that the factory was closing permanently and she was being made redundant. With the remaining funds from her inheritance Eloise wasn't too worried about money while she looked for a new job. Her local village shop was shorthanded, and Eloise decided to take a temporary position with them while looking for her next permanent role.

Eloise realised that there was a good chance that the contribution she made in April would turn out to be above her earnings for the year. She spent a few weeks on furlough, which gave her lower pay than normal as she earned over the maximum £2,500 a month and her company did not make up the difference. The village shop pays significantly less, and Eloise didn't know when she would find a new job or what the salary would be - although she doubted it would be much more than her salary from the factory.

Eloise called her provider to inform them what happened, and to ask if there was anything she needed to do. Her provider confirmed that once Eloise knew whether the contribution was in excess of her earnings, and by how much, she would need to inform them so that they can arrange for the excess tax relief to be returned to HMRC.

Eloise would then have two choices. She could either opt to leave all of the remaining funds in the pension, which in effect would mean that some of the money had been paid in as a gross contribution, as it would not have benefited from tax relief. Alternatively, Eloise could ask to receive a 'refund of excess contributions lump sum'. This type of payment is only available for personal or third party contributions which turn out not to qualify for tax relief because they are over the scheme member's relevant earnings. They aren't available in respect of employer contributions; nor where someone has only exceeded their annual allowance. Eloise would need to confirm the value on which she was entitled to receive tax relief for the year so that her provider could return only the excess amount.

The Results

Eloise couldn't act straight away, as she didn't know yet exactly what the rest of the year would bring in terms of income. Assuming that her income overall would be lower for the year, Eloise decided that she would most likely opt to receive a refund of excess contributions lump sum, which would allow her the option to contribute more again in a later tax year when she would once again qualify for tax relief.

Important points to consider

The value of pension funds may fall as well as rise. Your money is tied up until you take your benefits. Benefits can generally be taken any time after age 55, although this is due to increase to 57 in 2028.

This information is based on our understanding of current legislation, including (but not limited to) FCA, PRA and HMRC regulation. It does not constitute any form of advice.

Contact Details

If you'd like to speak to us about anything in this case study, please contact us on:
T 0370 414 7000
We may record and monitor calls. Call charges will vary.
E enquiries@curtisbanks.co.uk
Please remember not to send any personal, financial or banking information via email as it is not a secure method of communication.