

# Proskauer Benefits Brief: Fixing Retirement Plan Overpayments

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In this episode of the Proskauer Benefits Brief, [Paul Hamburger](#), co-chair of Proskauer's Employee Benefits & Executive Compensation Group, and associate [Katrina McCann](#) discuss how to fix retirement plan overpayments, based on (1) the type of plan (i.e., defined contribution or defined benefit plan), (2) whether the overpayment was with respect to a lump sum or ongoing payments, (3) the type of overpayment (whether it was to the wrong person or paid at the wrong time), and (4) who caused the overpayment. They discuss the requirements, the decisions involved, and certain ERISA and taxation issues that can arise when addressing these overpayments.

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**Katrina McCann:** Hello, welcome to the Proskauer Benefits Brief: Legal Insights on Employee Benefits and Executive Compensation. I'm Katrina McCann, I'm an associate in the New York office and on today's episode I am joined by Paul Hamburger a partner in our DC office and we're going to talk about how to fix retirement plan overpayments.

When we talk about retirement plan overpayments, we're specifically limiting this to retirement plans. Many of the principles we'll talk about today may apply to overpayments by other plans such as severance plans or health and welfare plans, but this discussion is specifically limited to retirement plan overpayments.

So, Paul what are the key factors to think about when we're evaluating how to handle an overpayment once you'd identified it?

**Paul Hamburger:** When we deal with overpayments from retirement plans, the first thing we want to look at is what type of plan are we talking about? Has somebody been overpaid from a defined benefit pension plan or have they been overpaid from a defined contribution retirement plan, like 401k plan for example? It is important to know because that's going to impact how we fix it and also it will help us identify the nature of the error.

The second factor we want to know is whether the overpayment was a single sum or lump sum overpayment amount or is it an overpaid annuity that might be paid over the course an employee or former employees' lifetime. So, are we dealing with an overpaid annuity or was it an overpaid lump sum?

The third factor to look at is the type of overpayment, so the questions that we ask here relate to following: Is this a type of money that was not even owed by the plan? In other words, did we pay too much money, but to the right person or did we pay any money but to the wrong person? The second type of overpayment is overpaying money that is part of what might be actually owed to somebody, so they haven't legitimately say in their account balance but I paid it at the wrong time. I paid it while they were still employed or I paid it at a time when they really weren't entitled to get that payment. So that is the factor that we want to look at is to the type or the nature of that overpayment.

The fourth factor is, who caused the problem? Did the participant mislead the plan in order to get the overpayment or did the plan administrator make a mistake and simply err in calculating the amount owed to the participant?

**Katrina McCann:** So, after understanding these four-key factors we move into the legal considerations. So, there are lot of unique issues that arise in these specific context, but let's talk about the general legal principles and considerations. We have to think about issues under ERISA and about tax qualification issues. Paul can you tell me a little bit more about the ERISA considerations involved with overpayments?

**Paul Hamburger:** Sure, when you have an overpayment from a retirement plan, either defined benefit pension or 401k type retirement plan, the error is going to have to be fixed by a plan fiduciary. Therefore, the way in which these errors are fixed has this fiduciary overlay to it. The fiduciary is to act in the best interest of the plan and its participants. So that means initially, how is the fiduciary going to get that overpaid money back into the trust?

There are three general ways that this happens. One is through a process called recoupment, where we recoup those monies from the person who received the overpayment perhaps. Method two is we offset, so for example, if we have an overpaid annuity we might offset future annuity payments or future amounts owed by the plan to compensate for the fact that earlier overpaid amounts were made. And the third decision the fiduciary might make is to just simply forget about it from the perspective of the participant.

Now if the fiduciary makes the decision to recoup, then the question is how much can be recouped from the person who received the overpayment, the participant, beneficiary or other individual? But at the end of the day, the employer is likely going to be a backstop to make the plan whole for that overpayment. It's possible that a record keeper that caused the overpayment may also make the plan whole, if they were actually the cause of it.

Often however, participants might not have the means to repay that overpayment, so it becomes tricky for the fiduciary to decide how far to go down the road of recouping from a participant as opposed to from an employer, who may make the plan whole more readily.

The third ERISA issue to consider is what does your plan say? Do you have plan terms or summary plan description terms that explain that if a participant is overpaid the plan reserves the right to recoup that overpayment or offset future amounts owed against the overpayment?

**Katrina McCann:** In addition to ERISA, we need to think about tax qualification issues. Paul, can you tell us a little more about these?

**Paul Hamburger:** Anytime a tax qualified retirement plan is involved in an overpayment situation, there is a qualification issue. The reason is that an overpayment means that the plan administrator has deviated from the terms of the plan and therefore we need to fix it. The recognized method of fixing overpayments through the IRS correction program, known as the employee plan's compliance resolution systems or EPCRS, has a number of steps that can be taken depending on what type of plan is involved, depending on whether it is a lump sum or an annuity and depending on the type of overpayment involved. A lot of this can be done through self-correction. Moreover there is an exception for de minimis amounts that are under \$100. So, there is a great way to find a roadmap to curing overpayments by going through the rules in EPCRS.

Second if somebody did receive an overpayment it's possible that they rolled over that amount to an IRA or another qualified plan. Problem is, that that overpayment they were not entitled to can't in turn be rolled over. So therefore it has to be pulled out of the IRA or other qualified plan. There are tax issues associated with over-contributions to IRAs that may come into play and then there are mitigating provisions to help ameliorate the impact of some of those excise taxes.

The third question that we deal with from a tax perspective is: Are we fixing the error in the same year that the overpayment was made? Or, did the overpayment occur in one year and the fix isn't happening until a later tax year? That becomes very important because if it is going to be fixed in the same year before any amounts have been formally reported to the IRS, it is much easier to fix that type of a repayment issue than one where the money has already been reported as taxable on a form to the IRS. That becomes important because one of the recoupment methods that we talked about from an ERISA perspective which is also relevant from a tax perspective is having the person repay. If the person repays the overpayment, the problem may be if it crosses over tax years that they included the amount in income in an earlier year. Now they need to be compensated in the later year when they repay it. Historically there have been provisions that permit the deduction of that repayment in a later year. With the latest round of tax reform in place, it's not clear whether the same itemized deduction will be available for all those types of repayments. So that has to be looked at more closely.

And then the final thing from a tax perspective is we need to make sure we are appropriate; the plan is made whole for those overpayments. So, again even if we can't recoup from the participant we might be able to recoup from the employer or another service provider that caused the error in the first place.

**Katrina McCann:** Thank you for joining us today on the Proskauer Benefits Brief. Stay tuned for more legal insights on employee benefits and executive compensation and be sure to follow us on iTunes.

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