DLK ADVISORY

EMPLOYEE OVERPAYMENTS: WHAT TO DO

Once the end of financial year workload abates and payroll staff have time to have a closer look at what occurred in the previous income year, it's not unusual for unintended overpayments to employees to come to light. If this happens for your business, it's important to follow ATO guidance and consider all parties' rights and obligations when deciding what to do next.

Critically, the first step is to confirm whether the business will seek to recover the overpayment. This should be decided by business management in consultation with human resources, not by payroll staff. If no recovery will be sought then the original payment processing remains as is. Keep a clear record of the decision not to recover the overpaid amount.

If the business will seek recovery, you need to consider whether the overpayment relates to a previous income year, the current income year or both.

Remember to communicate clearly with the employee about any adjustments made to their Single Touch Payroll (STP) record – and therefore to their income statement – as part of recovering overpayments.

Previous income year
For an income year that's been finalised, the business will need to seek repayment of the gross overpaid amount directly from the employee. The STP record must be amended to reduce the gross by the amount of the overpayment. No tax adjustment should be made.

When the employee later lodges their tax return, the overpayment will no longer be taxable because it's no longer shown in STP, so they should get back any tax previously withheld on it.

Current income year
Where an overpayment affects a current income year, the process is to reduce the gross and the tax in STP by the original overpayment. The business then only needs to recover the net amount from the employee.

Superannuation
If the business paid superannuation on the original overpayment, the overpaid super can be used to offset future obligations for the same employee for up to 12 months.

Common questions
Should we only make adjustments once the employee has repaid?

No. The STP adjustments should occur when the decision is made to seek recovery. The decision means the amount becomes a loan to the employee and not taxable wages.

What happens if the amount isn't repaid by income year end?
Once the original overpayment is reversed in STP, internal records should show the amount as a loan, not taxable employee wages, so it doesn't matter for payroll purposes if the employee hasn't repaid the business by income year end.

Can we just reduce the employee's salary by the overpaid amount?
No. This would be viewed as a salary sacrifice, meaning it would come under FBT law as a debt waiver fringe benefit subject to full FBT.

Can the employee repay through the payroll system?
Yes. For the employee to repay through the payroll system, you need a written agreement indicating why the overpayment occurred, the total due and the amount to be repaid each cycle. Repayments should be post-tax deductions from the employee's pay. Alternatively, they could pay back external to the payroll system.

CONTACT
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