ACA Introduction to HMRC announcement below

The Lifetime Allowance will be reducing from £1.8m to £1.5m on 6 April 2012, and by way of protection from that drop individuals can apply for Fixed Protection before then. As you may be aware there has been considerable discussion in recent days about how the provision of death in service benefits may affect an individual's Fixed Protection where there is insurance cover for the payment of those benefits.

HMRC will shortly publish an announcement giving further guidance in this area (this will be separate to a PSS Newsletter scheduled for publication on 30 March). In view of the timescales involved HMRC has provided us with an advance copy of the announcement for us to circulate to members (see below). HMRC has advised us that if you want to forward this to colleagues please feel free to do so.

Karen Goldschmidt
Chairman
ACA Pension Taxation Committee

<u>HMRC announcement below</u>

Fixed protection – lump sum death benefits paid on death in service

This announcement is to clarify HM Revenue Customs' interpretation of the tax rules for benefit accrual for those individuals with fixed protection in relation to lump sum death benefits and benefit accrual.

Lump sum death benefits and life insurance

HMRC are aware that there is concern about the views we have expressed in relation to the position where insurance has been taken out to cover the potential cost of paying lump sum death benefits and whether payment of insurance premiums on or after 6 April 2012 is benefit accrual for the purposes of fixed protection. Given the interest this issue has generated and in the light of the further information we have received from the pensions industry this note sets out and clarifies our revised position.

Where a member who applies for fixed protection has a right to a defined benefits lump sum death benefit, as explained in the Registered Pensions Schemes Manual at http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm11101532.htm the guidance sets out

"*Whether or not an individual can continue to have death benefits (life cover) and keep fixed protection depends on the type of arrangement providing the death benefits.* http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM03109040.htm *gives guidance on what type of benefit is provided by what type of arrangement.*

If the death benefit promised is a defined benefit (and this is often the case in ***occupational pension schemes****) continuing to provide death cover should not cause loss of fixed protection. This is because a death in service benefit is not considered to be part of a member's pension rights. So if a member continues to be provided with death in service benefits this will not be benefit accrual and so will not cause loss of fixed protection.*

If the death benefit promised is other money purchase, cover may only continue with the member keeping fixed protection if it is provided by a policy established before 6 April 2006. The conditions at
http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM03109032.htm
need to be met. Fixed protection will be lost where contributions are made to a policy set up on or after 6 April 2006.

HMRC's view is that increases in the benefit applying from 6 April 2012, whether for example as a result of a salary increase, a higher multiple of salary or both, cannot give rise to benefit accrual nor will the payment of contributions to fund the benefit.

We have been told that in many cases pension schemes may take out an insurance policy to cover the potential cost of paying lump sum death benefits.

HMRC's view is that in such cases where the only lump sum death benefit being provided under an arrangement under the scheme rules is an amount equivalent to the proceeds of an insurance policy i.e. there is no provision for a defined benefits lump sum death benefit, then the arrangement is clearly an "other money purchase arrangement" (for more detail see the Glossary definition of "other money purchase arrangement" at http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM20000000.htm

In addition, where the lump sum death benefit is expressed as being the greater of a defined benefit (an amount determined by reference to salary, service or some other factor) and the policy proceeds, then this will be a hybrid arrangement as depending on circumstances either a defined benefit or an other money purchase benefit will be payable. So in both cases, the payment of a premium on or after 6 April 2012 will result in benefit accrual and loss of fixed protection if the premium is a "relevant contribution" as defined by paragraph 14 of Schedule 36 to Finance Act 2004 by virtue of paragraph 14(11) of Schedule 18 to Finance Act 2011. See also our guidance at
http://www.hmrc.gov.uk/manuals/rpsmmanual/RPSM11101530.htm#IDAEXVKC

However, HMRC are aware that there are a number of other types of insured death benefit lump sums. HMRC accept that the following scenarios will not involve an other money purchase benefit and therefore not lead to benefit accrual and loss of fixed protection:

a. A lump sum death benefit (LSDB) of 4 x final salary is paid out of scheme funds. This benefit is a defined benefits lump sum death benefit. (For the purposes of these scenarios the defined benefits lump sum death benefit is assumed to be a lump sum equal to 4 x final salary, in practice the defined benefit may be different).

b. A LSDB is calculated as in a. above and is backed by an insurance policy where, if the policy proceeds exceed the LSDB, the excess is paid to, and retained within, the scheme.

c. A LSDB is calculated as in a. above and is backed by insurance policy with the scheme liable to make good any shortfall where the proceeds of the policy are insufficient to fully fund the cost of the LSDB.

d. A LSDB is calculated as in a. above and is backed by insurance policy. The policy will not pay out more than the LSDB but may contain restrictions which, if they apply, will result in an amount payable to the scheme (or payable directly to the beneficiary(ies) identified by the trustees) which is less than the unrestricted defined lump sum death benefit. It has become clear from information provided to us, that many policies contain such restrictions. They may for example apply when there is a "catastrophe" event or in the case of particular individuals who represent a greater risk. Where the LSDB paid to the beneficiaries after the restriction is applied can itself be expressed as a defined benefits LSDB, for example
- it represents a percentage of the defined benefits LSDB that would have been provided in normal circumstances, or
- it is paid on a pro rata basis, or
- it is expressed as a lower amount, or
- the maximum paid under the policy is capped,

then HMRC accept that the LSDB actually paid is a defined benefits LSDB.

The exact position will of course depend upon the restrictions that apply under a particular policy but provided the maximum LSDB that can be provided under the policy is the defined benefits LSDB of 4 x salary and the restricted LSDB is defined in a manner which satisfies either the definition of "defined benefits" at section 152(6) Finance Act 2004 or possibly "cash balance benefits" as defined at section 152(5) there will be no other money purchase elements to the benefits to be provided. For the avoidance of doubt where, under a group policy, there are restrictions applying to particular members covered under the policy but which do not apply in the case of the member(s) with fixed protection, then no account need be taken of those restrictions.

e. Where an individual has restricted benefits under one policy but a further policy is taken out by the scheme in respect of the individual to ensure that the maximum 4 x final salary LSDB is paid, the benefit will be a defined benefits LSDB subject to the top-up policy not itself being an other money purchase arrangement because the entire proceeds will be paid out as a lump sum death benefit.

f. Where dependants' pension under a scheme's rules are insured, the insurance policy might, for example, make provision for a dependants' pension equal to say 30% of the member's salary, but with the pension restricted to the 'free–cover' divided by a specified multiple (say 30). So, if free-cover is £500,000, the max dependant's pension is £16,667. HMRC accept that this is a defined benefit arrangement as a specified benefit (a pension) will be provided and that pension is calculated by reference to a factor rather than just the amount available for the provision of dependants' benefits.

What about people whose life cover has ceased because they believed the continuing payment of premiums on or after 6 April 2012 would lead to benefit accrual and loss of fixed protection?

In such cases, HMRC would not regard re-instatement of the life cover as being a new arrangement (which itself would lead to loss of fixed protection as it would not be made in "permitted circumstances") made for the member so long as:

- the cover is re-instated as soon as possible whether with the same or a new insurer, and
- the basis of the cover provided has not been increased in comparison to the cover previously provided.

HMRC will update the guidance in the Registered Pension Schemes Manual in due course.

Death in service lump sums - refunds of contributions

HMRC is aware that it has been suggested that we may view a refund of contributions made on the death of a member as a money purchase benefit.

For the avoidance of doubt, HMRC's view is that the payment of a refund of contributions on death is a defined benefit and that the lump sum is a defined benefits lump sum death benefit. Where the rules also provide for the refund to include an element of "interest" or growth to be paid, then provided that the scheme rules provide for the payment and it is expressed or can be expressed in percentage terms then this will not affect the defined benefits nature of the lump sum. The scheme rules may specify an annual percentage rate of "interest" or a rate in line with the average annual base rate of a bank etc or a rate to be determined by the scheme trustees in accordance with actuarial advice. All these examples are accepted as providing a defined benefit.

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