

HMRC has recently taken an unexpected stance in relation to the extent to which fixed protection is compatible with ongoing life assurance cover. HMRC's interpretation of the legislation affects many pension plans that provide lump sum death benefits based on a multiple of salary where these are capped by reference to cover provided by a life assurance policy. Employers and trustees should decide urgently whether action needs to be taken to eliminate the risk that fixed protection will be lost by employees who continue to be provided with death benefits.

Background

Fixed protection is aimed at individuals whose benefits from all registered pension plans will exceed the lower lifetime allowance of £1.5million that will apply from 6 April 2012. Fixed protection will allow individuals to maintain the current lifetime allowance of £1.8million. Those who apply for fixed protection cannot accrue additional benefits in registered pension plans on or after 6 April 2012. Generally this means that members need to opt-out of active membership of a registered pension plan – but many members remain eligible for death benefits. HMRC previously indicated that the provision of a lump sum death benefit, based on a multiple of salary, would not in itself amount to accrual and would not cause fixed protection to be lost.

HMRC's interpretation

HMRC recently indicated in correspondence (and clarified in a formal announcement today) that where the lump sum death benefit is limited to the amount provided by an insurance policy, there could be a different outcome. The capped benefit is considered to be capable of falling within the definition of a money purchase benefit meaning that members lose fixed protection when a contribution is paid as this is deemed to be benefit accrual in most cases. (The only exception relates to certain insurance policies established prior to 6 April 2006: any cap by reference to such a policy will not constitute a money purchase benefit.) Applying the same logic, fixed protection could also be lost if lump sum death benefits are capped in other ways, for example by reference to 'catastrophe limits'.

Once fixed protection is lost, action cannot be taken to reinstate it. It is therefore important that employers of potentially affected employees consider the impact of HMRC's stance and seek legal advice without delay. Trustees who are aware of such cases may also wish to do so.

Possible actions could include:

- Paying next year's life assurance premiums before 6 April to 'buy some time'.
- A rule change so that the pension plan 'self-insures' the relevant lump sum death benefits on an uncapped basis for members with fixed protection.
- Establishing a separate 'excepted life policy' for affected members.
- Member communications (targeting those likely to be affected).

The most appropriate course of action for any given pension plan will depend on its rules and administrative practices, and their interaction with complex legislative provisions. Employers should however take urgent professional advice in any event.

For further information please contact any of the partners listed below or your usual contact in the Squire Sanders pension team.

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