Edison Wealth Management

When life assurance leads to a tax charge on pension death benefits

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Life Assurance vs Lifetime Allowance

It is not uncommon for beneficiaries and their executors to find that pension benefits are subject to an unexpected lifetime allowance tax charge. This may be due to a pay-out from a death in service scheme, which may seem odd to those who have not yet seen this in practice.

What many people perhaps aren't aware of is that most death-in-service benefits are subject to pension scheme rules. As with other pension funds and benefits, any excess above the current lifetime allowance limit of £1,030,000 could suffer additional charges of up to 55%.

You'd be forgiven for thinking that the £1,030,000 lifetime allowance adequately covers death-in-service pay-outs, which can be significant sums. They are seen as cost effective and so can equal multiples as high as 4, 8 or even 10 times salary. On death, these benefits are added to the cumulative value of the individual's pensions.

Who it affects?

Individuals with higher salaries, generous benefits packages, and accumulated pension benefits: personal and occupational.

For example, a salaried executive on £100,000, with death-in-service of 8x salary, will exceed the lifetime allowance if their pensions are valued at above £230,000, which is common place.

So, individuals with large salaries and/or pension funds, may wish to check with their employer how death-in-service benefits are provided.

Relevant Life Policies

A 'relevant life policy' could help get around the problem. Much like traditional death-in-service benefits, the policy would be established and paid for by the employer, proceeds would be paid tax-free and not classed as a benefit-in-kind. Premiums are also tax relievable for the employer. The key difference being, however, that benefits would not be tested against the lifetime allowance.

Protecting the higher Lifetime Allowance

At each reduction to the lifetime allowance it has been possible for individuals to 'protect' the higher amount. When the allowance reduced from £1.25 million to £1 million in 2016, individuals could retain the higher allowance using Fixed or Individual Protection 2016. A condition of Fixed Protection 2016 is that no further benefit accrual or pensions savings are made by them or on their behalf after 5th April 2016.

This is an easy and cost-free application with the HMRC and clearly can help mitigate the risk of exceeding the allowance for those with significant pension savings.

The risk of changing jobs

What those individuals may not know is that joining a new pension or death-in-service scheme will invalidate Fixed Protection 2016, thus possibly resulting in a tax charge of up to 55% for their beneficiaries.

How Edison can help?

Edison can help assess the risk of exceeding the lifetime allowance, taking into account pension and employer benefits. There may be cases where alternative provision for life assurance might be preferable.

To contact us, do not hesitate to call on 0207 287 225 or by email (help@edisonwm.com).

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Important Information

The above is a simplification of the legislation. It does not constitute advice. This piece was written based on the legislation applicable at the time. The views expressed above are subject to changes in legislation. The Financial Conduct Authority does not regulate tax advice.

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