Relevant Life Plans - 10 facts for contractors

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Contractors can use Relevant Life Plans (RLPs) insurance to provide a financial safety net for their dependents should the worst happen. RLPs are the same as the death-in-service benefits that contractors may have received when employed.

As Contractor Financial's life and income protection insurance expert Mark McBurney explains, RLPs are identical to personal life insurance except in two key respects: "A contractor's limited company takes out the policy, not the contractor individually.

"Plus, the contractor's company also benefits from corporation tax relief on the premiums. So, RLPs can be a highly tax efficient method of ensuring that a contractor's loved ones receive up to fifteen times the contractor's combined income from salary and dividends as a cash lump sum if they die."

McBurney has created a list of ten key facts about RLPs to help contractors choose the right protection for their needs:

1. RLPs are a death-in-service benefit payable to a contractor's beneficiaries

"RLPs are effectively the same as the death-in-service benefit that most contractors would receive when they were employed," continues McBurney. "The policy will pay out a cash lump sum to the contractor's beneficiaries in the event of their death for as long as the premiums are paid and the policy is in force."

2. RLPs are taken out by a contractor's company, not the contractor

Unlike personal life insurance, an RLP is taken out by the contractor's limited company and not the contractor personally. The premiums are paid by the company and the cash lump sum benefit is paid to the contractor's family.

"RLPs are designed for companies to provide a benefit to their employees' families. Contractors are employees of their own limited company, so the principle is the same," highlights McBurney.

3. Premiums are corporation tax deductible

Unlike personal life insurance policies, the premiums for RLPs are paid for by the contractor's limited company out of gross fee income. As a legitimate business expense, the premiums are also tax deductible against corporation tax. So, a contractor benefits from diverting the costs to their business and the resulting tax efficiency.

4. There is no P11D benefit-in-kind to pay

According to McBurney, there is no benefit-in-kind income tax charge for an RLP: "When contractors take benefits such as a company car or private health insurance, they have to declare the benefit on their P11D at the end of the tax year. They then pay income tax and National Insurance Contributions (NICs) on the value of the benefit as determined by HMRC's rules.

"However, HMRC's rules say that there is no benefit-in-kind charge for the premiums that a contractor's limited company pays out on RLPs. The contractor's employer – their limited company - foots the entire bill. There are no income tax or NIC liabilities for either the contractor or their company. "

5. The benefits do not form part of an employee's pension lifetime allowance

Another major benefit of RLP is that the policy does not count towards the contractor's lifetime allowance for pensions. McBurney explains: "Contractors have a limit of how much they can accumulate in a pension before they have to start paying tax, which is £1.25m for the 2015/16 tax year.

"Lump sum payments from a registered pension scheme would be included in this pot, and amounts in excess of the lifetime allowance are taxed at 55%. However, RLPs are not included so higher earners in particular will benefit."

6. The lump sum can be worth up to 15x salary and dividends

When employed, many contractors will recall that their death-in-service benefit would have paid out a multiple of their salary, typically between three and five times. RLPs recognise that contractors take their remuneration tax efficiently through a combination of a low salary and dividends.

"Contractors can choose to take out a policy that pays out the multiple of salary and dividends that they choose, or can best afford," says McBurney. "Although there is no statutory maximum, the maximum multiple offered by most providers is typically 15x salary and dividends, which for high earning contractors can be a considerable sum to leave to their loved ones."

7. The payout is free from income tax and inheritance tax

As well as being tax efficient to pay for, an RLP is also tax efficient when paying out. There are no income tax or inheritance tax liabilities for the contractor or their dependents should the contractor suffer an untimely death and the policy pays out.

8. RLPs only include death benefits and only pay out a lump sum

“As well as understanding the benefits, it is important for contractors to understand what RLPs won’t cover,” warns McBurney. “An RLP will only pay out a lump sum to a contractor’s dependents in the event of their death. An RLP is not a critical illness or income protection policy.

“Contractors should make separate provision for income protection in the event that they become too ill to work. Their RLP is not a substitute for this kind of protection.”

9. There is no surrender value

Unlike some pensions and investments that pay out if they are cancelled early, an RLP is a life insurance policy. It remains in force as long as the contractor’s limited company maintains the premiums and none of the conditions of the cover are breached. If the contractor chooses to stop paying the premiums, then the cover simply stops and there is no surrender value.

10. Policies must not be set up for tax avoidance purposes

McBurney notes that RLPs use discretionary trusts that are taken out and paid for by the employer – the contractor’s limited company – to pay the beneficiaries: “This type of financial structure is open to abuse and under some circumstances can be used as a tax avoidance vehicle.

Mark McBurney

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Mark McBurney is an experienced financial adviser, with ten years' history in the mortgage market, now specialising in protection for contractors.

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“For that reason, financial services providers stipulate that the contractor can only specify individuals, such as family members, and charities as beneficiaries. The employer, the contractor’s limited company, cannot be a beneficiary to avoid any suggestion that the policy has been created for tax avoidance purposes.”

McBurney concludes: “Contractors should seek professional advice from a financial adviser before taking key decisions about RLPs and other forms of protection.”

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