Warning

This slide presentation was prepared for staff of the University of Dundee and presented on 3rd December 2015 and has been uploaded to the University’s website to provide information to pension scheme members, (in particular members of the USS and the UoDSS).

Although it has been prepared to offer guidance, this presentation is not intended to amount to advice, and should not be considered a substitute for individual financial advice from a suitably authorised person.

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Aims for today

To help you understand...

• Your pension benefits
• The upcoming changes to the USS
• Tax limits
  • How they work and how they will change
  • What might cause you to exceed them
• Deadlines and actions required
• Mitigations and options available to manage any current or future tax penalty
• Where you can obtain additional information
Advice

We can...

• Provide information on tax changes
• Provide information on pension benefits including options available to you

We can’t...

• Provide individual financial advice

  ▪ If you require individual advice, you should contact an independent financial advisor
Introduction to Xafinity

- A leading provider of pension and employee benefits advice
- 400 employees; located in six offices throughout the UK
Agenda

1. Pensions – the basics
2. The USS – the upcoming changes
3. Tax limits – now and in future
4. Tax charges – what you need to do
5. Mitigations and options within USS
6. Your responsibilities
For most employees, the University provides a “defined benefit” pension. This means that pension at retirement is based on:

- **How long you have been in the scheme**
- **Pensionable pay**
- **The date you joined**

At retirement you will receive:

- **A pension, payable until death**
- **A one off cash lump sum**
- **Death benefits for your dependants**

For most employees :-

- Your pension, to date, will be **1/80 of final salary for each year of pensionable service, including transferred in service or service purchased by paying AVCs.**
- Your lump sum will be **three times pension.**
Final Salary Benefits – How they work

Example for a Member with 20 years’ service and a final salary on retirement or date of leaving of £80,000

• Annual pension is calculated as:

$$\frac{20}{80} \times \£80,000 = £20,000$$

- Defined Benefit pension of £20,000

• Pension Commencement Lump Sum is calculated as:

$$\frac{60}{80} \times \£80,000 = £60,000$$

- Defined Benefit tax-free cash of £60,000
USS – the Upcoming changes (1)

- Switch from Final Salary to Career Revalued Benefits on 1 April 2016

- Final Salary Benefit:
  
  \[ \frac{1}{80} \times (\text{Final Salary at 31 March 2016}) \times (\text{Service to 31 March 2016}) \]

- Final Salary Benefit linked to inflation from 31 March 2016 until retirement

- Career Revalued Benefit – \( \frac{1}{75} \times \text{capped Salary for each scheme year} \), plus revaluation until retirement

- Career Revalued Benefit Salary capped at £55,000 from October 2016

- Lump sum of three times pension for Final Salary and Career Revalued Benefits
USS – the Upcoming changes (2)

- Employee Contributions increase from 7.5% to 8.0% of salary
- Employer Contributions increase from 16.0% to 18.0% of salary
- Defined Contributions on salary above £55,000 into individual account
  - 12% of salary from Employer;
  - 8% of salary from Employee
- Scheme will cease to be “Contracted-out” with effect from 6 April 2016
- Employees pay extra National Insurance Contributions
  - 1.4% of “mid band Earnings” £5,824 to £40,040 in 2015/16
- Start to accrue the new State Single Tier Pension
Career Revalued Benefits – How they work

- Each year considered in isolation
- Year 1 Pension = \( \frac{1}{75} \times \text{Salary}^* \) in year 1
- Year 2 Pension = \( \frac{1}{75} \times \text{Salary}^* \) in year 2
  PLUS Inflation on Year 1 Pension
- Year 3 Pension = \( \frac{1}{75} \times \text{Salary}^* \) in year 3
  PLUS Inflation on Year 1 and Year 2 Pensions
- Accumulated until retirement
- Lump sum of three times annual pension at retirement
- Spouse’s pension of 50% of member’s pension

* Salary for part time workers are actual, not full time equivalent and are capped at £55,000 from October 2016
Career Revalued Benefits – How they work

- USS accrual of $\frac{1}{75} \times$ Salary each year
- Revaluation in line with CPI to all previous years’ accrual

- Lump sum of three times pension
- Spouse’s pension of half of member’s pension
NHS and TPS - Already Career Revalued

NHS
- Pension accrues at 1/54\textsuperscript{th} of pensionable pay each year
- No lump sum on top – cash is by commutation of pension
- Pension revalues at CPI + 1.5% each year

TPS
- Pension accrues at 1/57\textsuperscript{th} of pensionable pay each year
- No lump sum on top – cash is by commutation of pension
- Pension revalues at CPI + 1.6% each year

Both broadly equivalent benefits to USS
Taxation of Pensions - Background

- Registered pension arrangements are currently tax efficient to encourage saving for retirement
  - **Exempt** – the contributions you pay in get tax relief
  - **Exempt** – the lump sum you receive at retirement is tax free
  - **Taxed** – your pension income is taxed

- The level of tax relief granted by the Government has been limited, with different regimes applying over different periods.
- The current regime was introduced on 6 April 2006 (‘A day’).
- Government considering options for future approach to taxation
Tax limits on pension savings

The Annual Allowance (AA) places a limit on the value of tax efficient benefits you can build up each year
- The value of pension savings you make each year is compared to the AA
- AA is currently £40,000 (reduced from £50,000 from April 2014)
- Unused relief can be carried forward (up to three years)
- AA will be tapered down to £10,000 for very high earners from April 2016

The Lifetime Allowance (LTA) places a limit on the value of tax efficient benefits you can build up over your working lifetime
- The total value of all approved pension benefits is compared to the LTA when you retire
- LTA is currently £1.25m (reduced from £1.5m from April 2014)
- LTA will reduce to £1.0m with effect from April 2016
- LTA of £1.0m will start to rise with CPI from April 2018
How are my pension benefits valued?

For the Annual Allowance (AA) test

- Each £1 of pension is valued at £16
- Each £1 of cash is valued at face value
- Any contributions to a defined contribution arrangement funds are valued as the amount paid in

For the Lifetime Allowance (LTA) test

- Each £1 of pension is valued at £20
- Each £1 of cash is valued at face value
- Any defined contribution funds are taken at market value

The factors applied are standardised and do not allow for the age of the member or the form of the pension (i.e. non escalating or inflation linked)
How have the limits changed?

Annual Allowance (£000s)

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<tr>
<td>Allowance (£000s)</td>
<td>215</td>
<td>225</td>
<td>235</td>
<td>245</td>
<td>255</td>
<td>50</td>
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Lifetime Allowance (£m)

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<tr>
<td>Allowance (£m)</td>
<td>1.5</td>
<td>1.6</td>
<td>1.65</td>
<td>1.75</td>
<td>1.8</td>
<td>1.8</td>
<td>1.5</td>
<td>1.5</td>
<td>1.25</td>
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When is the Annual Allowance test applied?

The total value of your pension savings each year is compared to the Annual Allowance (AA).

- The value of your pension savings each year is known as the ‘Pension Input Amount’
- It is compared to the Annual Allowance
  - Currently £40,000
- If your Pension Input Amount exceeds the Annual Allowance you may be subject to a tax charge
- You can carry forward unused relief for up to three years
- Annual Allowance to be tapered for very high earners from 2016/17
AA test – How is my Pension Input Amount calculated?

- **Value the benefits at the start of the year (A):**
  - Pension at start of year x 16 + Lump Sum* at start of year
  - And increase in line with CPI

- **Value your benefits at the end of the year based on salary and service at the year end (B):**
  - Pension at end of year x 16 + Lump Sum* at end of year

- **Your Pension Input Amount is equal to (B) – (A)**

- *If tax is payable, the tax charge on your Pension Input Amount is paid at your highest marginal rates of income tax*

- *For most USS, NHS and TSS members, a lump sum is payable in addition to the pension*
Protection against the AA – Carry Forward...

- “Carry Forward” facility has been introduced to reduce the chance of a one off event such as promotion triggering a tax liability.

- Any unused allowance from the previous three tax years (starting with the earliest year) can be used to offset a tax liability.

- Members can only carry forward unused allowance if, for the tax year in question, they were either:
  - Participating in a registered pension plan in the UK (e.g. USS); or
  - Earning benefits in an overseas pension plan and qualified for UK tax relief on the savings
Changes to the Pension Input Period

- Previously the PIP was 1 April to 31 March for USS, NHS, TSS
- From 2016/17, all pension scheme PIPs to be aligned with tax year
- For 2015/16, tax year, pension savings will be measured over two periods

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Timing of PIP</th>
<th>Annual Allowance</th>
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<tbody>
<tr>
<td>2014/15</td>
<td>1 April 2014 to 31 March 2015</td>
<td>£40,000</td>
</tr>
<tr>
<td>2015/16</td>
<td>1 April 2015 to 8 July 2015 (‘mini’ PIP)</td>
<td>£80,000</td>
</tr>
<tr>
<td>2015/16</td>
<td>9 July 2015 to 5 April 2016 (‘mini’ PIP)</td>
<td>Nil, but can carry forward a maximum of £40,000 from previous ‘mini’ PIP</td>
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<tr>
<td>2016/17</td>
<td>6 April 2016 to 5 April 2017</td>
<td>£40,000 subject to tapering for high earners</td>
</tr>
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- Opportunity to maximise £40,000 AA in remainder of 2015/16 input period via insured Defined Contribution AVCs
- No detriment to members from change in PIP timing
AA Example 1 (high earner with long service)

- Benefits at the year end (March 2016)
  
  \[
  \frac{31}{80} \times \£109,000 = \£42,238
  \]
  
  Defined Benefit pension of £42,238

- Less benefits at the start of the year
  
  \[
  \frac{30}{80} \times \£100,000 \times 1.025 = \£38,438
  \]
  
  Defined Benefit pension of £38,438

- Real increase in pension = £42,238 – £38,438 = £3,801
- Real increase in lump sum = 3 x £3,801 = £11,402
- Pension Input Amount = £3,801 x 16 + £11,402 = £72,210
- This is split £19,266 in first mini-PIP and £52,944 in the second.
- Tax payable (only £40k allowed in second mini-PIP) = 40% x £12,944 = £5,178
AA Example 2 (significant promotion)

- Benefits at the year end (March 2016)
  
  \[
  \frac{25}{80}^{\text{th}} \times \£75,000 = \£23,438
  \]

- Less benefits at the start of the year
  
  \[
  \frac{24}{80}^{\text{th}} \times \£60,000 \times 1.025 = \£18,450
  \]

- Real increase in pension = £23,438 – £18,450 = £4,988
- Real increase in lump sum = 3 x £4,988 = £14,964
- Pension Input Amount = £4,988 x 16 + £14,964 = £94,772
- This is split £25,285 in first mini-PIP and £69,487 in the second.
- Tax payable (only £40k allowed in second mini-PIP) = 40% x £29,487 = £11,794
Tapering of Annual Allowance

- For high earners (> £110,000), annual allowance of £40,000 is reduced by £1 for each £2 of Adjusted Income over £150,000, subject to a minimum AA of £10,000.

- Adjusted Income = actual earnings less member contributions, plus Pension Savings amounts plus external income

- Example – USS member with no external income:-
  - Earnings of £140,000, plus Pensions Input Amount of £40,000.
  - Adjusted Income = £140,000 – (8.0% x £140,000) + £40,000 = £168,800
  - Restricted Annual Allowance = £40,000 – (£168,800 – £150,000)/2 = £30,600
  - If no carry forward relief, tax payable on £40,000 – £30,600 = £9,400
  - Tax = 40% x £9,400 = £3,760
AA Example 3 (very high earner - USS)

- Valuation of benefits at March 2017
- Final Salary benefits revalued at CPI so no input to Annual Allowance in most circumstances
- CRB - \( \frac{1}{75} \times £55,000 = £733 \), plus lump sum of £2,200
- Defined contributions of 12% from Employer, 8% from Employee on Earnings over £55,000
- Cut off salary before “tapering” of annual allowance is £131,310
- Tapering starts to have effect when salary = £145,527
- Any external income will reduce these figures
NHS and TPS critical salaries

NHS member

- Cut off salary before tapering of annual allowance is around £130,300.
- Tapering starts to have an effect when salary exceeds around £131,900

TPS member

- Cut off salary before tapering of annual allowance is around £129,100.
- Tapering starts to have an effect when salary exceeds around £133,500
Potential AA Triggers

There are no hard and fast rules but there are groups of members who are likely to be more at risk of breaching the AA than others

- High earners
- Middle earners who receive a significant pay increase
- Members with multiple appointments (allow for total salary)
- Ill health retirements (although exemption for “severe ill health”)
- Members who pay added years AVCs or have purchased additional pension/added years (Post April 2013 USS AVCs accrue on a pro-rata basis)
- Members who have other pension savings
- Redundancy or purchase of additional service by your employer
How will I know if I have breached the AA?

• Your scheme administrator must send you a ‘Pensions Saving Statement’ by 6 October each year automatically if you have exceeded the AA in that scheme in the previous tax year.

• If you contribute to more than one arrangement you should aggregate your pension savings and ask for statements if you think you will need them.

• The HMRC website provides support, including calculators to help you work out whether you have exceeded the AA and help on how to complete a tax return.

You are responsible for checking the value of your pension savings each year.
What to do if you have exceeded the AA?

• You must inform HMRC – it’s your responsibility
• You do this using the income tax self assessment form
• A tax charge is payable on your excess pensions savings at your highest marginal rates of income tax
• You can pay your charge by...
  • ‘Scheme Pays’ if the tax charge is over £2,000. No cash is required but your scheme benefits will be reduced
    or
  • A cash payment from your income or savings
What are the time limits for paying the AA tax charge?

• For members who have exceeded the AA in 2012/13 and subsequent years

  • To use Scheme Pays, apply by 31 July in the year following the tax year in which the AA charge becomes due (i.e. 31 July 2016 for pension earned from 1 April 2014 to 31 March 2015)

  • By 31 January following the end of the tax year if paying via self assessment
When is the Lifetime Allowance test applied?

The total value of all of your benefits is compared to the Lifetime Allowance (LTA) when there is a “Benefit Crystallisation Event”

For example:

- Retirement
- Death
- You reach age 75

*If the value of your benefits exceeds the LTA, a tax charge will be due*
LTA test – How are my benefits valued?

For a defined benefit scheme (e.g. USS, NHS, TPS):

• Annual pension x 20 + Lump Sum

For a defined contribution arrangement (personal pension, money purchase AVCs, historic DC arrangements):

• The fund value

*It is important to allow for benefits in all arrangements including any benefits relating to former employments and any personal pension arrangements as well as those in your current scheme*
LTA Example 1 (retiring this tax year)

- Retiring in March 2016
- Salary of £130,000 and 40 years’ service:
  - Pension is 40/80 x £130,000 = £65,000
  - Lump sum is 3 x pension = £195,000
- Value of benefits for LTA test is:
  - £65,000 x 20 = £1,300,000  plus  £195,000
  - £1,495,000, which is above the 2015/16 LTA of £1.25m
- £245,000 of the benefit is subject to a tax charge
LTA Example 2 (retiring in 10 years)

Retiring in March 2026

Current salary of £85,000, current service of 30 years,
4.0% p.a. salary growth; 2.5% p.a. CPI / revaluation: DC returns 5.0% p.a.

- Projected Final Salary pension is 30/80 x £108,800 = £40,800 p.a.
- Projected CRB Pension for 10 years = £10,600 p.a.
- Projected lump sum is 3 x total pension = £154,200
- Defined contribution accumulation = £102,500

Value of benefits for LTA test is:

- £51,400 x 20 = £1,028,000 plus £154,200 plus £102,500
- £1,284,700 – above the projected 2025/26 LTA of £1.22m

£64,700 of the benefit is subject to a tax charge
How much is the LTA tax charge?

A tax charge is payable on the value of benefits in excess of the LTA. The level of charge depends on how it is paid.

- **Paid as a lump sum** – effective 55% tax charge applied to the lifetime allowance excess if taken as a lump sum.

- **Paid via a reduction to your pension** – 25% tax charge applied to value of excess pension (valued by multiplying the excess pension by 20).

The remaining pension in both cases will be subject to income tax at standard rates.
Protection available against LTA changes

**Individual Protection 2014**
- Protected up to value of benefits on 5 April 2014 if between £1.25m and £1.5m
- Further benefit accrual possible
- Can apply up to 5 April 2017

**Fixed Protection 2016**
- Protected up to £1.25m
- **No further accrual**, in real terms, after 5 April 2016
- Final Guidance still outstanding from HMRC
- Can apply before the first “Benefit Crystallisation Event” after 5/4/16*

**Individual Protection 2016**
- Protected up to value of benefits on 5 April 2016 if between £1.0m and £1.25m
- Further benefit accrual possible
- Final Guidance still outstanding from HMRC
- Can apply before the first “Benefit Crystallisation Event” after 5/4/16*

HMRC has provided an online tool to help individuals decide whether to apply for IP14: [http://www.hmrc.gov.uk/tools/lifetimeallowance/index.htm](http://www.hmrc.gov.uk/tools/lifetimeallowance/index.htm). IP16 tool to follow.

* You can apply after 5/4/16 even if you have drawn some benefits before 6/4/16.
Mitigations (USS) – Enhanced Opt Out (EOO) (from April 2016)

- Cease building up further pension benefits (permanent or temporary)
- Remain a member of USS for death in service and incapacity cover
- Must be in place for at least 12 months, subject to auto enrolment issues
- Limited employee contributions of 2.5% of salary (to cover the benefits still offered being offered)
- May be useful for members with high salaries and long service who are close to, or above, both the AA and LTA
- Rejoin the Career Revalued Benefits section after 12 months
- Available to all members (not just Final Salary Scheme)

*Detailed information will be available on the USS website in due course. You should also consider seeking financial advice before using any of the mitigations*
Mitigations (USS) - Voluntary Salary Cap (VSC) (from April 2016)

- Members may elect to have their pensionable salary capped to avoid exceeding the Annual Allowance
- Available from 1 October 2016
- Salary capped at agreed figure above the DB salary threshold of £55,000
- Annual election to have lower salary used for DC pension contributions
- Optional limited employee contributions of 2.5% of salary (to allow member to retain life cover and incapacity benefits)
- Useful for members with high salary and short service who will breach the AA on a regular basis

*Detailed information will be available on the USS website in due course. You should also consider seeking financial advice before using any of the mitigations*
Using the Scheme Options

Increase (or reduce) your tax free cash

USS provides a standard tax free cash sum of 3 times your pension. This can be increased by ‘selling’ part of your standard pension (or reduced by ‘buying’ additional scheme pension)

- This has a limited effect on the value of your benefits for the LTA assessment as you are simply changing the ‘shape’ of your benefits
- The flexibility is useful for members who want to increase or reduce their tax cash sum

Review your options at retirement and consider the tax implications of increasing or reducing your tax free cash sum
Using the Scheme Options

Flexible retirement
Subject to some conditions, members can take their benefits in stages from age 55

• Taking some of your benefits early means your pension will be reduced to reflect the fact it will be paid over a longer period
• This will reduce the value of your benefits for the LTA test
• It will also reduce the rate at which you accrue further benefits and therefore the value of your benefits for the AA test
• Conversely, if you take your benefits late they may be increased by a late retirement factor, increasing the value of your benefit for the LTA test
• Flexible retirement requires employer consent and means a reduction in the rate at which you accrue further benefits

You may wish to consider how flexible retirement would effect the level of your benefits and the value of your benefits for LTA and AA purposes. You should also talk to your Employer about your retirement plans.
Planning and Support

• You may not have been affected in the past, but an increasing number of employees will be affected in future with the AA and LTA changes from 2016
• Plan ahead for your retirement and discuss your plans with your Employer
• Understand the mitigations and options available in your scheme
• Use available supporting material from USS, SPPA, HMRC websites and Pensions Wise
• Collect information on all of your pension arrangements – past and present
Responsibilities

AA and LTA

• Tax is your responsibility
• All pension arrangements should be taken into account
• Use the support available

More generally

• Use the support available
• Plan your retirement and talk to your Employer
• Consider taking independent financial advice
Key Dates

Annual Allowance tax charge
- For 2013/14 tax year, ‘Scheme Pays’ elections must have been made by 31 July 2015
- For 2014/15 tax year, you have to complete your self assessment by 31 January 2016, and ‘Scheme Pays’ elections must be made by 31 July 2016

Lifetime Allowance
- It is no longer possible to apply for Fixed Protection 2014
- You have been able to apply for Individual Protection 2014 from August 2014, and have until 5 April 2017 to apply.
- No deadlines for applying for Individual / Fixed Protection 2016, BUT
- For Fixed Protection 2016, accrual must cease by 5 April 2016.

*If you require individual advice, you should contact an independent financial advisor*
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