CONTENTS

SECTION 1: PENSIONS OVERVIEW

SECTION 2: ANNUAL ALLOWANCE

SECTION 3: LIFETIME ALLOWANCE

SECTION 4: OPTIONS FOR MEMBERS

SECTION 5: NEXT STEPS
PENSIONS OVERVIEW

TYPES OF PENSION SCHEME

Defined Benefit (DB)

USS Retirement Income Builder

Defined Contribution (DC)

USS Investment Builder
PRE 2006
Limits on years of service and contributions

POST 2006
Tax “simplification”!
No benefit limits, but tax penalties
PENSIONS OVERVIEW
TAX LIMITS – KEY TERMS

ANNUAL ALLOWANCE (AA)

The maximum value of the benefits built up or total contributions made each year

LIFETIME ALLOWANCE (LTA)

The maximum value of your benefits (pension and cash) on retirement

Tax charge arises when you exceed an allowance
SECTION 2
ANNUAL ALLOWANCE
ANNUAL ALLOWANCE (AA) AMOUNT TO COMPARE AGAINST LIMIT

Defined Benefit

- Accrued benefit (allows for service to start of year)
- Accrued benefit (allows for service to end of year) + CPI

Defined Contribution

- Total contributions paid by member and employer in the year

Start of year

End of year

x 16 (if cash by commutation)

x 19 (if cash is 3 times pension)
Annual Allowance Changes Since Introduced

- **2006**: £215,000
- **2010**: £255,000
- **2011**: £50,000
- **2014**: £40,000

Pay tax on the value above the Annual Allowance:

- Total HMRC value of annual pension savings

Annual Allowance vs. Excess (AA tax charge incurred)
ANNUAL ALLOWANCE – EXAMPLE
BEFORE SUMMER 2015 BUDGET

Pat’s salary last year was £80,000, salary this year is £100,000, 25 years of service

1 April 2015

Accrued benefit plus CPI
£25,300

1 April 2016

Accrued benefit
£32,500

(32,500 – 25,300) x 19 = £136,800

Calculations

Annual Allowance
£40,000

Excess above allowance
£96,800
(i.e. 136,800 – 40,000)

Tax charge
£38,720
(assuming 40% marginal tax rate)
CARRY FORWARD

Any unused AA in the previous three years can be used in the current year.

SCHEME PAYS

If AA charge more than £2,000, it can be settled from your pension savings.
**EXAMPLE BEFORE SUMMER 2015 BUDGET**

Pat’s salary last year was £80,000, salary this year is £100,000, 25 years of service

Accrued benefit plus CPI

£25,300

1 April 2015

Accrued benefit

£32,500

1 April 2016

\[(32,500 – 25,300) \times 19 = £136,800\]

**Calculations**

- Annual Allowance: £40,000
- Carry forward from previous 3 years: £15,000
- Total allowance: £55,000
- Excess above allowance: £81,800
  (i.e. 136,800 – 55,000)
- **Tax charge**
  (assuming 40% marginal tax rate): £32,720

If use Scheme Pays (assuming a factor of 20:1) = £1,636 p.a. pension deduction/ £4,908 cash deduction
BUDGET 2015 CHANGES
ANNUAL ALLOWANCE

NEW TAPERED ANNUAL ALLOWANCE

REALIGNMENT OF THE PENSION INPUT PERIOD (PIP)
For people with earnings £150,000 - £210,000 the Annual Allowance will be progressively reduced from £40,000 to £10,000 on a uniform scale from April 2016.
### BUDGET CHANGES

**INCOME DEFINITIONS**

#### “THRESHOLD INCOME” INCLUDES THE FOLLOWING

<table>
<thead>
<tr>
<th>Basic Salary</th>
<th>Performance related pay</th>
<th>Taxable benefits (e.g. car, medical plan)</th>
<th>Taxable social security benefits</th>
<th>Pensions in payment (including State Pension)</th>
<th>Taxable dividend, rental and savings income</th>
</tr>
</thead>
</table>

#### LESS

- Your pension contributions
- Certain charitable donations

#### PLUS

- Employer contributions to a new salary sacrifice arrangement

#### “ADJUSTED INCOME”

**THRESHOLD INCOME**

<table>
<thead>
<tr>
<th>Plus 1</th>
<th>Plus 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension contributions to a DC arrangement e.g. Investment Builder</td>
<td>Annual pension savings under Retirement Income Builder</td>
</tr>
</tbody>
</table>
Determine **Threshold Income** = Broadly total taxable income (e.g., salary net of member contributions, bonus, rental income, investment income)

Is **Threshold Income** greater than £110,000?

**NO**

The member is not subject to the Tapered Annual Allowance. Their Annual Allowance is £40,000

**YES**

Determine **Adjusted Income** = Threshold Income + any DC contributions + any Pension Input Amount for DB members

Is Adjusted Income greater than £150,000

**NO**

**YES**

The member is subject to the Tapered Annual Allowance. Their Tapered Annual Allowance will be between £10,000 and £40,000
Determine Pat’s Threshold Income
£100,000 (unchanged salary)
- £8,000 (member contributions to USS)
+ £25,000 (from rental income)
= £117,000

Is Threshold Income greater than £110,000?

The member is not subject to the Tapered Annual Allowance. Their Annual Allowance is £40,000

Determine Adjusted Income
£117,000 (Threshold Income)
+ £136,800 (Pension Input Amount)
= £253,800

Is Adjusted Income greater than £150,000

Pat is subject to a Tapered Annual Allowance of £10,000 (since Adjusted Income is more than £210,000)
SUMMER BUDGET CHANGES
SPLITTING THE 2015/16 TAX YEAR

Pre Alignment Tax Year

1 APRIL 2015 to 8 JULY 2015
99 DAYS

ANNUAL ALLOWANCE
£80,000

PLUS

CARRY FORWARD FROM
2012/13, 2013/14 & 2014/15

Post Alignment Tax Year

9 JULY 2015 to 5 APRIL 2016
272 DAYS

NO ADDITIONAL ANNUAL ALLOWANCE

£80,000 LESS PRE-ALIGNMENT SAVINGS (MAX. £40,000)

PLUS

REMAINING CARRY FORWARD FROM 2012/13, 2013/14 & 2014/15
Pat’s salary last year was £80,000, salary this year is £100,000, 25 years of service

(32,500 – 25,625) x 19 = £130,625

Calculations

- Tax charge before Summer Budget: £32,720
- Pre alignment value: £34,857
  - (£130,625 x 99/(366+5))
- Carry forward to post alignment period: £40,000
  - (£80,000 – 34,857 up to a maximum of £40,000)
- Post alignment value: £95,768
  - (£130,625 – £34,857)
- Post alignment Annual Allowance: £40,000
- Carry forward from previous 3 years: £15,000
- Total allowance: £55,000
- Excess above allowance: £40,768
  - (i.e. 95,768 – 55,000)
- Tax charge: £16,300
  - (assuming 40% marginal tax rate)

If use Scheme Pays (assume a factor of 20:1) = £815 p.a. pension deduction/ £2,445 cash deduction
**ANNUAL ALLOWANCE FROM APRIL 2016/17 EXAMPLE**

**Sam’s salary: £100,000 (no other taxable)**

**USS provides DB on full salary up to 1 October 2016. Thereafter hybrid benefits:**
- **DB up to Salary Threshold (£55,000)**
- **DC above Salary Threshold**
- **Assume opted for 1% match**

**Accrued DB pension increases with USS pension increases (broadly CPI)**

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>HMRC value of DB pension</td>
<td>£19,633</td>
</tr>
<tr>
<td>$((£100,000 + £55,000) \times 0.5 \times (1/75) \times 19)$</td>
<td></td>
</tr>
<tr>
<td>HMRC value of DC</td>
<td>£4,500</td>
</tr>
<tr>
<td>$((12% + 8%) \times (£100,000 – £55,000)) \times 0.5$</td>
<td></td>
</tr>
<tr>
<td>HMRC value of 1% match</td>
<td>£1,000</td>
</tr>
<tr>
<td>$(2% \times £100,000) \times 0.5$</td>
<td></td>
</tr>
<tr>
<td><strong>Total HMRC value</strong></td>
<td><strong>£25,133</strong></td>
</tr>
<tr>
<td>Annual Allowance</td>
<td>£40,000</td>
</tr>
<tr>
<td>(Threshold Income less than £110,000)</td>
<td></td>
</tr>
<tr>
<td><strong>Carry forward</strong></td>
<td><strong>£14,867</strong></td>
</tr>
<tr>
<td>(i.e. £40,000 - £25,133)</td>
<td></td>
</tr>
</tbody>
</table>

The HMRC value of the USS benefits is lower than the Annual Allowance and no tax charge is due.
## ANNUAL ALLOWANCE FROM APRIL 2016/17

### EXAMPLE

**What if Sam’s salary was £150,000?**

- **Threshold Salary:**
  \[
  150,000 - (9\% \times 150,000) = £136,500
  \]

- **Adjusted Salary:**
  \[
  136,500 + 36,967 = £173,467
  \]

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>HMRC value of DB pension:</td>
<td>£25,967</td>
</tr>
<tr>
<td>[((£150,000 + £55,000) \times 0.5 \times (1/75) \times 19)]</td>
<td></td>
</tr>
<tr>
<td>HMRC value of DC:</td>
<td>£9,500</td>
</tr>
<tr>
<td>[((12% + 8%) \times (£150,000 – £55,000)) \times 0.5]</td>
<td></td>
</tr>
<tr>
<td>HMRC value of 1% match:</td>
<td>£1,500</td>
</tr>
<tr>
<td>[2% \times £150,000 \times 0.5]</td>
<td></td>
</tr>
<tr>
<td><strong>Total HMRC value:</strong></td>
<td>£36,967</td>
</tr>
<tr>
<td><strong>Annual Allowance:</strong></td>
<td>£28,266</td>
</tr>
<tr>
<td>(Adjusted Income is £173,467)</td>
<td></td>
</tr>
<tr>
<td>Assume no carry forward from previous 3 years</td>
<td></td>
</tr>
<tr>
<td><strong>Excess above allowance</strong></td>
<td>£8,701</td>
</tr>
<tr>
<td>(i.e. £36,967 - £28,266)</td>
<td></td>
</tr>
<tr>
<td><strong>Tax charge at 45%</strong></td>
<td>£3,915</td>
</tr>
</tbody>
</table>
ANNUAL ALLOWANCE
MEETING THE TAX CHARGE

- Tax is payable in respect of year when Annual Allowance exceeded
- Default position is that member pays tax as a lump sum through self-assessment
- Member can notify HMRC that charge will be met by “Scheme Pays”
  - Tax charge that relates to USS benefits must exceed £2,000
  - Paid from the fund to HMRC
  - Member benefits adjusted to reflect amount paid
  - No effect on death benefits

Using Scheme Pays is likely to be more tax-efficient, but reduces retirement income
• First source under USS is Investment Builder account

• Balance from Retirement Income Builder benefits
  • If retiring, either from lump sum or from future pension payments (valued using normal commutation factor)
  • In other cases, reduce lump sum and pension (valued using cash equivalent factor)

• Modeller available on USS website
WHAT DOES IT MEAN FOR MEMBERS?
KEY DATES AND ACTIONS: 2015/16 TAX YEAR

- **Members to notify HMRC on self assessment tax returns** that they want to use Scheme Pays and to have completed self-assessment form
  - 6 Oct 2016

- **Latest date for members to make irrevocable election to proceed with Scheme Pays**
  - 31 July 2017

- **HMRC matches up scheme tax payments with elections by members for Scheme Pays on tax returns**
  - 31 December 2017
  - February 2018 onwards

- **Requirement for schemes to have sent pension savings statements to those who have exceeded the AA in that scheme**
  - 31 January 2017

- **Date when tax payable from scheme becomes due**
  - 31 December 2017

© MERCER 2016
Threshold Income and Adjusted Income include income outside core University employment. Hence, employers will not be able to identify all employees liable to a pensions tax charge.

Pension savings statements will only be sent to those members whose annual pension savings exceed the standard Annual Allowance of £40,000.

**Mandatory** Scheme Pays facility is only available when the AA of £40,000 has been exceeded (rather than any lower Tapered AA).

An **optional** Scheme Pays facility may be provided by USS to cover those who exceed their Tapered AA but do not exceed £40,000:
- Currently unclear whether this will be offered.
- Will have different reporting deadlines.
4. Fill in your return

Pension saving tax charges etc

You have said that you are liable to pension saving tax charges and taxable lump sums from overseas pension schemes in the tax year 2015 to 2016. Please complete the following questions.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of pension benefits in excess of your Available Lifetime Allowance, taken by you as a lump sum:</td>
<td>£</td>
</tr>
<tr>
<td>Value of pension benefits in excess of your Available Lifetime Allowance, not taken as a lump sum:</td>
<td>£</td>
</tr>
<tr>
<td>Lifetime Allowance tax paid by your pension scheme:</td>
<td>£</td>
</tr>
<tr>
<td>Amount saved towards your pension, in the period covered by this return, in excess of the Annual Allowance:</td>
<td>£</td>
</tr>
<tr>
<td>Annual Allowance tax paid or payable by your pension scheme:</td>
<td>£</td>
</tr>
<tr>
<td>Pension scheme tax reference number:</td>
<td></td>
</tr>
<tr>
<td>Amount of unauthorised payment from a pension</td>
<td>£</td>
</tr>
</tbody>
</table>

If Scheme Pays is being considered, enter the Pension Scheme tax reference number here.
SECTION 3
LIFETIME ALLOWANCE
LIFETIME ALLOWANCE (LTA) CHANGES SINCE INTRODUCED

- **2006**: £1.5m
- **2010**: £1.8m
- **2012**: £1.5m
- **2014**: £1.25m
- **2016**: £1.0m (increasing with CPI from 2018)

**Total HMRC value of retirement benefits**

- 25% Lifetime Allowance charge on excess
- 25% tax free cash - max £250,000 from 2016

Pension (taxed)
LIFETIME ALLOWANCE
CALCULATION AND IMPACT

HMRC value = DB pension x 23
+ DC fund value

EXTRA TAX CHARGE
…if the HMRC value exceeds the Lifetime Allowance

© MERCER 2016
**LIFETIME ALLOWANCE EXAMPLE**

Pat received a pay rise in April 2016 to £150,000 and retires in April 2018 with 40 years’ service in USS

**Pre April 2016 DB benefits:** Pension of £47,500 p.a., Cash of £142,500

**USS Retirement Income Builder benefits:** Pension of £4,000 p.a., Cash of £12,000

**USS Investment Builder pot:** £47,600

Total value = £1,232,100 (being (47,500 + 4,000) x 20 + 142,500 + 12,000 + 47,600)

<table>
<thead>
<tr>
<th>DB pension of £51,500 pa</th>
<th>Excess over LTA £232,100</th>
</tr>
</thead>
<tbody>
<tr>
<td>plus DB cash of £154,500</td>
<td>(1,232,100 – 1,000,000)</td>
</tr>
<tr>
<td>plus DC pot of £47,600</td>
<td>USS pays 25% tax (£58,000)</td>
</tr>
</tbody>
</table>

Pension could be reduced by £2,900 pa and cash reduced by around £8,700 if conversion is at 20:1

Alternatively, use Investment Builder account of £47,600 to part pay the LTA charge and pay balance of £10,400 through a pension reduction of £520 p.a. and cash reduction of £1,560
LIFETIME ALLOWANCE PROTECTION

FIXED PROTECTION

Protects current LTA

But you cannot build up any more benefits in a pension scheme

FP14 is fixed protection at 5 April 2014 (i.e. protected LTA of £1.5m)
FP16 is fixed protection at 5 April 2016 (i.e. protects LTA of £1.25m)

INDIVIDUAL PROTECTION

Protects your personal LTA calculated at 5 April to a maximum of current LTA

Can continue building up benefits in a pension scheme

IP14 is individual protection at 5 April 2014 (i.e. protects LTA of up to £1.5m)
IP16 is individual protection at 5 April 2016 (i.e. protects LTA of up to £1.25m)

Can apply for IP14 up to 5 April 2017

Registration for FP16 and IP16 is online (No certificates will be issued – only an online response and a protection reference number)
LIFETIME ALLOWANCE
INDIVIDUAL PROTECTION - EXAMPLE

AT 5 APRIL 2016:
• 38 years of service
• £90,000 salary
• Scheme is final salary, 80ths plus 3 times cash lump sum
• Plus AVC “pot” of £100,000

BENEFITS AT 5 APRIL 2016:
• Pension of: \( \frac{38}{80} \times 90,000 = £42,750 \) pa
• Cash of: \( 3 \times 42,750 = 128,250 \)
• AVCs of: £100,000

HMRC VALUE AT 5 APRIL 2016:
• \( 42,750 \times 20 + 128,250 + 100,000 = £1,083,250 \)

INDIVIDUAL PROTECTION 2016 = £1,083,250
SECTION 4
OPTIONS FOR MEMBERS
OPTIONS FOR MEMBERS
CHANGING YOUR USS BENEFITS

Affects further build up of benefits
Enhanced opt out
Voluntary Salary Cap

Affects employer contributions
Options for Members
Changing Your USS Benefits

Enhanced opt out

- Opt out of scheme but maintain cover for death in service and ill-health benefits only.
- Member contribution of 2.5% of salary.
- Employer contribution of 2.1% of salary (towards deficit reduction).
- Can opt to cancel (annual review): once cancelled, cannot opt for EOO again.

Voluntary Salary Cap (VSC)

- Members can set their own salary cap (subject to a minimum of the Salary Threshold (initially £55,000)).
- Members can choose to retain cover for death in service and ill-health benefits on full salary.
  - Pay contribution of 2.5% of salary above VSC
- Full employer contributions continue on salary up to the VSC, plus 2.1% of salary above the VSC.
- Can review decision annually.
OPTIONS FOR MEMBERS
IMPACT OF CHANGING BENEFITS

REMAIN IN THE SCHEME

Value £

Value of past and future benefits (net of income tax)
Member contributions
Value of AA and LTA tax
Net value of benefits
Value of benefits NOT accrued in future
Value of AA and LTA tax
Member contributions
Net value of benefits

OPT OUT OF THE SCHEME

NET VALUE

Reduction in net value
SECTION 5
NEXT STEPS
<table>
<thead>
<tr>
<th>YOU</th>
<th>ACTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>Be aware of the changes</td>
<td>UNDERSTAND</td>
</tr>
<tr>
<td>Calculate potential impact to you</td>
<td>CALCULATE</td>
</tr>
<tr>
<td>Understand choices and consider your best outcome</td>
<td>CHOOSE</td>
</tr>
<tr>
<td>Implement your decision (e.g. protection application or arranging Scheme Pays for tax bill)</td>
<td>TAKE ACTION</td>
</tr>
<tr>
<td>Review your financial position</td>
<td>REVIEW OFTEN</td>
</tr>
</tbody>
</table>
### MORE INFORMATION

<table>
<thead>
<tr>
<th>Source</th>
<th>Website</th>
</tr>
</thead>
<tbody>
<tr>
<td>USS website:</td>
<td><a href="http://www.uss.co.uk/">www.uss.co.uk/</a></td>
</tr>
<tr>
<td>Annual Allowance guidance:</td>
<td><a href="https://www.gov.uk/tax-on-your-private-pension/annual-allowance">https://www.gov.uk/tax-on-your-private-pension/annual-allowance</a></td>
</tr>
</tbody>
</table>
Confidentiality

Our clients’ industries are extremely competitive. The confidentiality of companies’ and universities’ plans and data is obviously critical. Mercer will protect the confidentiality of all such client information.

Similarly, consulting is a competitive business. We view our approaches and insights as proprietary and therefore look to our clients to protect Mercer’s interests in our proposals, presentations, methodologies and analytical techniques. Under no circumstances should this material be shared with any third party without the written consent of Mercer.

Copyright © 2016 Mercer