USS
UNIVERSITIES SUPERANNUATION SCHEME LIMITED

Factsheet 16

Additional information for high earners

Introduction

The tax preferential pension benefits payable to individuals in the UK are restricted to maximum allowances permitted by HM Revenue & Customs (HMRC). For the majority of members the maximum benefits they can achieve will not exceed HMRC allowances because they are quite generous, being aimed at higher earning employees in the UK.

Changes are also proposed in the 2009 budget to the way in which tax relief applies for high earners, this also has an impact on how much extra you can save towards your pension. It is very important therefore that you also read the 'Information for high earners in USS' document available under the 'Factsheet' section of the USS website www.uss.co.uk

This factsheet concentrates on how benefit restrictions apply to higher earning members of USS.

Historically there have always been limits on what you can pay in to a pension scheme and the maximum benefits you can receive. The limits prior to 6 April 2006 on maximum permitted benefits were very complicated, different rules applied depending on when you joined the scheme, your salary, the reason for retirement or leaving and the length of time you were in a scheme like USS.

The HMRC regulations changed retrospectively from 6 April 2006 and the new regulations can be summarised as follows:-

1. a new threshold for the tax favourable benefits you can receive on retirement (from all schemes) of a capital value initially set at £1.5 million – this is called the 'Lifetime Allowance'. You can accrue benefits that exceed this limit but the excess will be subject to a tax recovery charge;

2. a new limit on tax-free cash of 25% of the value of your benefits up to a maximum of 25% of the lifetime allowance (this is nearly twice the pre April 2006 limit);

3. the ability to pay up to 100% (or up to £3,600 pa if that is greater) of taxable earnings into a pension (although tax favourable benefits are subject to an upper limit of, initially, £215,000 which applies to the annual increase in the value of your pension);

4. the earliest retirement age increased to age 55, from age 50, for retirements on or after 6 April 2010. This does not apply to incapacity retirement or to members made redundant that were members of the scheme prior to 6 April 2006 and have had continuous membership since.

It will be your responsibility to report to HMRC the value of your benefits via your tax return, if requested.

The annual limits quoted above have to date been increased annually and the current rates are available below. However, the limits have been frozen from the tax year 2010/11 until at least April 2016.

The effect of the Lifetime Allowance on your retirement benefits

Under the new simplified regime you are allowed to accrue a benefit, which has no upper limit, however any benefit in excess of the Lifetime Allowance (LTA) is subject to a tax charge. The capital value of your USS benefit is simply the pension multiplied by 20 plus the amount of tax free cash taken; this value, when measuring against the LTA figure in force at the relevant date, must include any other benefits you may be entitled to from other registered pension schemes (any pension scheme approved by HMRC), should they have already been taken or will be taken on the same day*. The statutory lifetime allowance (SLA) is set by HMRC, the value of the SLA from the tax year 2006/07 to 2015/16 is as follows:-

2006/07	£1.5 million
2007/08	£1.6 million
2008/09	£1.65 million
2009/10	£1.75 million
2010/11 to 2015/16	£1.8 million (limit frozen until at least April 2016)

*Benefits already in payment before April 2006 are valued at 25 times the value of the annual pension in payment.

If the value of all of your retirement benefits exceeds the value of the SLA then a tax charge is applied to the excess. This excess can be returned to you as a lump sum refund, in which case a 55% tax charge applies, alternatively you may choose to take the excess as a monthly pension, in which case the initial tax charge is 25% but of course the additional pension will be subject to PAYE which for a higher rate tax payer means that the total deduction will be at least 55%.

For example, if the total capital value of your benefits was £1.75 million in the 2008/09 tax-year, assuming you could not/did not opt for one of the protection methods discussed in the next section, you would have an excess benefit value of £100,000.00.

You could choose simply to take a refund of this excess, less tax at 55%, therefore USS would pay a refund to you of £45,000 and would make a payment to HMRC of £55,000.

Alternatively you might decide to use the £100,000 excess to increase the value of your USS pension. However, before that is achieved USS must deduct 25% for tax, leaving £75,000 to secure additional pension benefits. On the face of it you have saved a substantial amount of tax, however, if you are registered for tax in the UK you would pay 40% PAYE on the additional pension in addition to the original 25% deduction, also note that tax rates are increasing for very high earners. This might however be attractive if perhaps you are planning to live and become resident overseas and the tax rates in that country are less than in the UK.

The Benefit Modeller is available on the USS website www.uss.co.uk for you to check the value of your benefits against the SLA. You need to calculate your potential pension first, then select 'Lifetime Allowance' from the 'Options' drop-down.

Protecting the value of your pre-April 2006 benefits

The value of the benefits you had already built up as at 6 April 2006 may well have been in excess of the SLA and would normally be subject to the tax penalty if you did nothing. There were two ways in which you could protect the accrued value of your benefits, Primary and Enhanced protection; these options were only available between April 2006 and April 2009 and you could have opted for either or both depending upon your circumstances.

If you have not applied for either of these forms of protection you are no longer able to. Please refer to the HMRC website for full details on how these forms of protection work **http://www.hmrc.gov.uk/pensionschemes/protection-of-existing-rights.pdf**

The Annual Allowance

This is an allowance on the amount of benefit you can accrue or contributions you can make in any one tax-year above which you will not receive tax relief on the contributions. The annual allowance does not apply in the year in which you retire. It is measured as a capital value.

The increase in the value of your USS pension from the start to the end of the tax year is calculated and then multiplied by 10. If this results in a value of more than the Annual Allowance (£215,000 for the tax year 2005/06) then the excess is subject to a tax charge of 40%. It is important to remember, that the increase in value of any other pension benefits you may have will also need to be included, as will any contributions to a money purchase type pension arrangement. The annual allowance is however quite generous and there would be very limited circumstances under which a member of USS might exceed this annual allowance.

The annual allowance is set by HMRC, the value of the annual allowance from the tax year 2006/07 to 2015/16 is as follows:-

2007/08	£225,000
2008/09	£235,000
2009/10	£245,000
2010/2011 to 2015/16	£255,000 (limit frozen until at least April 2016)

If you are calculating your benefits to measure against the annual allowance you will need to know the 'input period' which has been set by the scheme. This technical terminology describes the period over which benefits have been valued and for USS is 1 April to 31 March.

Maximum tax-free cash

As well as a limit on the total value of your tax beneficial retirement package there is a limit on the amount of tax-free cash you can receive which is 25% of the value of your benefits (or 25% of the SLA if this is lower - £437,500 in April 2009). Please refer to factsheet twenty-four for a full explanation of your cash options.

Statutory Earnings cap

Members joining or re-joining USS on or after 1 June 1989 were subject to an earnings cap for pension purposes, set by HMRC. The contributions payable by the member and the institution were based on a maximum remuneration figure determined by the government. The published figure was usually reviewed annually to reflect changes in the retail price index and rounded to the next higher multiple of £600. Any remuneration in excess of the cap could not be taken into account when calculating benefits. The figure for the final year of the statutory earnings cap (2005/2006) was £105,600.

The statutory earnings cap was removed with effect from 6 April 2006 but for the purpose of calculating USS benefits its effect on past service accrued prior to that date remains. Members who were subject to the cap as at April 2006 had the option to continue to have their future benefits subject to this earnings cap. The continuation of the statutory earnings cap is written into the USS scheme rules and is known as the 'scheme specific cap'. It is increased on an annual basis using the same methodology as the statutory cap. The scheme specific cap will be revalued each year and any past service benefits, which were capped, will be based on the relevant figure at retirement; in addition it will be used as the basis for ongoing contributions for any members who decided to keep the cap for future accrual.

If you are unsure as to whether the cap applies to part of your USS benefits please check with your employer.

Dealing with the Earnings Cap.

If you were affected by the Earnings Cap for any service from 1 June 1989 (14 March 1989 in some cases) to 6 April 2006 your benefits accrued from 6 April 2006 will now be calculated by reference to your full pensionable salary and your pension contributions will also be based on actual salary (unless of course you requested that your salary remained capped by the USS scheme specific cap).

If after 6 April 2006 the Earnings Cap no longer affects you then your benefits will be calculated in at least two parts. The benefits from 1989 (or date you joined the scheme if later) to April 2006 will be calculated by reference to the scheme specific cap in the year in which you retire or leave. The benefits from April 2006 will be calculated by reference to your full pensionable salary. Additionally, you may have transferred benefits to USS from another scheme and these may have been based on an uncapped salary, or you have earlier uncapped service, these will continue to be calculated by reference to your full pensionable salary.

You and your employer have the option of making a payment to remove the effect of the Earnings Cap in all or in part. There is only one opportunity to make a payment to remove the effect of the cap however there is no time restriction on when this is made, so long as you remain an active member of the scheme.

If a payment is made to remove completely the effect of the earnings cap then all of your benefits will be calculated by reference to your full pensionable salary. If only part of the earnings cap is removed then your benefits will be calculated separately but with a reduced amount being subject to the cap. There are some restrictions on removing the cap, please speak to your employer regarding your options.

Calculating your pension

Following is an example where a member has service subject to the earnings/ USS scheme specific cap up to April 2006. This example is further complicated because the member has service transferred-in to USS that was not originally subject to the earnings cap and is therefore not restricted in USS.

Date joined USS	:	1 September 1990
Date of birth	:	14 July 1950
Anticipated retirement date	:	30 September 2010
Service transferred-in from NHS	:	15 years
Pensionable salary (full)	:	£150,000.00 pa
Scheme specific cap	:	£112,800.00 pa

Firstly, we need to work out which elements of service are, and are not, subject to the earnings/USS scheme specific cap.

We know that the transfer-in is not subject to the cap, we also know that service from April 2006 is not subject to the cap, therefore:-

6 April 2006 to 30 September 2010	= 4 years 178 days (Unrestricted)
Transfer-in	= 15 years (Unrestricted)
Total unrestricted service	**= 19 years 178 days**

Subject to the earnings/scheme specific cap:-

1 September 1990 to 5 April 2006 = 15 years 217 days

Total restricted service **= 15 years 217 days**

Pension calculation is therefore:-

19 y 178 d	X	1/80th	X	£150,000.00	=	£36,540.00

PLUS

15 y 217 d	X	1/80th	X	£112,800.00	=	£21,988.10

TOTAL PENSION = £36,540.00 + £21,988.10
TOTAL PENSION = £58,528.10 per annum.

The standard tax-free cash is simply 3 times the resulting pension.

For members as at April 2006 who we thought might be affected, a split of their service was issued in order that they could undertake these calculations. Contact your employer if you require a copy.

Increasing your retirement benefits

With the above allowances in mind, you might have the ability to increase your retirement benefits. This can be achieved by paying extra contributions to one of the USS additional voluntary contribution facilities. Please refer to *factsheet one* for full details.

Briefly, you could pay to either the USS added years facility (up to an extra 15% of salary) or to the money purchase AVC run by Prudential (up to an extra 93.65% of earnings assuming no contribution are made to the added years facility). You receive tax relief at the appropriate rate and you can then take up to 25% of the capital value of all your USS benefits as a tax-free lump sum at retirement. Importantly, you can choose from where to take any tax-free cash.

The standard USS package includes a tax-free lump sum that is three times your annual pension, but you can take much more than this, up to the 25% maximum level. You may therefore be able to take the full value of any Prudential AVCs as a tax-free lump sum at retirement.

It is vital that you read the 'Information for high earners in USS' document available from the USS website in conjunction with this factsheet, especially if you are considering AVCs as it may not be as attractive for very high earning members.

Recycling

Due to the increased scope to pay contributions to pension schemes and therefore to take tax free cash, HMRC introduced rules in an attempt to limit any perceived abuse of the more generous rules with regard to tax free cash. Recycling is generally thought to only occur where there has been a previous pension benefit brought into payment and the tax free cash is used to fund a secondary scheme in order to increase the subsequent lump sum, however the rules are more far reaching.

The greater concern for USS members is with regard to large additional contributions paid shortly before retirement which will in turn increase a member's tax free cash. There would seem less of an issue with USS added years AVCs as the 15% limit on contributions means that there is very little scope to boost tax-free cash via added years, however there is more opportunity for recycling to be an issue with regard to the Prudential AVC.

Following legal advice from the scheme's solicitor and further guidance from HMRC, it was confirmed that increasing contributions prior to retirement can be considered as recycling even if the additional funds have not been received from a prior retirement. It would seem however that HMRC would wish to determine your motive in paying that money in ie was it solely to increase the available amount of tax free cash, and then decide whether you will be caught by recycling.

This could mean therefore that should you receive a bonus, an inheritance or some other unexpected payment which is then paid to the scheme, then that payment may not be deemed as recycling as there was no pre planning of the payment – essentially the guidance would deem that the payment has been made because of the windfall and not because of the potential lump sum. However if you increase the amount of tax free cash available by taking out a loan, receiving a pre-retirement payment from the employer, or use savings and all of the above will be replenished/paid off following receipt of the increased lump sum, then this could be seen as recycling, causing the tax free lump sum to potentially be subject to a 55% tax charge with USS being subject to a scheme sanction charge of 35% of the lump sum.

The legislation does however set out a framework for the operation of the rule, and therefore it is only triggered if all of the following apply:

1. The member receives or will receive a tax free lump sum from a pension scheme

2. Because of the lump sum the amount paid is significantly higher than it would otherwise of been. Employee and employer payments are included

3. The recycling was pre-planned. This is a similar point to the above but it does clarify that contributions made several years in advance of retirement can be included.

4. The lump sum, taken together with any other lump sum in the previous 12 months, is more than 1% of the lifetime allowance in force in that year.

5. The amount deemed to represent the additional contributions exceed 30% of the lump sum

The test to see whether recycling has or has not occurred is somewhat subjective which is of course an unsatisfactory situation for both members and institutions due to the uncertainty that surrounds it, however it is important that you are aware of the potential consequences of large payments made shortly before retirement.

It is worth noting that HMRC states that very few lump sum payments will be caught by the recycling rules and indeed none will be where contributions are just part of an individual's normal pattern of retirement saving. A more detailed explanation of recycling can be found on the HMRC site at the address below:

http://www.hmrc.gov.uk/manuals/rpsmmanual/rpsm04104920.htm

Financial Advice

The new tax regulations from April 2006 provide many opportunities to significantly increase your retirement savings, however you need to assess whether the new benefit restrictions might impact you in the future. Importantly you also need to consider the proposed changes affecting high earners announced in the 2009 budget.

The trustee company recognises that you may wish to seek financial advice on your options. If you visit the USS website (www.uss.co.uk) you can view a list of financial advisers. These advisers have been selected on the basis that they possess the highest level of qualification in retirement planning; they have also received training on the specific features of USS.