Changes to Pensions Tax Relief from April 2016

There are significant tax benefits to saving via a pension arrangement – you receive tax relief on your pension contributions and are able to take part of your retirement benefits as a tax-free lump sum.

However, there is a tax free limit on the amount of pension benefits that you can build up each year (called the Annual Allowance) and also on the total amount of tax free pension benefits that you can build up by retirement (called the Lifetime Allowance).

The tax limits were introduced in 2006 and changes are being made to these limits from 6 April 2016:

- The Annual Allowance (AA) is going to become a tapered amount with a maximum limit of £40,000 reducing to £10,000 depending on the amount of your income.
- The Lifetime Allowance (LTA) is reducing from £1.25 million to £1.0 million.

This briefing note covers the detail of the changes and what the changes mean for you.

Does the whole briefing note apply to me?

We've divided this note into two main sections – the Annual Allowance is covered on pages 3 - 6 and the Lifetime Allowance on pages 7 – 8. On this page, we give a brief summary of the key points.

Annual Allowance

The Annual Allowance (AA) can affect you at any stage of your career: it depends on your salary level, salary increases, pensionable service and any Additional Voluntary Contributions (AVCs) you're paying.

The AA is currently £40,000. The new tapered annual allowance will affect more people. The tapering will come into effect for those with income of £150,000 with the minimum amount of £10,000 allowance affecting those who have total earnings in excess of £210,000. Your annual allowance will be determined by your **total taxable income from all sources** (including salary, bonus, taxable benefits in kind and income from investments or rental properties).

Lifetime Allowance

You should give more careful thought to the Lifetime Allowance (LTA) as your career progresses and your total benefits build up.

Under the 2016 changes, individuals with a gross Defined Benefit (DB) pension of £50,000 per annum or more at retirement will be over the new Lifetime Allowance limit of £1m and any excess will be subject to additional tax at retirement. Action can be taken to mitigate any charges but steps will need to be taken in the next few months. More details about the protections that you can put in place are given later in the briefing, however one of the options may be for you to stop building up benefits with effect from **5 April 2016**.

Will the University be providing any more information to me on this?

Yes we're holding a seminar for those employees who consider they may be affected by the changes – see details below. This will be a chance for you to find out more about the changes and to understand how they will affect you. There will be plenty of time for you to ask questions at the seminar.

26 February 2016

Time: 12.30 – 13.30

Venue: Newman Lecture Theatre C/D (Streatham Campus)

Videolink to Penryn Campus - DM Seminar J

You should seek financial advice before making any decisions about your benefits. The University is unable to provide financial advice to individual employees on this matter. If you feel you need advice, you should consult your financial adviser. If you do not have one, you can find one in your area at: www.unbiased.co.uk.

The Annual Allowance

What is the Annual Allowance?

The Annual Allowance (AA) is the total amount of benefits that you can build up in a defined benefit (DB) pension scheme each year, for tax relief purposes. If you are in a Defined Contribution (DC) pension scheme, it is the total amount of contributions that can be paid each year before you incur a tax charge. This limit is currently set at £40,000 by HMRC. With effect from 6 April 2016, the AA will be on a tapered basis which means that there will be increased restrictions for higher earners.

There are two steps to follow to determine whether or not you will be affected.

- total income assessed for income tax in the tax year. This is all your income that is subject to tax – in addition to your salary from the University it will include any bonus payments you may receive from the University and income from other sources – eg royalties, examination marking/external examining, taxable benefits in kind and investment income (from shares, deposits, property, etc.)
- **minus** any tax relief you get and the pension contributions you have made to any pension arrangement.
- **plus** any income given up for salary sacrifice benefits made after 9 July 2015 (such as child care vouchers or the University's car or cycle-to-work schemes)

If your Threshold income is below £110,000 for a tax year then the restricted AA will **not** apply. However, if your Threshold income exceeds this level in future tax years then the restricted AA may apply at that time.

If your Threshold income is £110,000 or above for the tax year 2016/2017, or any year thereafter, you will then need to assess your Adjusted income – see Step 2 below.

Step 2 - Adjusted income

Your Adjusted income is broadly defined as:

- total income assessed for income tax (see Step 1 above)
- **minus** any tax relief (see Step 1 above)
- **plus** your pension contributions and the University's pension contributions

The "tapering" reduction to the AA is £1 for every £2 of Adjusted Income in excess of £150,000. This means that those with an adjusted income of £210,000 or more will see their AA reduced to £10,000.

If the total pension benefits you have built up in the last tax year exceed the AA you may incur a tax charge, but there may be ways to mitigate the charge, depending on your circumstances. There is more information on this later in this briefing.

Example :

Step 1:Threshold Income

Pensionable Pay	£130,000
Non pensionable pay	+ £5000
Bonus paid during year	+ £10000
Other taxable income	+ £1000
Pension contributions	(- £10,400)
Total Threshold income =	**£135,600**

Step 2: Adjusted Income

Threshold income	£135,600
Total of Employer (18%) and Employee (8%) pension contributions	£33,800
Total Adjusted Income =	**£169,400**

In this example:

- Step1: Threshold income exceeds £110,000
- Step 2: Adjusted income exceeds £150,000 by £19,400.

Under the tapering arrangements, the Annual Allowance is reduced by £9,700 to £30,300.

How do I calculate my Annual Allowance in a tax year?

Previously, the one year period to which the AA applies - the Pension Input Period (PIP) - depended on the pension scheme you are a member of and varied by scheme. From 6 April 2016 all PIPs must be concurrent with the tax year. This is already the case for the Universities Superannuation Scheme (USS) and the NHS Pension Scheme, ie the PIP ending in the tax year 2014/15 was the year from 1 April 2014 to 31 March 2015.

For each tax year HMRC require you to add up your pension savings in **all the pension arrangements you have contributed to,** where the PIPs of the arrangements end in that same tax year. The total from all your pension arrangements will count towards your Annual Allowance for the tax year.

The USS, the NHS Pension Scheme and Additional Voluntary contributions (AVCs) which purchase 'added years' in these schemes are known as defined benefit (DB) pension savings. The annual pension saving in a defined benefit scheme is calculated as follows:

Pension built up over the year x a factor of 16 + lump sum built up over the year

Money Purchase AVCs, such as the Prudential arrangement for USS members, are known as defined contribution (DC) pension savings. The annual pension saving in a defined contribution scheme is simply the amount of gross contributions you make over the year.

Any deferred DB benefits you have from previous employment are generally exempt from the AA arrangements provided they are revalued simply in line with inflation.

Transitional arrangements for the 2015/16 tax year

Transitional arrangements have been put in place to facilitate the change in PIPs. The 2015/16 tax year has been split into two 'mini tax years' for the purposes of assessing PIPs and testing them against the AA:

- pre-alignment tax year: 6 April 2015 to 8 July 2015

The AA for the pre-alignment tax year has been set at £80,000.

- post-alignment tax year: 9 July 2015 to 5 April 2016

The AA for the post-alignment period is nil, but up to £40,000 of any unused AA from the pre-alignment period can be added.

You can also carry forward unused AA from the previous 3 tax years, carrying forward from the earliest of the 3 prior tax years first.

How can I find out my potential tax liability?

You should have already heard from the USS if you have exceeded the AA during previous years. In addition, USS Final Salary section members are able to obtain an estimate of how much of the AA they are using through the Benefit Modeller on the USS website here: http://www.uss.co.uk/SchemeGuide/FinalSalaryBenefitssection/modellersandcalculators/benefitmodeller/Pages/default.aspx.

We have set out below example calculations for members of the USS.

Examples for the 2016/17 tax year

From 1 April 2016, all members will build up career revalued benefits (CRB) based on a pension accrual rate of 1/75ths and cash accrual rate of 3/75ths. From 1 October 2016, Pensionable Salary will be capped at £55,000 in the CRB section of the USS. Members with earnings in excess of £55,000 will have access to a defined contribution (DC) section of the scheme. Contributions based on Pensionable Salary in excess of £55,000 will be payable by both members (8%) and the USS (12%).

Any increase in value of benefits above the AA is subject to the AA tax charge at the individual's marginal rate of tax. *The examples below have been simplified for easy review.*

			Example 1	Example 2	Example 3
Salary data					
a.	Pensionable Salary (CARE)		110,000	150,000	220,000
Defined benefits					
b.	Pension accrued	*(a x 0.5 + 55,000 x 0.5) x 1/75*	1,100	1,367	1,833
c.	Cash accrued	*(a x 0.5 + 55,000 x 0.5) x 3/75*	3,300	4,100	5,500
d.	Value of DB benefits (accrual)	*(16 x b) + c*	20,900	25,967	34,833
e.	Employee DB contributions	*8% x (a + 55,000) x 0.5*	6,600	8,200	11,000
f.	Employer contributions (CRB)	*18% x (a + 55,000) x 0.5*	19,800	23,400	29,700
Defined contribution benefits					
g.	Employee DC contributions	*8% x (a – 55,000) x 0.5*	2,200	3,800	6,600
h.	Employer DC contributions	*12% x (a – 55,000) x 0.5*	3,300	5,700	9,900
i.	Total DC contributions	*g + h*	5,500	9,500	16,500
Pension tax calculations					
j.	Threshold Income	*a – (e + g)*	101,200	138,000	202,400
		If j is less than 110,000, your AA is 40,000. No further calculations required			
k.	Total value of benefits accrued	*d + i*	26,400	35,467	51,333
l.	Adjusted Income	*j + k*	127,600	173,467	253,733
m.	Annual Allowance	*If j is less than 150,000, 40,000, if k is greater than £210,000, £10,000, otherwise*	40,000	28,267	10,000
		40,000 – ((l – 150,000) x 0.5)			
n.	Excess over Annual Allowance	*m - k*	nil	7,200	41,333
o.	Tax liability	*Marginal tax rate x n*	nil	3,240	18,600

What can I do about it if the value of my benefits exceeds the Annual Allowance?

1. If the value of the pension benefits earned in any of the three tax years prior to the current tax year was less than the standard AA (£50,000 for 2012/13 and 2013/14, and £40,000 for 2014/15), you can carry forward this unused AA to the current tax year.
2. Unused AA in a particular tax year can only be utilised once as carry forward to a future tax year.

3. If you exceeded the AA in any of the previous three tax years, the available AA to carry forward from that particular previous tax year is nil.

You may also have pension arrangements to consider, other than the USS or NHS Pension Scheme, for example, any personal pension arrangements.

We've set out below an example 'carry forward' calculations for the Example member 2 above.

Example A - Use of 'carry forward' for the 2016/17 tax year

Year	Value of pension savings earned over the year	Unused AA	Excess over AA
2013/14	£20,118	£29,882	
2014/15	£33,525	£6,475	
2015/16	£36,326	£3,674	
2016/17	£35,467		£7,200

Here, the member has unused AA in each of the previous three tax years, due to his/her pension savings being lower than the AA in each year. The member is therefore able to offset the unused AA from 2013/14 (i.e. the earliest year) against the excess over the AA in 2016/17, thereby reducing the taxable amount of £7,200 to zero.

Example B - Use of 'carry forward' for the tax year 2017/18

Consider the same member in the following tax year, 2017/18, where the value of the member's pension savings over the year is £37,773.

Year	Value of pension savings earned over the year	Unused AA	Excess over AA
2014/15	£33,525	£6,475	
2015/16	£36,326	£3,674	
2016/17	£35,467		(£7,200)
2017/18	£37,773		£15,200

The member has unused AA in 2014/15 and 2015/16 which he/she is able to offset against some of the excess over the AA in 2017/18, thereby reducing the taxable amount of £15,200 to £5,051.

What must I do if I still have a tax liability, even after taking account of carry forward?

If you have a tax charge as a result of exceeding the Annual Allowance (despite carry forward), this is a personal tax and it is your responsibility to discharge it. If you incur a tax charge, you will need to report it to HMRC on your Self-Assessment Form.

If your tax charge is £2,000 or less, you will need to fund it yourself, for example, from income or savings or if you're retiring and taking a tax-free lump sum at the time the charge is due, you could use part of this to pay the tax charge.

If your tax charge is more than £2,000, you have an additional option called "scheme pays". Under this option, you can ask the scheme to pay the charge (or part of the charge) for you, with a corresponding deduction in your benefits depending on how much the charge is.

If you are a member of the USS and are likely to suffer further AA tax charges, you may wish to consider the options offered by the USS to amend your scheme benefits. Please see the Appendix for more information.

The Lifetime Allowance

What is the Lifetime Allowance?

The government sets an upper limit on the value of the retirement benefits from which you draw your pension benefits before tax penalties apply. This is called the Lifetime Allowance (LTA). From 6 April 2016 the Lifetime Allowance is being reduced from £1.25 million to £1.0 million. From 6 April 2018 the Lifetime Allowance will increase annually in line with CPI inflation.

The Lifetime Allowance is only tested at the point at which you retire and draw your pension benefits but if you have significant pension savings already then you may wish to take action before the Lifetime Allowance reduces next April. There are steps that can be taken now to mitigate any potential future tax charge.

What does it mean for me?

The change in the Lifetime Allowance will be of interest to you if you think the value (as defined by HMRC) of all your pension savings at the time you draw your pension benefits will exceed £1.0 million. You need to take into account **all** of your pension arrangements. If the total of your pension benefits, when being put into payment, exceeds the Lifetime Allowance, then you will incur a tax charge only on the amount over the Lifetime Allowance threshold.

How can I find out if I'm affected?

If you think you might be affected by the reduction in the Lifetime Allowance, you should check the total value of your pension benefits. To do this, you should ask all your pension schemes/providers to send you the "capital value" of your benefits **for Lifetime Allowance purposes** or, if applicable, this information may be available from your schemes/providers online. You then need to add all your pension benefit capital values together to get the total value which you need to compare with the Lifetime Allowance.

How is the capital value of your pension benefits assessed for Lifetime Allowance purposes?

The capital value of any DB pension entitlements you may have (eg in the USS and/or NHS Pension Scheme), for Lifetime Allowance Purposes, is calculated by multiplying the annual level of the pension, as at the time it comes into payment, by a factor of 20 and adding to this any tax-free lump sum. For an up to date level of your DB pension entitlement, please contact the scheme. (Contact details for the USS and NHS Pension Scheme are at the end of this note.)

The capital value of any DC arrangements you have (eg any Money Purchase AVCs), for Lifetime Allowance Purposes, will be the face value (fund value) of all the funds that you are invested in at the time that you use the funds to purchase a pension annuity at retirement or, in the case of a USS member transferring Prudential AVCs to the USS, the value of the resulting benefits being taken from the USS.

For example, consider a USS member with a pension at retirement of £50,000 pa and a lump sum of £150,000 - the capital value of these benefits is £50,000 x 20 + £150,000 = £1,150,000. As this is above the new LTA of £1.0 million, the excess of £150,000 may be subject to an LTA charge.

What can I do about it if I believe I may now have a Lifetime Allowance issue?

There are protections in place that you can opt for these are shown below:

Protection	What is protected?	Key points
Individual Protection 2014 (IP2014)	• Protected LTA equal to value of pension savings on 5 April 2014 subject to an overall maximum of £1.5m	• Value of pension savings must be greater than £1.25m on 5 April 2014 • Have to register with HMRC by 5 April 2017 (This will be replaced by IP2016 from April 2016)

		• Can continue to contribute
Individual Protection 2016 (IP2016)	• Protected LTA equal to value of pension savings on 5 April 2016 subject to an overall maximum of £1.25m	• Value of pension savings must be greater than £1.0m on 5 April 2016 • Can continue to contribute
Fixed Protection 2016 (FP2016)	• LTA remains at £1.25m	• No further contributions from 6 April 2016

The decision on whether or not to take Individual Protection and/or Fixed Protection will be your personal responsibility. You may wish to take independent financial advice on this decision. Considerations in applying for Individual Protection may include (but are not necessarily limited to):

1. The level of your LTA at 5 April 2016 - this protection option might be particularly attractive to individuals with a personal LTA at 5 April 2016 that is already close to, or above £1.25m, but individuals may well want to apply anyway for both Fixed and Individual Protections.
2. The wish to continue contributing to a pension arrangement, and the extent that the resulting benefits may be payable in retirement as unauthorised payments.
3. If you do choose to continue pension contributions post-5 April 2016 with the intention of taking Individual Protection, whether this would breach any Fixed Protection you may have also chosen to take.

Please note that the change to the LTA does not apply to the A Day protections that were introduced in April 2006, the Fixed Protections introduced in April 2012 or April 2014 or the Individual Protection introduced in April 2014.

HMRC will be introducing an online self service system for applying for both the IP and FP protections but this will not be available until July 2016.

An interim process is being made available for those who wish to apply after 1 April 2016 and those wishing to take their benefits before July 2016 so that they can be assured of some protections in place. However this will be a temporary application so a formal application will still need to be made using the online service in July 2016.

If you wish to make a temporary application then this will need to be done in writing to HMRC – you will need to inform them of the pensions saving that you currently have (which must be in excess of £1m) as well as giving them a breakdown of the benefits and a declaration that you currently do not hold any other type of pensions protection that HMRC may have introduced at an earlier date.

Where can I find out more?

1. If you think you're affected by the Annual Allowance or Lifetime Allowance and would like to read up on it in detail, further detailed information can be found at:

   http://www.hmrc.gov.uk/pensionschemes/understanding-aa.htm

   http://www.hmrc.gov.uk/pensionschemes/understanding-la.htm

2. If you have any questions about your benefits under the USS or the NHS Pension Scheme, please contact them directly at:

   - USS – www.uss.co.uk or on (0151) 227 4711 / 0845 068 1110
   - NHS Pension Scheme – www.nhsbsa.nhs.uk/pensions or on 0191 279 0571 / 0300 3301 346.

Appendix – Options for members of the USS affected by the AA or LTA

There are two options available to members of the USS who are affected by the Annual Allowance and/or Lifetime Allowance. A brief summary of these options is set out below. Unlike the previous options, which were only available for members of the Final Salary section, these options are available for all members.

1) Enhanced opt-out

This existing option is continued in its current form and it will be made available to all members from April 2016.

Under this option, you would cease accruing service in the USS. In order for your death in service and incapacity cover to continue, you would need to pay a contribution of 2.5% of salary. After making this election:

- if you die in service or retire due to incapacity, your benefits will be payable as if you had remained in USS active membership
- if you leave USS eligible employment or retire other than due to incapacity, your benefits will be based on your service and pensionable salary prior to the date of your election

You can cancel the election but it must remain in place for at least 12 months (subject to automatic enrolment requirements)

You can choose to make contributions to the DC section but will not receive the employer matched DC contribution.

This option may be of interest to members with higher salaries and longer service who may exceed or already have exceeded the LTA and are perhaps likely to breach the AA often.

For more information see the USS website:

www.uss.co.uk/SchemeGuide/FinalSalaryBenefitssection/taxconsiderations/Pages/default.aspx

2) Voluntary Salary Cap (VSC)

This option offers you the choice to cap pensionable salary. The cap will be no lower than the value of the DB salary threshold (currently £55,000, revalued each year in line with capped CPI).

This option will be available from 1 October 2016 (the date at which the DB salary threshold takes effect). For following years, elections will need to be made at 1 April and must remain in place for a full scheme year. The election must be received in advance of the commencement of the tax year and cancellation notices will only take effect from 31 March.

Your pension contributions will be based on your salary up to the VSC.

You will have the option to retain incapacity and death in service benefits based on full salary, subject to payment of the appropriately calculated extra cost of this benefit, namely 2.5% of full salary above the VSC.

This option may be of interest to members with higher salaries and shorter service (i.e. those unlikely to breach the LTA at this stage but likely to breach the AA on a regular basis).

More information about this option will be made available closer to October 2016.

Glossary

Term	Abbrv'n	Description
Defined benefit	DB	Sometimes called a final salary pension scheme - is one that promises to pay out an income based on how much you earn when you retire.
Defined Contribution	DC	Funds built up through your own contributions, those of your employer - gives you an accumulated sum when you come to retire, which you can use to secure a pension income through buying a product called an annuity or opt for income drawdown. You can also take the full amount as a lump sum, but may face a large tax bill.
Career Revalued Benefits	CRB	The CRB is the new section of the USS schemes, please refer to their website for more information http://www.uss.co.uk/SchemeGuide/CareerRevaluedBenefitssection/Pages/default.aspx
Annual Allowance	AA	The annual allowance is a limit to the total amount of contributions that can be paid to defined contribution pension schemes and the total amount of benefits that you can build up in defined benefit pension scheme each year, for tax relief purposes.
Tapered Annual Allowance		If your Adjusted income is above £150,000, your Annual Allowance will be tapered. The "tapering" reduction to the AA is £1 for every £2 of Adjusted Income in excess of £150,000. This means that those with an adjusted income of £210,000 or more will see their AA reduced to £10,000
Life Time Allowance	LTA	The maximum amount of tax relieved pension benefits that you can build up to retirement. The LTA taken into account only when you decide to retire and take your benefits
Fixed Protection	FP	'Fixed protection' is designed to help you protect the value of your current pension savings against a future lifetime allowance tax charge You must cease all pension accrual if you take out FP
Individual Protection	IP	Is designed to help you protect the amount of your current pension savings up to a limit of £1.25 million – you can continue to accrue pension benefits in future but these will be subject to a tax charge.
Capital Value		See page 8 for more information, the capital value of your pension benefits can be obtained from your pension administrators/providers
Threshold Income		See page 2 for how to determine your Threshold Income. If this is above £110,000, then you will need to calculate your Adjusted income.
Adjusted income		See page 2 for how to determine your Adjusted Income. If this is above £150,000, then your annual allowance will be reduced/tapered.
Pension Input Period	PIP	See page 3. Pension contributions to test against the Annual Allowance are calculated by reference to what contributions were made during a PIP which ends in the tax year concerned.