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Changes to Taxation of Pensions

and how it affects your retirement savings choices with NHS and USS pension schemes

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Today's presentation

- To introduce you to the tax changes
- To explain how they might affect you
- To introduce you to the options available to you
- To explain what decisions you need to take
  - By when?
  - What help is available to you?
- Chance for you to ask questions

What we don't cover today

- Individual advice
- Wider lifestyle issues affecting your other savings choices
- Proposed changes to the way USS benefits will be calculated
- Proposed changes to public sector pension provision generally following the Hutton Review

A quick reminder of how benefits build up in the NHS and USS schemes

Standard defined benefit (DB) pension calculation for both NHS (1995 section members) and USS

- Annual pension of 1/80th of pensionable salary for each year of service, plus a lump sum of three times the annual pension, i.e:

$$\frac{\textbf{Pensionable Service (in years)}}{\textbf{80}} \textbf{ x Pensionable Salary = annual pension}$$

Plus

Annual pension x 3 = tax free lump sum

Note: NHS (2008 section members) accrue benefits at 1/60th with an option to part exchange part of their pension for cash up to 25%, therefore the above calculation would differ for these members

Employees impacted are typically those with

- Defined benefits final salary pensions
- High pensionable salary
- Significant pensionable pay rises
  – this could include (for example) an increase in a clinical excellence award or a London weighting pay increase for a new employee joining Queen Mary from outside London
- Long service
- Limited 'carry forward' relief from previous years

Who else may be impacted?

- Those contributing to other pension schemes – you need to include all your pension benefits when considering whether the pensions tax will affect you
- Those who make additional voluntary contributions (AVCs) – again, you need to include these
- Ill health retirees

What are the Government's pensions tax changes?

- Annual Allowance
  - the maximum amount by which the value of your DB pension savings can increase in any year

  Plus
  - the total amount of contributions paid by both you and any employer to any defined contribution (DC) pension arrangement

  Plus
  - any personal pension arrangements

- Currently £255,000, but reducing to
  - £50,000 from April 2011

Bear in mind that in a **DB scheme** it is the increase in the value of your pension savings over the year that is used in the pensions tax calculation - not the amount of contributions paid

What are the Government's pensions tax changes?

- Lifetime Allowance
  – the maximum value at retirement of your total pension savings

- Currently £1,800,000, but reducing to
  – £1,500,000 from April 2012

- Some protection has been announced by the Government

How does the Annual Allowance work in practice?

- For the NHS and USS defined benefit schemes
  - Broadly, the value of pension and lump sum increase over the pension year (including AVCs), with an adjustment for inflation (the measure of inflation used will be the Consumer Price Index or CPI)
  - This increase in value is then multiplied by a valuation factor

- For defined contribution pension arrangements (e.g. Prudential or Standard Life AVCs, or other personal pension plans)
  - Total value of contributions from all sources in the pension year

- If you have both types, you need to add the figures together

Annual Allowance pensions tax charge: on the excess

- Taxed at your highest rate of tax (40% or 50%)
- Payable through self-assessment or 'Scheme Pays'
- Measured over the NHS and USS pension scheme year ("Pension Input Period" or "PIP") with any tax paid following the end of the tax year in which the PIP ends
- NHS and USS pension scheme PIP is year ended 31 March so virtually coincides with tax year
- Therefore affected participants in the NHS and USS pension schemes will face first tax bill by 31 January 2013
- If you participate in personal pension plan / other pension arrangements, find out what the PIP is – you may already be building up benefits for which you could face an Annual Allowance tax bill by 31 January 2013

How does the charge apply to DB benefits?

Start year:	20/80 x £100,000 = £25,000 pa
Start year: indexed	£25,000 x **1.03** = £25,750 pa
End year:	21/80 x £110,000 = £28,875 pa
Increase:	£28,875 –£25,750 = **£3,125 pa**
Value of increase:	**19** x £3,125 = £59,375
Taxable benefit:	£59,375 - **£50,000** = £9,375
Tax at marginal rate 40%:	£3,750

- Based on member who is 40% taxpayer with pensionable salary of £100,000 and pensionable service at start of year of 20 years
- Member is promoted during the year; receives pensionable pay rise of 10%
- Member has no unused 'look back' capacity (explained on a later slide)
- CPI is 3%

How does the charge apply to DB benefits with AVCs and other DC benefits?

Start year:	20.5/80 x £150,000 = £38,438 pa
Start year: indexed	£38,438 x **1.03** = £39,591 pa
End year:	21.75/80 x £154,500 = £42,005 pa
Increase:	£42,005 –£39,591 = **£2,414 pa**
Value of increase:	**19** x £2,414 = £45,866
Other DC contributions:	£15,000
Taxable benefit:	£45,866 + £15,000 - **£50,000** = £10,866
Tax at marginal rate 50%:	£5,433

- Based on member who is 50% taxpayer with pensionable salary of £150,000, pensionable service at start of year of 20.5 years (including extra years accrual purchased through AVCs) and who purchases an additional 0.25 years accrual during the year through AVCs
- Member receives pensionable pay rise of 3%
- Member has no unused 'look back' capacity (explained on a later slide)
- CPI is 3%

Is there any relief?

Yes

- The Government allows you to 'look back' over the last three tax years
- Any 'unused' allowance up to £50,000 in any year can be carried forward (but not indefinitely – can only look back three tax years)
- Any carried forward allowance will reduce your exposure to the pensions tax in the current year
- An example (illustrative only – the scheme will probably only provide information on your current year position and you may need to take financial advice on your look back position)

Tax Year	Notional Annual Allowance with carry forward	Total increase in value in year	Unused Allowance to carry forward
2008/09	£50,000	£30,000	£20,000
2009/10	£70,000	£60,000	£10,000
2010/11	£60,000	£40,000	£20,000
Total to carry forward to 2011/12			£20,000

How do I pay the tax?

- If you are impacted by the pensions tax it will be collected through self-assessment after the end of each tax year, unless you opt for the pension scheme to pay the tax on your behalf – known as ‘scheme pays’
- If opting for scheme pays, your pension benefits will be reduced to reflect the tax paid by the scheme on your behalf
- Scheme pays will not be available if the tax is £2,000 or less – in this case you will have to pay the tax yourself through your tax return
- Details of scheme pays only recently announced; NHS and USS will need to determine their policy and practice – we expect more information to follow

Regardless of whether you pay the tax yourself or opt for the pension scheme to pay the tax on your behalf, this is a personal tax for which Queen Mary has no responsibility

What are Queen Mary and the pension schemes doing to help me?

- Queen Mary recognises that this is complex for some
- USS currently provides annual statements which should provide the information you need; however NHS does not ordinarily provide statements
- From 2012/13 tax year onwards there will be a statutory responsibility for the schemes to provide you with a savings statement within six months of the end of the tax year if you have triggered a pensions tax charge; but if you are an NHS member you may need to request this information from the scheme for 2011/12 tax year
- The options Queen Mary are able to offer are limited by their agreement with the pensions schemes. The schemes are currently looking at options which they can make available for Institutions to implement – these options will only be relevant to you if you will exceed, or are likely to exceed, the new lower Annual Allowance and / or Lifetime Allowance
- USS have placed an Annual Allowance Modeller on their website which a USS member can use in conjunction with their benefit statement. The Modeller can be found at:

  http://www.uss.co.uk/SchemeGuide/modellerscalculators/Pages/Annualallowancemodeller.aspx

Annual Allowance: What are my options?

Option 1 (status quo)

- Remain a member of the scheme and build up future service benefits in line with the current rules
- In this case:
  - The amount of pension you build up in the NHS or USS pension scheme will remain unchanged
  - If your pension built up in any year exceeds the Annual Allowance you will be liable for tax on the excess at your highest tax rate
  - You will be able to ‘look back’ over the last three years to carry forward any unused allowance
  - Your pension scheme should provide you with all the information you need about your NHS or USS retirement benefits for your self-assessment tax return (although NHS members may need to request this from the scheme for 2011/12 tax year)

Annual Allowance: What are my options?

Option 2

- Remain a member of the NHS or USS pension scheme**, reduce your AVCs** and build up future service benefits in line with the current rules
- In this case:
  – The amount of pension you build up in the NHS or USS pension scheme will remain unchanged, apart from the pensionable service you were purchasing via your AVC
  – If your pension built up in any year exceeds the Annual Allowance you will be liable for tax on the excess at your highest tax rate
  – You will be able to 'look back' over the last three years to carry forward any unused allowance
  – Your pension scheme should provide you with all the information you need about your NHS or USS retirement benefits for your self-assessment tax return (although NHS members may need to request this from the scheme for 2011/12 tax year)

Annual Allowance: What are my options?

Option 3

- Withdraw from the NHS or USS pension scheme
- In this case:
  - You cease to be an active member of the scheme and move into deferred membership. The amount of pension you build up in the NHS or USS pension scheme will only increase from its current value with inflation
  - The increase in pension in any year in the NHS or USS pension schemes will not exceed the Annual Allowance
  - Any pension savings you make outside of NHS or USS pension scheme will count towards your Annual Allowance and will affect your exposure to tax
  - Other benefits from the NHS or USS pension scheme, such as life insurance cover, are removed
  - Your pension scheme should provide you with all the information you need about your NHS or USS retirement benefits for your self-assessment tax return (although NHS members may need to request this from the scheme for 2011/12 tax year)

What about the reduced Lifetime Allowance?

- The Lifetime Allowance reduces in April 2012
- Recap:
  - It is reducing from £1,800,000 to £1,500,000
- If you exceed the Lifetime Allowance at retirement you will pay a tax charge
- If you expect to exceed the Lifetime Allowance this may impact what choice you make in response to the lower Annual Allowance

How does the Lifetime Allowance work in practice?

The lifetime allowance applies **at the time you retire** and want to start receiving your pension. At this time, your total retirement savings are valued as:

- your annual pension from all defined benefit retirement schemes that you are a member of (the NHS or USS pension scheme or any arrangements from past employers) multipled by the valuation factor required by the Government, being:
  - a factor of 23 for the NHS and USS schemes;
  - a factor of 20 for DB schemes that do not include the 3 x annual pension lump sum

plus

- the value of your retirement savings funds in any DC arrangements (e.g. Prudential or Standard Life AVCs, personal pension plans)

Exactly how does the excess Lifetime Allowance tax charge work?

The amount of tax varies depending on the form in which the 'excess' over the Lifetime Allowance is received:

- cash lump sums will be taxed at 55%
  - *if you had pension savings of £2,600,000 at retirement in the 2010/11 tax year, £800,000 would be subject to the tax charge of 55% (tax due £440,000) leaving a lump sum of £360,000*
- annual pension will be taxed at 25% plus income tax at your normal rate of tax
  - *if you had pension savings of £2,600,000 at retirement in the 2010/11 tax year, £800,000 would be subject to the tax charge of 25% (tax due £200,000) leaving £600,000 for the scheme to provide additional pension income which would be taxed in payment*

Lifetime Allowance: What are my options?

Option A (status quo)

- Remain a member of the scheme and build up future service benefits in line with the current rules
- In this case:
  - The amount of pension you build up in the NHS or USS pension scheme will remain unchanged
  - Where your pension benefits built up from all sources exceed the Lifetime Allowance at retirement you will be liable for a pension tax charge (see slide 20)
- This option is compatible with Annual Allowance Option 1

Lifetime Allowance: What are my options?

Option B

- Make changes to your current arrangements based on your analysis of your Annual Allowance position and pay any Lifetime Allowance pension tax charges
- In this case:
  - The amount of pension you build up in the NHS or USS pension scheme will be determined by your choice for the Annual Allowance
  - Where your pension benefits built up from all sources exceed the Lifetime Allowance at retirement you will be liable for a pension tax charge (see slide 20)
- This option is compatible with Annual Allowance Option 2 and Option 3

Lifetime Allowance: What are my options?

Option C

- Withdraw from the NHS or USS pension scheme and apply for ‘Fixed Protection’ (unless you already have Primary or Enhanced Protection)
  - You must cease to be an active member of the scheme; as if you had left employment
  - You must also cease to be an active member of any other registered pension schemes
- In this case:
  - You will apply to the Government to have Fixed Protection which reduces the possibility of you having to pay the Lifetime Allowance tax charge
  - You must apply for Fixed Protection before **April 2012**
  - There is a limit to the DB benefits you can build up in the NHS or USS pension scheme, and you can no longer make AVCs or personal pension contributions
  - If any of these conditions are broken, you will lose Fixed Protection
- This is compatible with Annual Allowance Option 3 (except that you will not be allowed to make contributions to or accrue further benefits under other registered pension plans)

For more information

- Questions can be emailed to: pension@qmul.ac.uk
- Refer to the NHS or USS factsheets:

  NHS

  http://www.nhsbsa.nhs.uk/Pensions/3126.aspx

  USS

  http://www.uss.co.uk/Factsheet%20List/Limits%20to%20tax%20relief%20and%20tax-free%20benefits.pdf
- Contact the NHS or USS pension schemes on
  – NHS – 0845 421 4000
  – USS – 0151 227 4711
- Speak to an Independent Financial Adviser

Any questions?