



Tax and your pension

Video transcript

Hello and welcome to this webinar about Tax and your pension. My name is Rebecca Dodd and I'm a pensions consultant from Mercer. The aim of the webinar is to give you a better understanding of how tax relief is applied to pension savings and when benefits might be subject to income tax.

But first of all today, we'll have a look at your benefits in USS. So how it all works. Then we'll move on to tax relief on your contributions, and then paying tax on your benefits once in retirement. And then we'll finish off with a look at the calculators and tools that can help you understand your pension, so the options available to your retirement and any tax implications that you could face.

Here we'll take a look at how your benefits and savings in USS can build up. There are two main types of pension benefit in the UK; defined benefit (DB) and defined contribution (DC), and USS has both these types of benefit. Defined benefit (DB) means that your benefits on retirement are based on a predetermined formula. And in USS, the pension you build up depends on the salary that you earn each year up to a certain threshold, the years that you've been working, and a pension build up rate.

The pension you build up is not directly connected to how much you or your employers paid in; what matters is your formula. The defined benefit part (DB) of USS is called the Retirement Income Builder. There's also a defined contribution (DC) part of USS which is called the Investment Builder. In a defined contribution arrangement, any money paid in by you or your employer goes into your pot. Then at retirement, your benefits are based on the value of your pot of money, so it's completely dependent on how much has been paid into your pot and how it's grown over the years.

In general, you tend to have more flexibility in how and when you can take defined contribution savings. In the defined contribution part, the Investment Builder in USS, you can choose where your money's invested if you wish to, from a range of investments that USS offers or USS can invest these for you.

But for the defined benefit (DB) part, the Retirement Income Builder, it's USS that makes those investment decisions on behalf of all members so that you receive your specific level of benefit. I'm going to have a look at these in slightly more detail now.

In USS, everyone builds up Retirement Income Builder benefits, or defined benefits, on their salary up to the salary threshold and the salary threshold from 1 April 2025 is £71,484. If you earn above the salary



threshold, then you'll also build up Investment Builder savings, or defined contribution savings, on your salary above that threshold.

If your earnings fluctuate around the salary threshold, any contributions to the Investment Builder section stop and restart as is appropriate automatically.

Just having a closer look at the Retirement Income Builder. In the Retirement Income Builder, you build up a block of pension equal to a 75th of your salary for each year that you're a member of the scheme. And the salary used in this formula, though, is only up to a maximum of the salary threshold, which is currently £71,484.

So you build up a block of pension for each year or part year that you're paying into the scheme. Then, annual increases are applied to the block of pension between the time that it's earned and the time that it's eventually paid, and these increases are currently linked to the Consumer Prices Index, or CPI, measure of inflation, up to certain limits.

If you add all those blocks together with those annual increases, we get your total annual pension. And you'll also get a tax-free cash lump sum of three times your total annual pension, which is a one-off payment paid at the point of retirement, paid in addition to your annual pension.

You can exchange some of your pension for a higher tax-free cash lump sum on retirement and vice versa, so you could even take no tax-free cash and take a higher pension for life. But you make that decision when you come to retire. Then, once in payment your pension will increase each year. Again, these increases are currently linked to the Consumer Prices Index, or CPI, measure of inflation, up to certain limits.

So that you can keep track of how much you're building up, you'll receive details from USS each year in an Annual Member Statement, which can be accessed on the member portal, My USS.

Having a closer look at the Investment Builder. If you're earning above the salary threshold, then 20% of the value of your salary above this threshold is paid into your Investment Builder. This comes from the contributions that you and your employer are already paying in to USS and it's at no further cost to you. The contribution rate you pay is 6.1% of your total salary.

In this section we'll look at your contributions and tax relief. You'll get tax relief on the contributions you pay in to USS, meaning your contributions are tax-free. This means that some of the money that would normally go to the government in tax goes towards funding your pension instead.

For example, if you're a basic rate taxpayer and you had £100 that was paid to you as salary, then 20% of this would be paid as tax and you would be left with £80 in your take home pay. However, if you put £100 of your monthly wage into your pension, then the 20% of this that would usually be taken as tax is put into your pension instead.

As your contributions are taken from your pay packet before you're taxed, you'll only pay income tax on the remainder of your wage, so you've saved £20 in income tax. There are some limits to tax relief set by HMRC that you'll need to be aware of while you're contributing to your pension, and these are particularly relevant if you're a higher earner.

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For example whilst you're paying in to USS, you could be affected by the Annual Allowance, particularly if you're a higher earner. The Annual Allowance is the maximum amount of pension savings that you can build up each year before you get a tax charge. The Annual Allowance for the 2025/26 tax year is £60,000.

You can find more detail on the Annual Allowance on the **pensions tax** pages of the USS website. Or you could register for our **Focus on pensions tax** webinar where we cover the Annual Allowance in more detail.

I mentioned that you get tax relief on your contributions, but what are you and your employer actually paying in to USS? You as a member are paying 6.1% of your total salary. So regardless of whether you're earning above or below the salary threshold to USS. Your employer pays 14.5% of your salary to USS and this goes towards paying for all of your benefits from the scheme. So not just your pension benefits but also life cover and the running costs of the scheme.

Saving into a pension scheme like USS can be tax efficient, you do not pay income tax on your pension contributions. So that means the impact of your pension contributions on your take home pay is less than 6.1% of your salary.

Here we're going to look at an example of someone who earns £25,000 a year and so pays income tax at a rate of 20%. Their 6.1% contribution to USS amounts to £1,525 over a full year, but the impact on take home pay is £1,220. This means there's an annual tax saving of £305.

Using the Retirement Income Builder formula of building up a block of annual pension of a 75th of yearly earnings, this member will have built up a pension block of £333 a year. This is the amount that would be payable to the member in retirement, plus any annual increases, for the rest of their life. And the member is also entitled to a tax-free cash lump sum of three times their pension at retirement. So for this member it's £1,000.

At first glance you might think £333 a year does not look much compared to the contributions that have been paid in over the year. However, that £333 is an annual amount payable for the rest of the member's life, in addition to any valuable benefits payable after they've died.

Then we have an example of someone who earns £40,000 a year and so is also paying income tax at the 20% rate. Their 6.1% contribution to USS amounts to £2,440 over a full year but the impact on take home pay is £1,952. In this case this will provide a pension block of £533 a year and a tax-free cash lump sum of three times the pension at retirement of £1,600.

And finally we've got an example of someone who earns £55,000 a year and is paying income tax at the rate of 40%, assuming they're not in Scotland. Their 6.1% contribution to USS amounts to £3,355 over a full year but the impact on take home pay is £2,013. In this case, that will provide a pension block of £733 a year and a tax-free cash lump sum of three times the pension payable at retirement of £2,200.

Also, you may be able to pay your contributions through salary sacrifice if your employer offers it. It does go by some other names, but salary sacrifice means that your employer pays your contributions on your behalf and reduces your salary accordingly.



So as well as not paying income tax on your pension contributions, you also save on National Insurance contributions because your salary is reduced before National Insurance is worked out. So the impact on your take home pay might be even less than what we've shown on this slide.

As salary sacrifice would be operated through your employment contract, you will need to check with your employer whether salary sacrifice is available for you and if your contributions are being paid in this way.

To see an estimate of the actual cost of your contributions, you can use the **Contributions & Tax Calculator** tool in My USS. Once you're in My USS, you can click on the **Contributions & Tax Calculator** tool here.

In our example, our member has a salary of £25,000 a year and they're going to use salary sacrifice. The first thing we need to do is click the button to say **Contributions are being paid via salary sacrifice** and, then we can use the calculator to show the actual cost to the member and also the employer contribution that's paid on their behalf.

So if we click **Calculate** here we get the results. You can see for this member earning £25,000 and paying contributions via salary sacrifice, their 6.1% monthly contribution is actually £127 but the actual cost to them is just £92.

This section is about paying tax once your benefits come into payment. Once you retire and take your benefits, you'll get an income for life and a one-off tax-free, up to certain limits, cash lump sum of three times your pension. You can choose to have a lower monthly income and a higher cash lump sum, or vice versa; it's up to you.

There is a limit on the amount of benefits that can be taken as tax-free though, and USS will tell you this limit when they send you your retirement quote. Your benefit options on retirement, including pension and lump sum options, are covered in more detail in the **Approaching retirement** webinar.

You may be taxed on the monthly pension income you receive depending on the total level of your income. Your tax code, provided by HMRC, will be used to calculate the tax payable on your income in retirement. And the amount of income tax you pay on your USS benefits will also be determined by any income you earn from other sources.

You'll generally pay income tax if your total annual income adds up to more than your Personal Allowance. And this income could include any State Pension that you receive, a private pension such as a personal pension, or a workplace pension like the one that you've built up with USS, employment or self-employment earnings, any taxable benefits you receive, and any other income that you might receive from sources such as savings, investments, or property.

In 2025/26, the Personal Allowance is set at £12,570 a year, or £1,084 a month. For anything that you earn over and above your Personal Allowance you'll be charged the relevant tax rate. Again this depends on your total income. For the basic rate, which is currently between £12,571 and £50,270, you'll be charged 20% tax. For the higher rate, which is anything between £50,271 and £125,140, you'll be charged 40% tax. And for the additional rate, which is anything above £125,140, you'll pay 45% tax. These rates are slightly different in Scotland.



Also note that if your income is above £100,000 a year, your Personal Allowance actually reduces by £1 for every £2 over £100,000. That means your Personal Allowance is therefore zero if your income is £125,140 or above. So you would pay tax on the first £12,570 of earnings as well. For simplicity, all our examples assume the member has a full Personal Allowance.

Let's first look at the example of someone who is receiving the full State Pension of £11,973 a year and is receiving a pension from USS of £13,027 a year. This brings their total income from all sources to £25,000 a year, and so they pay income tax at a rate of 20%.

Their Personal Allowance is £12,570 and they would not pay tax on this level of income. Their remaining income is £12,430 and they would pay 20% on this, so £2,486. This means their total tax payable is £2,486.

We have also got an example of someone who has a full State Pension of £11,973 a year, but this time a pension from USS of £43,027 a year. So they receive an income of £55,000 a year. And I am assuming this and the previous example, there is no other sources of income.

So this person is paying income tax at a rate of 40%, assuming they are not in Scotland. Their Personal Allowance is £12,570 and they would not pay tax on this level of income. Their income between £12,571 and £50,270 is £37,700, and they would pay 20% tax on this, so that amounts to £7,540 tax. Their remaining income is £4,730 and they would pay 40% tax on this, so £1,892. This means their total tax payable is £9,432.

HMRC uses tax codes to tell your employer or your pension provider how much Personal Allowance you have to use on that income. Now depending on how much of your Personal Allowance you are using at other sources, you may not receive all of your Personal Allowance on your USS pension.

Until HMRC issues a notification of a new tax code for your pension, USS may need use an emergency tax code. The emergency tax code assumes you have got the full £12,570 Personal Allowance available.

This could result in a member paying too little or too much tax as it does not make any allowance for when in the tax year the payment starts or what other income a member might have. Once your new tax code is confirmed by HMRC and in place, any adjustments will be made to your income tax.

It is also useful to be aware that starting to receive any new pension or cash payments that impact your taxable income levels might push you into a higher tax band, or it might have an impact on your tax-free Personal Allowance, or it might mean that you need to complete a Self Assessment tax return.

Here we will look at the calculators and tools that you can use to understand more about what you are paying in to USS and what your benefits and savings could look like when you retire. USS has calculators and tools online which can tell you more about things like the cost to you of contributing, how much you can save in tax relief, how much you could get in the future, or the impact of different options that you might choose from.

If you have not yet joined the scheme, you can use a basic calculator on the USS website at uss.co.uk to get a quick estimate of how much it could cost you to be a member and what you could get from USS at retirement. You will find this basic calculator on the **what your pension might look like** web page, and that is in the **you're a new joiner** section of the area on the USS website **For members**. In here all you will need

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to do is input your date of birth and salary to be able to get that basic calculation of how much it would cost you and what your benefits might look like at retirement.

If you have already joined USS though, or you have paid in to the scheme in the past, you can log in to the online member portal My USS to use more detailed calculators. You will find that the calculators in My USS feature some prepopulated information because you will be logged in to your personal account.

However, some calculators can be tailored to help you understand the impact of any decisions or changes you might make. If you are thinking of contributing more of your salary in to USS, or you have previously built-up benefits and you are thinking about paying in again, you might find the Contributions & Tax Calculator useful. And there is also the Benefit Calculator. This can help you understand what your benefits could look like in the future.

So whether you are paying in, whether you have got benefits and savings in USS but you are no longer paying in, or even if you have retired but you still have some savings in the Investment Builder and you want to see what they might like, more information about using the Benefit Calculator, including a summary of what it can do with an explanation of each step, can be found on the Benefit Calculator section in My USS.

Here I am going to show you the Contributions & Tax Calculator. The Contributions & Tax Calculator in My USS will already be prepopulated with your current information. It will have things like contributions and benefits in there as well.

You can factor in any additional contributions that you are thinking of paying into the Investment Builder and you can estimate how much you will contribute and how much you will save in tax. And you can also see how much you could save in National Insurance with salary sacrifice, if your employer offers this. And you can also see how much your employer will contribute to your future as well.

For this member, we are going to click here to get the results. The member on this example is earning £25,000 a year, they're paying contributions via salary sacrifice, so their 6.1% monthly contribution works out to be £127, but the actual cost to the member is just £92 because they save on income tax and National Insurance contributions.

You can also use the Contributions & Tax Calculator to look at a **Tax modelling** section to see how the Annual Allowance, the Tapered Annual Allowance and Money Purchase Annual Allowance could affect you, particularly if you are a higher earner. Now these allowances, set by HMRC, limit how much tax relief you can receive when building up benefits each year before you might need to pay in a tax charge. You can find out more about these allowances on the **pensions tax** pages of the USS website.

There is also, as mentioned, the Benefit Calculator in My USS. When you go into the calculator, you can either do a projection of your benefits into the future, or if you have had a retirement quote, you can use your figures to see what your options are on retirement. Things like the combinations of pension and cash. But we will just go into the projection tool here.

In here, the Benefit Calculator can be used to get an instant estimate of what you could get in the future. So it can be helpful at various stages throughout your journey with USS. And as mentioned, it will already



be prepopulated with some of your information. Once you are in the calculator, you scroll down the page and you can use it to make quick changes to things like your salary and age that you want to retire at, to see what impact that has on your estimated benefits.

But you can also make further changes to look at the impact and what that might do to your benefits by clicking this **View options** button here. So if we go in there. In here, you can also model how making changes like saving more, transferring in, leaving USS, taking career break or taking flexible retirement could impact what you get.

And if you have got Investment Builder savings, and that is whether you are still paying in, whether you are no longer paying in or whether you have retired, you can estimate what these savings would look like in the future and the options that you have to take them, including changing the level of tax-free cash lump sum you might take at retirement and the impact that might have on your pension income.