

Tax-free cash options at retirement

Information for deferred members

USS's 'standard' package of benefits is an annual pension plus three times that pension as a tax-free cash lump sum.

However, you do not have to opt for this standard package of benefits.

This factsheet sets out your options.

Introduction

The 'standard' package of benefits under USS is a pension (income for you for the rest of your life), plus three times the pension as a tax-free cash lump sum.

However, you do not have to opt for this standard package of benefits. All members can take less cash, or in fact no cash at all, and you then receive a higher pension in lieu of the cash.

You also have the option of taking up to the current maximum tax-free cash lump sum (25% of your total benefits) set by HM Revenue & Customs (HMRC).

The options that apply to you are set out in the enclosed retirement quotation you will receive from USS. This factsheet is designed to help explain the options in more detail. In addition to this factsheet, there is a very useful modeller available on the USS website.

You enter the basic details from the enclosed quotation and the modeller allows you to quickly see how the amount of cash you take will affect your pension entitlement.

Please see the 'Benefit conversion modeller' at www.uss.co.uk

However, the Trustee is aware that not all members have access to the internet and may also appreciate a bit more explanation.

Following are some frequently asked questions and example calculations. If you feel that you would still like to speak to someone regarding your options then please contact us.

Your retirement quotation sets out the standard package (Option 1), the amount of pension you would receive if you decided to take no cash at all (Option 2) and the maximum amount of cash you are allowed to take (Option 3).

How do I work out the conversion?

In the retirement quotation we provide you with a 'commutation factor'. The commutation factor is the rate we use to convert cash into pension, or vice-versa. For example, if the factor is 17.06 this means that for every £17.06 of cash you give up USS will pay an additional £1 a year gross pension. Alternatively, for every £1 a year of gross pension you give up, USS would provide you with an extra £17.06 of tax-free cash.

How does this work?

If we assume in this example you are entitled to a 'standard' pension of £10,000 a year and £30,000 cash but only want to receive £20,000 cash. Using the example commutation rate of 17.00 the additional pension would be:

$$\frac{\text{£10,000 (cash given up)}}{17.06} = \text{£586.16 a year}$$

Benefits would be a pension of £10,586.16 a year with tax-free cash of £20,000. Alternatively, you may want a higher pension of £11,000 a year and want to know the effect on the amount of cash.

The reduction in cash would be:

$$\text{£1,000 (extra pension needed)} \times 17.06 = \text{£17,060}$$

Benefits would be a pension of £11,000 a year with tax-free cash of £12,940.

Will my decision affect the value of any spouse's, civil partner's or dependant's pension payable following my death in retirement?

The decision you take regarding your tax-free cash lump sum has no effect on the value of any potential spouse's or dependant's pension payable following your death after retirement. These benefits are calculated as 50% of your pension earned at retirement, plus USS pension increases to the date of your death.

Which option is best for me?

This is a very personal decision and you may need to take financial advice on what's best for you.

You need to consider what you would do with the cash. For example, if you have a debt, you may want to pay it off. Alternatively you might have your eye on something to spend it on. Otherwise you will need to invest the money and you need to work out if you will get a better return this way rather than opting for a higher pension that is reviewed each year in line with USS pension increases.

You also need to consider how long you think you might live in retirement, a morbid thought but very important. If you have a healthy lifestyle and your family has, in the past, lived into their old age then you might want to go for the maximum pension on the basis you are expecting to draw this income for a long time. If, unfortunately, the opposite applies perhaps you would want to take as much cash as possible and enjoy it now.

What is the lifetime allowance?

The lifetime allowance (LTA) is the maximum amount of pension savings you can build up in a tax-privileged way in aggregate of all of your pension benefits in the UK. You can of course build up a higher value than the LTA, however the excess will be taxed.

The LTA is £1 million from 6 April 2016 (reduced from £1.25 million).

The LTA value of your USS benefits is set out in your retirement quotation and is shown as a capital value and the percentage of the LTA which your USS benefits will use up. Should you have other pension schemes outside of USS that are already in payment, these pensions will have already used up part of the LTA if they came into payment after 5 April 2006. You will have been informed by your other registered UK pension scheme(s) of the percentage of the LTA used when your pension came into payment, and you are required by law to disclose this information to any subsequent pension scheme when the information is requested.

A registered UK pension scheme is a scheme that has been approved by HMRC, generally speaking a scheme provided by an employer, personal pension, stakeholder, Free Standing AVC etc.

Should you have any pensions which came into payment before 6 April 2006, these will need to be valued for LTA purposes when your USS pension or any other pension comes into payment. It will be necessary for you to provide USS with all the above information before your final retirement benefits can be calculated. This will allow us to see how much of the LTA you have already used up, if any, and ensure that your USS benefits are not in excess of the LTA. Should your benefits exceed the LTA, the excess will be taxed.

The LTA value of your pension benefits is calculated as 20 times the actual pension you receive, plus the value of any cash taken, if that pension came into payment after 5 April 2006. For example, if you receive a pension of £10,000 a year and received £30,000 tax-free cash, then the LTA value would be £230,000, or 23% of the £1 million LTA applicable in the 2016/17 tax year.

Where a pension came into payment before 6 April 2006 and needs to be taken into account due to an additional pension coming into payment after 5 April 2006, then the value of that pension is calculated by multiplying the annual pension at the date the first post 5 April 2006 pension came into payment by a factor of 25. For example, if the annual pension in payment was £10,000 then the LTA value would be £250,000, or 25.00% of the LTA applicable in the 2016/17 tax year (note that cash is not taken into account in this case). In reality, you will only be asked for the current annual pension and will not have to do this calculation yourself.

Please see the 'Limits to tax relief and tax-free benefits' factsheet at www.uss.co.uk

Why do the LTA values differ between Option 1, 2 and 3?

The factor used to calculate the LTA is 20 times the actual pension received plus the value of any tax-free cash taken. This factor is provided by HMRC and is irrespective of gender or retirement age. If you opt to receive anything other than the standard USS pension package (pension plus three times that pension as tax-free cash) then the LTA values will differ.

This is because when we convert any additional cash to pension (over and above the standard three times pension figure), or vice-versa, USS applies its own scheme specific factors, not the 20:1 factor. This means that whenever the USS commutation factor is different to 20:1 (most cases), the LTA value of your USS benefits will vary.

The following examples help illustrate this, they are all based on a member with a 'standard' package of £10,000 a year with £30,000 tax-free cash, based on a conversion factor of 17.06.

How does this work?

Example 1: Member opts to receive no cash.

£30,000 cash is converted to additional pension using a factor of 17.06.

Additional pension is therefore:

$$\frac{\text{£30,000}}{17.06} = \text{£1,758.49}$$

Total pension actually received is therefore £11,758.49 a year plus £0 tax-free cash.

$$\text{LTA} = 20 \times \text{£11,758.49} + \text{£0}$$

$$\text{LTA} = \text{£235,169.80}$$

Maximum tax-free cash allowance used up is nil.

How does this work?

Example 2: Member opts to receive additional cash of £26,214 in addition to the standard package.

The 'standard' pension is reduced by:

Additional pension is therefore:

$$\frac{£26,214}{17.06} = £1,536.57 \text{ a year}$$

Therefore member receives a pension of £8,463.43 a year plus tax-free cash of £56,214.

The LTA = 20 x £8,463.43 + £56,214

The LTA = £225,482.60

Maximum tax-free cash is 25% of the LTA value of the USS benefits.

What if I am drawing benefits from two or more schemes at the same time?

USS needs to know of any benefits being brought into payment on the same day, to ensure that in aggregate you receive no more than 25% of the LTA value of the total benefits being drawn on that date as tax-free cash.

It should however be noted that USS will not allow more than 25% of your USS benefits to be taken from USS as tax-free cash, irrespective of the decisions you make with regard to other benefits being drawn on the same day. It must be stressed that for most members the benefits you receive will be well within both the overall LTA limit and also the maximum tax-free cash limit. Remember that the tax-free cash limit of 25% is the aggregate of all the benefits you receive on the same day; we are not concerned about the level of cash you received or are due to receive from another scheme if those benefits are drawn at a different retirement date.

I paid Additional Voluntary Contributions, how are these affected?

If you paid into the Added Years facility, the extra service simply counts as extra years' service and is valued as in the 'What is the Lifetime Allowance?' paragraph.

If you paid into the AVC facility with Prudential, you can take at least 25% and possibly 100% of that fund as tax-free cash (this is only possible where your Prudential fund at retirement is equal to or less than 25% of the total value of your USS benefits) but only if you take the Prudential benefits at the same time as your main scheme benefits. You may therefore decide to take all of your Money Purchase AVC as cash and take less from the main scheme and receive a higher USS pension, rather than use the Money Purchase AVC fund to buy extra retirement benefits. Instead of taking the Prudential benefits as cash you can use it to buy an income. You might choose to buy an annuity from the open market. Alternatively, you could use any funds you have built up to buy additional benefits from USS.

You will need to give at least one month's notice should you wish to transfer your Prudential AVC to USS, otherwise there may be a delay in the payment of your benefits. You are of course still entitled to leave your fund with the Prudential and receive a quotation from Prudential or you may use the open market option and receive quotations from other providers for the pension you could buy from them. If you decide not to draw your Prudential AVC fund at the same time as your main USS benefits then your ability to draw more than 25% of the Prudential fund as a tax-free lump sum may be limited.

If there is an excess over the LTA, who pays the tax charge?

The scheme administrator must withhold the tax and pay it direct to HMRC. The law, under which pensions in excess of the LTA are taxed, also states that where there is a tax charge due, not only must the scheme administrator pay the tax to HMRC, but it must also reduce the member's benefits by an equivalent amount to show the tax has been paid. Importantly, if you are drawing benefits from another scheme/s on the same date as you draw your USS benefits and an excess tax charge applies, you must decide which scheme pays the excess tax charge and inform that scheme accordingly. If you do have LTA excess then this will be subject to a tax recovery charge and your quote will highlight how your benefits are affected.

Financial guidance

Understanding how your pension works might seem complicated and intimidating, especially when you consider that any decisions you make now might affect your income for many years in the future. So it's natural that you might consider seeking guidance and/or advice to help you make the right decisions. Neither USS nor your employer's pensions staff are registered to provide you with financial advice and it would be illegal for them to do so. They can, however, provide you with information about the scheme and the options that are available to you. This should be your first step.

Please see our financial advice page on www.uss.co.uk for more information.

This publication is for general guidance only. It is not a legal document and does not explain all situations or eventualities. USS is governed by a trust deed and rules and if there is any difference between this publication and the trust deed and rules the latter prevail. Members are advised to check with their employer contact for latest information regarding the scheme, and any changes that may have occurred to its rules and benefits.

