

Tax-free cash options at retirement

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 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.

Following are some frequently asked questions and example calculations to help you understand the options.

If you feel that you would still like to speak to someone regarding your options, please contact the pensions officer at your institution in the first instance or see our financial guidance and advice page at www.uss.co.uk.

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 was 17.00, this means that for every £17.00 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 £17.00 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:

$$\frac{\text{£10,000 (cash given up)}}{17.00} = \text{£588.00 a year}$$

Benefits would be a pension of £10,588.00 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: **£1,000 (extra pension needed) x 17.00 = £17,000**

Benefits would be a pension of £11,000 a year with tax-free cash of £13,000.

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.

Whichever option you choose, the USS rules are designed to ensure that in the unfortunate event of your death within the first five years of retirement, a lump sum can be paid to your dependant. That lump sum is at least equal to the balance of benefits which you would have received if you had continued to receive your pension for the remainder that five year period.

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.

There is a section on the retirement notification form (available from your institution's pension contact) for this purpose. 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.

When you retire, it may be that a pension which came into payment before 6 April 2006 and needs to be taken into account when measuring the total value of all of your benefits against the LTA. In that case the value of the pre-April 2006 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% 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.

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.

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

Where there is an excess over the LTA, 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.

To summarise, if your benefits are subject to a tax charge this will be arranged for you, your benefits will be less as a result.

For more details please see the 'Limits to tax relief and tax-free benefits' factsheet at www.uss.co.uk

What is the annual allowance?

This is an allowance for the maximum amount of benefits you can build up in a year in a tax-beneficial way.

Your benefits are valued over the year. This limit is expressed as a capital value which is currently £40,000 a year. However, if you have taxable earnings in excess of £110,000 a year this allowance could be lower, but not less than £10,000 a year.

If you build up benefits worth more than this then you could be due to pay additional income tax (in addition to any tax due as a result of exceeding the LTA).

If you require assistance in calculating your allowance, or if you think you have exceeded the allowance, please contact USS for a full quotation.

Money Purchase Annual Allowance

From April 2015, if you have drawn benefits from a defined contribution type pension arrangement (such as the USS Investment Builder) but continue in membership of a scheme like USS, you will have a reduced annual allowance (known as the Money Purchase Annual Allowance or "MPAA") in respect of future contributions you make to the USS Investment Builder or another defined contribution-type arrangement. Please refer to the [Annual Allowance](#) factsheet for more information about the MPAA.

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 either the Added Years or Revalued Benefits AVC facilities, the extra benefits are valued together with your other benefits and count towards the LTA.

If you paid into the USS Money Purchase AVC facility with Prudential then, since 6 April 2006, 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 before 1 April 2016 to buy addition benefits from USS.

Please note that if you have Fixed Protection you may only transfer your Prudential AVC fund into USS to increase your lump sum. Any other option will result in the loss of your Fixed Protection and your benefits may be subject to a tax charge by HMRC.

Should you wish to take all your Prudential benefits as cash, or convert the fund to USS pension and lump sum then your Prudential benefits will be transferred into the main fund before you retire so that your benefits can be calculated. You will need to give at least one month's notice should you wish to transfer your Prudential AVCs to USS, otherwise there may be a delay in the payment of your benefits.

If you wish to pay a final contribution to the Prudential in the month of your retirement, payment of your retirement benefits cannot be made until the month following retirement. 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 benefit, your ability to draw more than 25% of the Prudential fund as a tax-free lump sum may be limited.

Financial guidance and advice

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 advice to help you make the right decisions. Unfortunately, USS employees and your employer's pensions staff are not registered to provide you with financial advice. 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.