

Annual allowance (AA)

The AA is the annual limit to pension savings that receive tax relief. The standard AA is currently £40,000 per tax year.

Should your pension savings over a tax year exceed £40,000, then you will be taxed on the excess at your highest marginal rate. This can be offset by any unused allowance from the three previous years.

Members with taxable income in excess of £110,000 will need to consider the effect of the taper on their AA.

You are likely to be affected by the AA if any of the following apply:

- You expect your pension savings across all pension arrangements to exceed £40,000;
- You expect your taxable income from all sources in the 2017/18 tax year to exceed or be near to £110,000;
- You have already accessed benefits from a defined contribution arrangement.

Introduction to the annual allowance (AA)

This factsheet explains how the AA is calculated, and how your allowance can be reduced depending upon your taxable income and whether you have already drawn any benefits from certain pension arrangements.

The AA is a measure of the increase in your retirement benefits over a 'Pension Input Period' (PIP). A PIP is a single tax year, and following a recent change, all pension schemes (including USS) have a standard PIP which runs from 6 April to 5 April each year.

The standard AA is currently set at £40,000 a year. However, members with taxable income of more than £110,000 a year may have a lower allowance, possibly as low as £10,000 a year, as explained later under 'The AA taper' section below. Any excess pension savings over this allowance are taxed at your highest marginal rate. You may, as we'll explain later, be able to 'carry forward' unused allowances from earlier years to offset against this.

How your benefits are measured against the AA

The benefits you build up over each PIP are measured against the AA using a method set out by HMRC. The measure is different depending on which type of pension benefits you build up, and therefore this method can be quite complicated - especially if you build up benefits in both the USS Retirement Income Builder (a defined benefit arrangement) and the USS Investment Builder (a defined contribution/money purchase arrangement).

- For a defined benefit scheme, the measure is the increase in the value of your benefit over the course of the year, and not the amount of contributions which have been paid by you and/or your employer. This measure is used for any benefits you build up in the USS Retirement Income Builder.
- For defined contribution/money purchase schemes, the measure is simply the contributions (gross) which both you and your employer have paid (investment returns are not included). This measure is used for any contributions made by you or on your behalf to the USS Investment Builder and, where relevant, the Prudential Money Purchase AVC (MPAVC) arrangement.

To work out the increase of the value of your benefits (your 'Pension Input Amount') in the USS Retirement Income Builder, the following process is carried out in four stages:

1. **The opening value** – firstly, the closing value of your defined benefits at the end of the previous PIP is used, so essentially the pension that would have been payable at that point, without adjustment for early payment. That figure is then revalued to the end of the PIP being assessed, to account for inflation, based upon the

increase in the Consumer Prices Index over the year to September immediately prior to the PIP. Sometimes it is necessary to adjust the opening value, for example to allow for a divorce settlement or transfer.

2. **The closing value** – your USS Retirement Income Builder benefits will be calculated at the end of the PIP, as if you were retiring on that date but without adjustment for early payment. Note that the revaluation step in point 1, to account for inflation, is not included here.
3. **The defined benefit value** is then found by subtracting the opening value from the closing value, and multiplying the result by a factor set out in legislation (currently 16, but USS has to increase this to 19 to account for the standard USS lump sum – which is three times your annual pension as standard).

The MPAVC provided by Prudential and USS Investment Builder elements of the calculation of your Pension Input Amount are simply the gross amount of contributions (both employer and employee) paid during the PIP, and therefore the **final step** is to add these to the result from stage 3 above. The total is then compared against your annual allowance.

For calculations from the 2016/17 tax year onwards, your benefits (where relevant) in the final salary section of the scheme (or the pre-1 April 2016 CRB section) are not included in either the opening or closing values. The benefits will increase in line with CPI inflation each year, and can therefore be ‘carved-out’ of the calculations.

If the grand total of all your benefits built up during the year exceeds your AA, and any available carry-forward you may have (see below for further details), the excess is subject to income tax at your marginal rate.

Important: If you have accrued benefits in any other pension scheme within the relevant PIP, the value of those benefits (for a defined benefit arrangement) or the contributions paid (for a defined contribution arrangement) will need to be added to the total above.

The AA taper

HMRC introduced a lower annual allowance for individuals with higher incomes, which applies for the tax year 2016-17 onwards. HMRC describes this as ‘tapering’. Tapering will only apply if you have both a ‘threshold income’ over £110,000 and an ‘adjusted income’ of over £150,000 (see below for definitions of these terms).

The effect of the taper is to reduce your AA (and therefore increase your tax if you accrue benefits/make contributions above the rate of your reduced annual allowance) as your salary increases. The AA is reduced by £1 for every £2 of adjusted income above £150,000, down to a minimum AA of £10,000. The table below illustrates the effect:

Adjusted income	Tapered AA
£210,000 and above	£10,000
£200,000	£15,000
£190,000	£20,000
£180,000	£25,000
£170,000	£30,000
£160,000	£35,000
£150,000 and below	£40,000

What are threshold income and adjusted income?

Threshold income and adjusted income are new terms, and can be described in general terms as follows:

Threshold income	Adjusted income
<p>Broadly this is taxable income from all sources plus:</p> <ul style="list-style-type: none"> • Any income sacrificed under a salary sacrifice arrangement entered into on or after 9 July 2015; minus • Pension contributions paid from taxed earnings. 	<p>Broadly this is threshold income, plus:</p> <ul style="list-style-type: none"> • The increase in ‘value’ of your employer contribution to any defined benefit arrangement, plus any employer contributions to a defined contribution arrangement.

USS doesn't have details of any taxable income you may have outside of your USS salary, so is not in a position to determine either your threshold income or adjusted income for you – this is something you will need to do yourself, or in conjunction with an adviser (see section 'Financial Advice' below for further information) when you have all of the necessary information. Please note that in calculating your adjusted income, the 'value' of the employer contribution to a defined benefit arrangement (such as the USS Retirement Income Builder) is not simply the contributions paid and you will, therefore, need to request this information from USS and any other relevant pension schemes.

A particular difficulty in planning your pension arrangements is that you won't be certain of your threshold or adjusted income until the end of the tax year; which is then too late to make arrangements for that year. You will, therefore, need to make a best estimate of your taxable income when considering whether the tapered AA will apply to you.

To help with this, USS has a new annual allowance tool available to help members estimate their tapered AA over the year, and the amount of their AA that will be used up by their USS benefits. You can access this modeller tool in the Resources area of the website: uss.co.uk.

If my taxable income exceeds £110,000 how will I know whether the taper will apply?

You won't know for sure whether the taper will apply, or what the reduction to your AA will be, until the end of the tax year when an accurate calculation can be undertaken.

You can, however, estimate the figures with a view of your taxable income for the year, with assistance from USS to estimate the pension element of the adjusted income figure. Some examples of this are shown in the table below.

A number of simplifying assumptions have been made in these examples but, crucially, we have assumed that your salary for USS purposes represents the only income you receive; and that you have no available AA to carry forward (see below). Additional contributions, such as the match, have also not been included.

The figures in the examples below are applicable for the 2017/18 tax year.

	Example 1	Example 2	Example 3	Example 4
USS salary	£120,000	£147,000	£160,000	£185,000
Other taxable income	Nil	Nil	Nil	Nil
Adjusted income	£137,000	£168,000	£182,000	£210,000
Pension input amount	£27,000	£33,000	£35,000	£40,000
Annual allowance	£40,000	£31,000	£24,000	£10,000
Amount subject to an AA charge	Nil	£2,000	£11,000	£30,000

Further information on the taper

Your employer's pensions contact at your institution will be able to provide you with further assistance in relation to your pension benefits and the annual allowance tool can provide you with estimated figures, but specialist independent advice may be required depending on your circumstances (see the section 'Financial Advice' below for further information).

Carry forward

Calculating your unused AA (carry forward)

If your total pension savings for the PIP in question are more than the AA, you may be able to reduce the excess with carry forward of any unused AA from the previous three years. You must use the AA in the current PIP first, then go back to the earliest of the three carry forward years available. If you have unused AA to carry forward, this has the effect of increasing your AA for the current PIP.

You will only have to pay tax if you are still in excess of the AA after taking account of any unused allowances.

You can only carry forward unused AA if, during the tax year, you were a member of either:

- A registered pension scheme (such as USS or TPS and the majority of other occupational pension schemes in the UK); or
- An overseas pension scheme and either you or your employer qualified for UK tax relief on pension savings in that scheme.

Carry forward will be available in line with the figures illustrated in the table below.

Current tax year	Carry forward years and maximum amounts
Tax year 2016/17	2013/14 (£50,000) 2014/15 (£40,000) 2015/16 (£40,000)
Tax year 2017/18	2014/15 (£40,000) 2015/16 (£40,000) 2016/17 (£40,000)
Tax year 2018/19	2015/16 (£40,000) 2016/17 (£40,000) 2017/18 (£40,000)

These examples assume that neither the taper provisions nor the money purchase annual allowance (see below) applies.

The calculation is complicated and you need to keep track of what you have used and any years in which the taper and/or money purchase annual allowance may have applied. You don't need to complete a tax return for AA purposes in relation to those years where you haven't exceeded the AA once you've taken into account any carry forward (although you may need to complete a tax return for other purposes).

More information about the AA and carry forward allowances can be found on the gov.uk website.

HM Revenue & Customs (HMRC) have developed a calculator to help you work out whether or not you are liable to any tax. You can find this on HMRC's website at www.gov.uk/hmrc.

Please note that the AA is a personal taxation matter. However, since April 2013, pension schemes have a statutory responsibility to provide you with a savings statement by 6 October each year if you have exceeded the standard (i.e. not tapered) AA. USS will send statements in September to members who have exceeded the standard AA during the previous tax year/PIP. These statements apply to USS pension savings only. If you think you've exceeded the AA during the previous tax year/PIP due to pension savings in another pension arrangement, as well as USS, please contact your employer.

Money Purchase Annual Allowance

Since April 2015, legislation allows those aged 55 or over to access their 'defined contribution' savings 'flexibly'.

Defined contribution refers to pension schemes where contributions are paid in and invested into a fund. The value of the fund is used at retirement to provide benefits such as a regular income or lump sum. They are also known as 'money purchase' arrangements. The USS Investment Builder is an example of this kind of arrangement.

Given that individuals can now access their pension funds from defined contribution arrangements some time before their normal retirement age, HMRC have introduced a new limit to prevent individuals from drawing benefits from their defined contribution arrangements and recycling (or re-paying) the same funds into another pension scheme, essentially receiving double tax relief on their funds. This limit is known as the Money Purchase Annual Allowance ('MPAA').

The MPAA only applies if you have accessed your defined contribution funds in a particular way. Importantly, there is currently no way that you can trigger the MPAA when taking your USS benefits, other than if you choose to leave your USS Investment Builder invested beyond retirement and then take the funds at a later date as an uncrystallised funds pension lump sum 'UFPLS' (please see the [retirement factsheet](#) for more information on this).

To clarify, if you take benefits from your USS Investment Builder through retirement (or flexible retirement), you will not trigger the MPAA, even if the retirement occurs before your normal pension age. However, you can trigger the MPAA if you transfer your USS Investment Builder elsewhere and withdraw the funds separately, or you may have already triggered the MPAA if you have accessed funds from a defined contribution arrangement outside of USS.

Impact of the MPAA

The MPAA works by restricting the amount of future contributions that you can pay into a defined contribution arrangement before a tax charge applies. The MPAA limit is currently £4,000 per year.

If you and your employer contribute more than £4,000 a year to a defined contribution arrangement (such as the USS Investment Builder), the contributions in excess of this threshold will be subject to additional income tax, negating the tax relief that had been applied automatically.

It's important to remember that you still retain an AA in respect of any 'defined benefit' arrangements, such as the USS Retirement Income Builder. If you pay into a defined contribution arrangement and are subject to the MPAA, you can still accrue defined benefits up to the AA less any defined contribution payments up to the MPAA (across all pension schemes).

For example, if you and your employer paid £2,000 into a defined contribution arrangement, you would still have £38,000 of the AA for defined benefit arrangements (based on 2017/18 rates). Please note, however, that in a defined benefit arrangement it is not the contribution itself that is tested, but the value of the benefits accrued.

Alternatively, if you paid £15,000 into a defined contribution arrangement you would still have £36,000 of the AA remaining for defined benefit arrangements. To explain this further, the £15,000 contribution is £11,000 in excess of the MPAA (£4,000 at time of publication), so the £11,000 excess will be subject to additional income tax and therefore only the untaxed element is deducted from the overall allowance of £40,000.

What if the MPAA applies as well as a reduced AA as a result of tapering?

Where someone is subject to the MPAA provisions and they are also subject to the taper provisions, the taper is applied to their alternative AA amount. The alternative AA amount is the standard AA less the £4,000 MPAA.

This means that where someone is subject to the maximum taper provisions currently resulting in an AA of £10,000, their alternative AA for defined benefit pension savings will be £6,000. They would also have a £4,000 MPAA limit and would still be able to use carry forward from the previous three years for accrual in a defined benefit arrangement. Please note, however, that an individual cannot use carry forward to reduce a charge on a money purchase input amount above the money purchase annual allowance.

Your responsibility

If you then pay more funds into the USS Investment Builder (or the USS MPAVC where applicable) and this exceeds the MPAA, we will send you a notification so you can inform HMRC of the excess. If you continue to contribute to a defined contribution arrangement outside of USS, you will be responsible for monitoring whether or not you have exceeded the MPAA and informing HMRC of the excess. Please note that from 1 October 2016, both your and your employer's contributions to the USS Investment Builder will be counted.

It is up to you to let USS know that you've triggered the MPAA.

Unlike the AA, there is no 'carry-forward' available from earlier years in respect of the MPAA.

Frequently Asked Questions

How do ongoing Added Years or Revalued Benefits AVC affect the AA?

If you were an active member of USS before April 2016, you may have taken out an arrangement to purchase additional years' service (final salary members) or additional revalued benefits (CRB members) in return for paying an additional lump sum or regular contributions. New Added Years or Additional Revalued Benefits arrangements cannot be put in place. However, you may still be paying into an arrangement which was in place before April 2016.

For monthly Added Years AVC arrangements taken out on or after 1 April 2012, a proportion of the total service you would have purchased by the end of the arrangement counts for the purpose of AA calculations each year. So, if you took out an arrangement to buy an additional five years' service over a 20 year period, this would equate to the purchase of an additional 92 days of service for each of those 20 years, which would be included in the closing value calculation each year.

However, for monthly AVC arrangements taken out prior to 1 April 2012, the full service to be purchased is counted in full for the first year of AA calculations only. So, if you took out an AVC before 1 April 2012 to purchase an additional five years' service, then in the PIP for the year the arrangement commenced only, a five-year increase in service would be added to the closing value calculation. This AVC arrangement would not be included in the AA calculations for future years, even if you were still paying into it.

How does a Money Purchase AVC affect the AA?

The gross amount deducted from your pay (before tax relief) is the value you add in to the AA calculation. So, it's much easier to work out how much you can pay into the MPAVC and stay within the AA limit.

Are deferred pension benefits counted?

Deferred benefits are payable to you when you retire from scheme/s into which you no longer pay contributions.

Any deferred benefits built up during the PIP count towards the AA for that period. Previous deferred benefits will count towards the AA only if they are increased above a certain percentage each year.

Other pension arrangements, do I need to consider them?

It is extremely important to remember that HMRC include all of your pension savings when looking at your AA. When working out your total pensions savings during any year, you must include pension savings from any other pension arrangements, whether they are occupational or personal pension arrangements. The combined value represents your total pension savings for the tax year.

How will I know if I've exceeded the AA?

USS will advise any members who, in respect of their USS benefits only, exceed the standard AA over any PIP. This notification will be sent by 6 October following the end of the PIP.

Special arrangements applied for the 2015/16 PIP. For this particular year we will advise any members who have exceeded either the £80,000 allowance over the 'pre-alignment period' (from 1 April 2015 to 8 July 2015), or the £40,000 allowance over the 'post-alignment period' (from 9 July 2015 to 5 April 2016 - less any carry-forward from the pre-alignment period). If you have pension savings outside of USS, you will need to check if you have exceeded the AA. Please note also that these statements will not incorporate the effect of any AA taper or the MPAA (if applicable).

What if I've exceeded the AA?

The government has put measures in place to try to mitigate the problem for those who have a one-off salary spike. These measures are called 'carry forward'.

Under carry forward, any unused AA for the three years prior to the one in which an AA charge is due can be used to offset an AA charge. If the total of the unused relief is greater than the accrual over the course of the PIP in question; or reduces the accrual to less than the AA in force during the PIP, then the amount payable will be reduced to zero.

So, if you trigger the AA charge in 2017/18, you can draw upon unused allowances for the tax years 2014/15, 2015/16 and 2016/17 to offset the charge.

Should you still have an excess and, therefore, an AA tax charge, you can either pay it yourself or you may be able to require the scheme to pay it. Please see the scheme pays factsheet for more information.

Can you calculate the effect of the taper for me?

USS is only able to calculate your USS pension benefits. You will need to gather information on your total taxable income, plus all pensions savings, and assess whether your AA has been reduced and, if so, whether there is a tax charge due.

Should I consider one of the USS tax options?

The Voluntary Salary Cap (VSC) was designed primarily for members looking to manage AA tax charges. For more information about the VSC, please refer to the Voluntary Salary Cap factsheet which you'll find in the Resources section of our website: uss.co.uk.

Can I use Scheme Pays?

Scheme Pays is a facility available to members which allows you, if you meet certain criteria, to request that USS pays an annual allowance charge on your behalf, in return for a corresponding reduction to your pension benefits. For more information on eligibility to Scheme Pays, please refer to the Scheme Pays factsheet in the Resources section of our website: uss.co.uk.

Financial advice

USS recognises that you may wish to seek financial advice on your options. If you need advice on tax matters, we suggest you contact a tax or financial adviser. You can find an IFA through the following website: www.unbiased.co.uk. Please be aware that you may be charged a fee for any advice.

Our website also has more information on financial advice. To find out more about financial advice, visit the USS website www.uss.co.uk.

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