The Government has announced that it plans to restrict further tax relief on pension contributions and retirement benefits. The purpose of this leaflet is to help you understand whether you are likely to be affected by these restrictions.

The vast majority of current members of the Xerox Final Salary Pension Scheme are not expected to be affected.

Background

On 6 April 2006, HM Revenue & Customs (HMRC) introduced new tax rules for the treatment of pension contributions and retirement benefits. A complicated set of regulations was swept away and replaced by two new controls:

- **Annual Allowance (AA)** – the maximum amount of pension savings you can have each year which benefits from tax relief.
- **Lifetime Allowance (LTA)** – the maximum amount of pension and/or lump sum you can get at retirement (from all the registered pension schemes you have been a member of) which benefit from tax relief.

Forthcoming changes

The Government is retaining these two allowances but has announced that it will be restricting further the tax relief on pensions. The main changes are:

**Annual Allowance (AA)**

- For the tax year 2011-12 onwards, the amount of the AA will be reduced to £50,000 (from the previous year’s figure of £255,000).
- The method for calculating the amount of pension saving for a ‘defined benefit’ pension scheme, like the Xerox Final Salary Pension Scheme, has changed.
- It will now be possible to ‘carry forward’ unused AA from the last three tax years if you have made pension savings in those years. This means that you could make pension savings of more than £50,000 in one year and not have to pay an AA charge if you had sufficient unused AA available to carry forward from the previous three tax years.

**Lifetime Allowance (LTA)**

- For the tax year 2012-13 onwards, the LTA will be reduced to £1.5 million (from the previous year’s figure of £1.8 million).
- There will be a new form of protection called ‘Fixed Protection’, available to people who expect the value of their pension benefits at retirement to be more than £1.5 million. If you apply for Fixed Protection, your LTA will be fixed at £1.8 million rather than at the reduced figure of £1.5 million. However, in return, you will normally be required to stop building up any further pension benefits.

Read on …

to find out more about these changes and whether you are likely to be affected by them now or in the future.

This guide is based on draft guidance and draft legislation from the Government, which may be amended as it goes through the Parliamentary process. However, in view of the timeframes which apply, Xerox wishes to share with you the current known position.
The Annual Allowance (AA) is the maximum amount of pension savings built up in any one year (which is called the Pension Input Period) which benefits from tax relief. The Pension Input Period for the Xerox Final Salary Pension Scheme is 1st April to 31st March.

Before April 2011, the AA was set at a very high level (£255,000) so it affected very few people. For the tax year 2011-12 onwards, the AA will be reduced significantly to £50,000.

However, the vast majority of current members of the Xerox Final Salary Pension Scheme are still unlikely to be affected by the reduced AA.

Annual pension savings up to £50,000 will continue to receive tax relief at the member’s highest rate of tax. Annual pension savings above the AA will be taxed at the member’s highest rate of income tax and the tax charge must be paid immediately. It will have to be paid by the member directly (through their self-assessment tax return) or, in certain cases, it may be possible for the Scheme to pay the charge with a corresponding reduction in the member’s pension benefits.

What are my pension savings?

As a member of the Xerox Final Salary Pension Scheme, your pension savings are:

- The increase in the value of your Scheme pension over the Pension Input Period (PIP).
- PLUS
- Any AVCs paid to the Xerox AVC Plan (including any SMART AVC ‘top-up’ payment from the Company).

If you are currently paying into any other pension scheme, you must do the same calculation for that scheme and add the figures together to arrive at your total pension savings.

Normally, if you have deferred benefits in another pension scheme which you have previously been a member of, but which you are not currently paying into, these do not count towards the AA. (Deferred benefits do, however, count towards the LTA.)

How do I calculate the increase in the value of my Scheme pension?

The increase in the value of your Scheme pension is calculated as the difference between the value at the start of the PIP and the value at the end of the PIP. Follow these steps to work out the increase:

1. Find the opening value of your annual pension at the start of the PIP.
2. This figure is adjusted for inflation by increasing it by the 12 month change in the Consumer Price Index (CPI) to the September before the start of the relevant tax year.
3. Find the closing value of your annual pension at the end of the PIP.
4. Deduct the opening value of your pension (adjusted for inflation) from the closing value and multiply this figure by 16 (factor specified by HM Revenue & Customs) – this is the increase in the value of your Scheme pension over the PIP.

Example 1

Mr A has been in the Xerox Final Salary Pension Scheme for 11 years at the start of the year. His Pensionable Earnings increase from £32,000 at the start of the PIP to £32,480 at the end of the PIP. The change in the CPI is 3%. This is how the value of his pension savings for the year is calculated:

1. Opening value of Mr A’s Scheme pension, calculated using the Scheme pension formula.
   2% x Pensionable Earnings (£32,000) x Pensionable Service (11 years) = £7,040 a year

2. Inflation adjustment – multiply opening value of the pension by the change in the CPI.
   £7,040 x 3% = £211
   Adjusted opening value £7,040 + £211 = £7,251 a year

3. Closing value of Mr A’s Scheme pension
   2% x Pensionable Earnings (£32,480 ) x Pensionable Service (12 years) = £7,795 a year

4. Increase in the value of Mr A’s Scheme pension – deduct opening value (adjusted for inflation) from closing value and multiply by 16.
   £7,795 – £7,251 = £544
   £544 x 16 = £8,704

As Mr A’s pension savings over the PIP do not exceed the AA (£8,704 against the AA of £50,000), Mr A receives full tax relief on his pension savings for the year.

If Mr A had paid any AVCs in the year, they would be added to the value of the increase in his pension to arrive at his total pension savings.
**How the AA may affect you if you have a one-off increase in Pensionable Earnings (e.g. promotion)**

If you have a large increase in your Pensionable Earnings one year – for example, as a result of promotion – it could be that your pension savings could exceed the AA in that year, even though you are not normally affected by it.

**Example 2**

Miss B has been in the Xerox Final Salary Pension Scheme for 25 years at the beginning of the PIP. During the year, she is promoted and her Pensionable Earnings increase from £40,000 to £50,000. The change in the CPI is 3%. This is how the value of her pension savings is calculated:

1. Opening value of Miss B’s Scheme pension, calculated using the Scheme pension formula.
   
   \[2\% \times \text{Pensionable Earnings (}£40,000\text{)}\times \text{Pensionable Service (25 years)} = £20,000 \text{ a year}\]

2. Inflation adjustment – multiply opening value of the pension by the change in the CPI.
   
   £20,000 \times 3\% = £600
   
   Adjusted opening value £20,000 + £600 = £20,600 a year

3. Closing value of Miss B’s Scheme pension

   \[2\% \times \text{Pensionable Earnings (}£50,000\text{)}\times \text{Pensionable Service (26 years)} = £26,000 \text{ a year}\]

4. Increase in the value of Miss B’s Scheme pension – deduct opening value (adjusted for inflation) from closing value and multiply by 16.

   £26,000 – £20,600 = £5,400
   
   £5,400 \times 16 = £86,400

Miss B’s pension savings in the PIP in question (£86,400) exceed the AA (£50,000) by £36,400. Unless she had unused AA from previous years (see next section), she would be taxed at her highest rate of income tax on the value of her pension savings in excess of the AA. Assuming that her highest tax rate is 40%, she would pay 40% of £36,400 = £14,560.

Please note that the AA tax charge must be paid immediately. It will have to be paid by the member directly (through their self-assessment tax return) or, in certain cases, it may be possible for the Scheme to pay the charge with a corresponding reduction in the member’s pension benefits.

If Miss B had paid any AVCs in the year they would also be added to the value of the increase in her pension to arrive at her total pension savings.

**‘Carry forward’ of unused AA from previous years**

One of the changes to the AA announced by the Government is to allow people to carry forward unused AA from the last three tax years if pension savings have been made in those years. (For carry-forward purposes, the AA will be deemed to have been £50,000 and not £255,000 for the tax years 2008-09, 2009-10 and 2010-11.)

This means that if your pension savings are more than £50,000 in any year – as, for instance, in the circumstances illustrated in Example 2 opposite – you still may not have to pay the AA charge. The following example illustrates this.

**Example 3**

Continuing with the same example of Miss B, let us assume that her £86,400 of pension savings shown in Example 2 opposite occur in the 2011-12 tax year and that her pension savings in the three previous tax years were:

- 2010-11 – £35,000
- 2009-10 – £30,000
- 2008-09 – £25,000

With the AA deemed to be £50,000 for each of those three years, Miss B has unused AA of £15,000, £20,000 and £25,000 respectively for these years. Her total unused AA available to carry forward is, therefore, £60,000.

Together with the £50,000 AA for the 2011-12 tax year, Miss B can have pension savings of £110,000 (i.e. £60,000 + £50,000) without the AA charge being due. This is greater than her actual pension savings of £86,400 for 2011-12, so she is not liable for any AA tax charge.

**AA exemptions**

There are certain situations when some or all of your pension savings are not tested against the AA, even though your total pension savings might be more than £50,000:

- **Death** – the AA does not apply for the tax year in which an individual dies.
- **Serious ill health** – in some circumstances, the AA may not apply for the tax year in which ill-health benefits are paid.
Will I be told what my pension savings are?

Each year, Xerox will send you a statement showing the value of your pension savings under the Xerox Final Salary Pension Scheme – you will receive a statement in October 2012 which will show the value of your pension savings for the Scheme PIP ended 31 March 2012.

Planned closure of the Xerox Final Salary Pension Scheme

As you will already know, the Xerox Final Salary Pension Scheme will be closed to all members for future benefit accrual from 31st December 2013. This means that existing members will not be able to build up any further benefits in the Scheme after that date.

However, after the Scheme closes, the pension which you have built up in the Scheme will continue to be linked to your Pensionable Earnings during the period between the closure date and the date you retire, provided that you remain in service until that time. This ‘salary linkage’ means that an increase in your Pensionable Earnings in a year could result in an increase in the value of your pension for AA purposes, which would count towards the AA that year.

If you join the BlackRock Stakeholder Pension Plan for Xerox employees when the Xerox Final Salary Pension Scheme closes, your pension savings will be calculated differently for this Plan as it is a ‘defined contribution’ arrangement.

Your pension savings under the BlackRock Stakeholder Plan alone are unlikely to breach the AA. However, if they are combined with an increase in the value of your Xerox Final Salary Pension Scheme pension arising from the ‘salary linkage’ described above, you could still be affected by the AA.

Do I need to do anything about the AA?

- As already indicated, the vast majority of current members of the Xerox Final Salary Pension Scheme are not expected to be affected by the reduced AA and will not have to take any immediate action.
- We will send you a statement each year showing the amount of your pension savings and, if they exceed the AA, we will provide you with details of your options.
- If you think you are likely to exceed the reduced AA and you are currently paying AVCs, you should consider stopping your AVCs as soon as possible. Don’t forget, if you are paying AVCs via the SMART method you only have one opportunity each year to stop your AVCs. If you want to stop your AVCs please contact Olwyn Smith at Xerox Pensions before 1st April:

  Direct line + 44 (0) 1494 615153; internal 647 5153
  Email: olwyn.smith@xerox.com

- If you think you will regularly exceed the AA in future years, you should contact Paul Hopkins, Director of Pensions (contact details at the end of this leaflet), to discuss what your options are.
The Lifetime Allowance (LTA) is the maximum amount of pension and/or lump sum you can get at retirement (from all the registered pension schemes you have been a member of) which benefit from tax relief.

For the tax year 2012-13 onwards, the LTA will reduce from £1.8 million to £1.5 million.

However, the vast majority of current members of the Xerox Final Salary Pension Scheme are still unlikely to be affected by the reduced LTA.

You will continue to receive total pension benefits up to the value of the LTA without incurring any additional tax when the benefits are paid. The only tax charge will be income tax payable on your pension as it is paid.

How will I know if my retirement benefits are likely to be more than the LTA?

To decide if your retirement benefits are likely to be more than the LTA, you need to work out the value of your pension savings for all the registered pension schemes that you belong to, or have belonged to, and add these together.

How you value your retirement benefits depends on whether your pension is already in payment and, for benefits not yet in payment, the type of pension arrangement that you belong to.

For a ‘defined benefit’ scheme, like the Xerox Final Salary Pension Scheme, the value of your pension savings is calculated at 20 times the retirement pension you expect to get.

Example 4
Mr C has been a member of the Xerox Final Salary Pension Scheme for 12 years and his Final Pensionable Earnings at retirement at age 65 are £32,480.

Mr C’s pension, calculated using the Scheme pension formula, is:

\[ 2\% \times \text{Pensionable Earnings (}£32,480\text{)} \times \text{Pensionable Service (12 years)} = £7,795 \text{ a year} \]

The value of Mr C’s pension, for the purpose of the LTA test, is:

\[ £7,795 \times 20 \text{ (factor specified by HMRC)} = £155,904 \]

The value of Mr C’s pension benefits is £155,904, well below the £1.5 million LTA limit.

If Mr C has paid any AVCs or has benefits from other pension schemes payable at retirement, these would also have to be added in and his total retirement benefits tested against the LTA.

Example 5
Mrs D has been with the Xerox Final Salary Pension Scheme for 30 years and her Final Pensionable Earnings at retirement at age 65 are £150,000.

Mrs D’s pension, calculated using the Scheme pension formula, is:

\[ 2\% \times \text{Pensionable Earnings (}£150,000\text{)} \times \text{Pensionable Service (30 years)} = £90,000 \text{ a year} \]

The value of Mrs D’s pension, for the purpose of the LTA test, is:

\[ £90,000 \times 20 = £1,800,000 \]

The value of Mrs D’s pension exceeds the LTA by:

\[ £1,800,000 – £1,500,000 = £300,000 \]

Mrs D would pay a tax charge on this excess (see next section).

If Mrs D has paid any AVCs or has benefits from other pension schemes payable at retirement, these would also have to be added in and her total retirement benefits tested against the LTA.

How much is the LTA charge?

If your retirement benefits exceed the LTA, you will be taxed on the excess. The amount of the charge depends on how you take your benefits. Any excess pension will be reduced by a 25% tax charge and the balance will then be paid and taxed as normal at your highest rate of income tax. You may be able to take the excess benefit as a lump sum, which would be reduced by a 55% tax charge overall.

In Example 5 above, therefore, if Mrs D took the excess benefit as a lump sum, she would pay a tax charge of:

\[ £300,000 \times 55\% = £165,000. \]

Lump sum death benefits and the LTA

Lump sum death benefits, payable to your dependants in the event of your death while you are working for Xerox, are also subject to the LTA.

Currently, the Scheme provides a death-in-service lump sum benefit equal to four times an amount set by the Company, which is normally your base salary plus two-thirds of planned variable earnings at the date of your death.

Currently, most members’ death benefits will be unaffected by the reduction in the LTA.
From January 2014, the death-in-service benefit will increase to six times base salary, rising to seven times base salary for employees who complete six years’ service with the Company.

From 2014, therefore, the reduction in the LTA could affect the amount of death benefits which can be paid tax-free, if you are a high earner.

Protection for members affected by the LTA

The Government has confirmed that protection for individuals who registered for Primary Protection or Enhanced Protection before 5th April 2009, under the pension tax regime introduced on 6th April 2006 (see front page), will continue.

A new form of protection (known as Fixed Protection) will be available for individuals who expect to exceed the reduced LTA when they come to take their benefits on or after 6 April 2012. Fixed Protection will provide you with an LTA of £1.8 million rather than £1.5 million, subject to certain conditions.

To receive Fixed Protection, you must:

- Register with HMRC for Fixed Protection before 5 April 2012.
- Not build up any further pension after 5th April 2012 (this will mean leaving the Xerox Final Salary Pension Scheme by that date and making no further pension contributions at all to any pension arrangement) and abide by certain restrictions on transfers.

If you think you will be affected by the lower LTA, you should contact Paul Hopkins, Director of Pensions, at Xerox Pensions (contact details at the end of this leaflet), to discuss your options.

More information

There is a lot more information about the AA and the LTA, and the forthcoming changes, on the HMRC website.

- For more information about the AA, go to:  
  http://www.hmrc.gov.uk/pensionschemes/annual-allowance/index.htm
- For more information about the LTA, go to:  
  http://www.hmrc.gov.uk/pensionschemes/lifetime-allowance/index.htm

Any questions?

We strongly recommend that you familiarise yourself with the information we have laid out in this leaflet. We know that the vast majority of members will not be affected and need take no further action. However, higher-paid employees (particularly those who have been a member of the Xerox Final Salary Pension Scheme for a long time) may need to take action.

If you think you might be affected by the changes to the AA and the LTA, please contact Paul Hopkins, Director of Pensions, at Xerox Pensions.

Direct line + 44 (0) 1494 615150; internal 647 5150
Email: paul.hopkins@xerox.com

This communication is issued by Xerox Limited as a Company communication to employees. It does not form part of the Trust Deed & Rules of the Xerox Final Salary Pension Scheme.