EXPLANATORY MEMORANDUM TO

THE SOCIAL SECURITY (DEFERRAL OF RETIREMENT PENSIONS, SHARED ADDITIONAL PENSION AND GRADUATED RETIREMENT BENEFIT) (MISCELLANEOUS PROVISIONS) REGULATIONS 2005

2005 No.2677

1. This Explanatory Memorandum has been prepared by the Department for Work and Pensions and is laid before Parliament by Command of Her Majesty.

2. Description

   2.1 These Regulations make further provision relating to the new choice of a lump sum payment as an alternative to an increase to the weekly pension ("increments") for people who defer their entitlement to the State Pension[1].

3. Matters of special interest to the Joint Committee on Statutory Instruments

   3.1 None.

4. Legislative Background

   4.1 The Pensions Act 2004 (c.35) changed the existing rules for deferring entitlement to the State Pension so as to provide for the new choice of a lump sum payment where a person has deferred his entitlement to state pension for a minimum of 12 months from 6 April 2005. The first opportunity to make such a choice will therefore arise in April 2006. These Regulations specify the time limits and manner of making that choice and the circumstances under which that choice may be changed. This is the first use of the relevant regulation-making powers.

   4.2 Under the Finance (No.2) Act 2005, the lump sum will be taxable at the marginal rate applicable to a person's other income in the "applicable year of assessment". This will normally be the tax year in which the person becomes entitled to his state pension on ceasing to defer, but may be the tax year following that year if the person so chooses in accordance with Social Security regulations.[2] This Instrument includes the provisions required to allow the person to choose that the lump sum be paid in the later year.

   4.3 These Regulations also amend existing regulations to provide for the lump sum to be disregarded in the calculation of State Pension Credit, Housing Benefit and Council Tax Benefit for the person's lifetime, in order to prevent a person's entitlement to those benefits from being reduced, or extinguished, if they defer and then choose the lump sum option. Additionally, they amend the rules relating to notional income so a person who has changed his original choice of increments to a lump sum is not treated as still possessing that income. They also amend

[1] In this Memorandum, the term "state pension" is used to refer to the contributory state retirement pension, shared additional pension and graduated retirement benefit unless stated otherwise.
[2] Section 8 of the Finance (No.2) Act 2005 refers to Social Security regulations providing for this choice.

existing regulations relating to decisions so as to enable awards of the relevant benefits to be changed where a person has made an election for a lump sum or changed an election for a lump sum or increments.

4.4 Finally, this Instrument amends provisions which modify the application of the new rules introduced by the Pensions Act 2004 in relation to those whose deferment began before 6 April 2005. These modifications include enabling the lump sum to be calculated in a different way where this would be to the claimant's advantage. However, this easement was imposed in certain cases where this "better-buy" situation could not in reality arise. The amendments included in these Regulations are therefore required to remove that unintended over-provision.

5. Extent

5.1 This Instrument applies to Great Britain. Equivalent provision will be made for Northern Ireland by statutory rules.

6. European Convention on Human Rights

6.1 As the Instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 Following the changes introduced by the Pensions Act 2004, from April 2005, people who defer their state pension for at least 12 months will have the choice of either a lump sum based on pension foregone plus interest, or increments calculated at a rate equivalent to 1% for every five weeks (10.4% for each year) a person defers. If a married person dies while still deferring (having deferred for at least 12 months), the surviving spouse will be able to choose between "inheriting" a modified version of the lump sum or increments to which the deceased would have been entitled had he claimed himself, either on claiming their own state pension, or following the death of his or her spouse, whichever is the later.[3,4] Surviving civil partners will also be able to make these choices by virtue of the Civil Partnership (Pensions and Benefit Payments) (Consequential, etc. Provisions) Order 2005 (SI 2005/2053).

Regulations 2 to 5: choice between increments and lump sum

7.2 Where a person does not make his choice at the same time as he claims his pension, he will be allowed a further period of 3 months in which to decide. This period will start on the date shown on the notification issued by the Pension Service advising the person that he is required to make this choice. The notice will include a statement of the respective gross amount of each option, to assist the person in reaching a decision. In the meantime, the normal weekly pension will be awarded if appropriate, under the provisions described in paragraph 7.9 below. The same process will apply where a person has claimed in advance of the

[3] This does not apply if the deferred pension is shared additional pension, which is not inheritable. [4]Until 2010, widowers are only able to inherit increments or a lump sum if they are over pension age when their spouse dies.

date he wishes to start drawing his pension, providing he has also deferred his entitlement for at least 12 months at the time of submitting the claim. A claim may be made up to 4 months in advance although no payment will be made until the due date. The 3 months in which to make a choice may be extended if there appears to the Secretary of State to be a valid reason (such as illness) why the choice could not be made in that time. If no choice is made, the person is treated under the Act as having chosen a lump sum.

7.3 Once a choice, or deemed choice, is made, there will be a further 3 month period during which the person can change that choice. This is intended to provide a limited safeguard for those who may have made their original choice without fully understanding the implications and also provides a final opportunity for those who are awarded a lump sum by default to make a positive choice if they wish to take increments instead. A change of election will be subject to a number of conditions; these include repayment of the lump sum where that was the first choice. Where the first choice was for increments, this will be netted off the lump sum before payment. It will also not be possible to change the election more than once and, if a person dies after making an election, his election may not be changed posthumously.

Regulation 6: amendments to the Transitional Regulations[4]

7.4 Where a person's period of deferment began before 6 April 2005, special rules apply. For the period up to that date, they can only earn increments at the old rate (equivalent to about 7.4% per year). If they continue to defer beyond 6 April 2006, they will be able to choose between increments at the new rate of 10.4% per year or a lump sum in respect of their deferment from 6 April 2005 onwards. The "old" increments will be added to their weekly pension from the date they start drawing it. In certain cases, a person in this situation may be entitled to a higher one-off cash sum if he asks for his date of claim to be backdated for up to 12 months instead of choosing a lump sum. This is because any pre- April 2005 increments would be included as part of the arrears of weekly pension calculated from that earlier date. The extra amount added by way of increments to the arrears payment will generally be higher than the extra amount included by way of interest in the lump sum calculation, depending on the value of the increments accrued pre- 6 April 2005. This potential "better-buy" effect will disappear in most cases by July 2006 (by which time the comparison would be between 12 months' arrears and 15 months' lump sum). However, in order to prevent people who opt for a lump sum inadvertently losing out during this temporary period, the transitional regulations allow a lump sum to be calculated in the same way as a payment of simple arrears where this would produce a higher amount than under the normal rules.

7.5 The Transitional Regulations currently enable an equivalent calculation to be applied to a surviving spouse's lump sum. However, as the rules relating to claims mean a surviving spouse could not actually be entitled to a payment of 12 months' backdated arrears in respect of the deceased's unclaimed pension, there was no need to cater for this situation. Regulation 6 therefore amends the Transitional Regulations to omit this superfluous provision.

[4] The Social Security (Retirement Pensions etc.) (Transitional Provisions) Regulations 2005 (SI 2005/469)

Regulation 7: amendments to the Graduated Retirement Benefit Regulations[5]

7.6 Paragraph (2) enables elections to be made and changed in respect of deferred graduated retirement benefit (GRB) in the identical time and manner to that described in paragraphs 7.2 and 7.3 for retirement pension. Paragraph (3) makes the same amendment to the transitional provisions relating to deferral of GRB as described in paragraphs 7.4 and 7.5 above relating to the deferral of retirement pension.

Regulation 8: delayed payment of the lump sum

7.7 This provision inserts a new regulation 21A in the Claims and Payments regulations[6] to enable a person to elect to delay receipt of his lump sum payment. Currently, regulations provide for payment following an award to be made as soon as reasonably practicable. This option to delay payment of the lump sum relates to the tax arrangements made by the Finance (No.2) Act 2005. Under that Act, a person will be liable to pay tax on the lump sum at the marginal rate that applies to his other income in the relevant tax year. For example, if in that year he was liable to pay tax on his other income at the basic rate, he would be liable for tax at 22% on his lump sum as well. The lump sum is not added to total income to determine tax liability so will not push a person into a higher tax bracket. For tax purposes, the "default" year of assessment for charging the lump sum to tax is the year in which the person starts receiving their pension. However, if the person makes an election to delay payment of his lump sum under this regulation, the year of assessment will be the tax year that follows that year.

7.8 New regulation 21A specifies that a tax election is to be made within 1 month of notifying his choice of lump sum, allows this election to be revoked so payment may be made immediately and provides that the election is invalidated if the person dies before payment is made. This last condition is because under the tax legislation, the lump sum cannot be chargeable to tax for a tax year later than the one in which the person died.

Regulations 9 and 10: amendments to the Decisions and Appeals Regulations[7]

7.9 These amendments are required as a consequence of the new provisions relating to choosing between a lump sum or increments. In summary, they will allow:
a) weekly state pension to be awarded while the person is considering what choice to make; that award will then be revised once the choice has been made;
b) an award of state pension to be revised if the person subsequently changes their choice;
c) an award of State Pension Credit, Housing Benefit or Council Tax Benefit to be revised if a person originally chose increments and then changed this to a lump sum (as increments are treated as income in these benefits, this will allow

[5] The Social Security (Graduated Retirement Benefit) Regulations 2005 (SI 2005/454)
[6] The Social Security (Claims and Payments) Regulation 1987 (SI 1987/1968)
[7] The Social Security and Child Support (Decisions and Appeals) Regulations 1999 (SI 1999/991) and the Housing Benefit and Council Tax Benefit (Decisions and Appeals) Regulations 2001 (SI 2001/1002)

benefit to be reassessed from the date on which the increments had originally been taken into account); and

d) an award of State Pension Credit, Housing Benefit or Council Tax Benefit to be superseded when a lump sum is paid (so qualifying the person for the lump sum disregard – see next paragraph), or when it is repaid following a change of election from lump sum to increments, when the disregard would cease to apply. The change will take effect from the date on which a lump sum is paid or repaid if that date coincides with the person's benefit payday, or otherwise from the start of the following benefit week.

Regulations 11, 12 and 13: disregard of lump sum in State Pension Credit, Housing Benefit and Council Tax Benefit

7.10 The policy intention is to remove a potential disincentive to defer for people on lower incomes by ensuring that those who do defer and opt for a lump sum will not then suffer a claw-back in these benefits. Under the current rules, capital in excess of a specified amount (normally £6,000) is deemed to provide a weekly income of £1 for every £500 (or part) in excess of that amount. Thus, without these amendments, a lump sum of £20,000 would, assuming the person had no other savings, result in an assumed income of £28 being taken into account in State Pension Credit.[8]

7.11 The same rules for deeming income from savings apply to Housing Benefit and Council Tax Benefit for pensioners. In addition, if a person receiving Housing Benefit or Council Tax Benefit who was either not entitled to State Pension Credit, or entitled only to the savings credit element, were to receive a lump sum that took their savings above £16,000, their Housing Benefit or Council Tax Benefit entitlement would be extinguished under current rules.

7.12 Regulations 11, 12 and13 amend, respectively, the Housing Benefit, Council Tax Benefit and State Pension Credit Regulations[9], firstly to modify the rules which deem a person to still have access to income if they have voluntarily relinquished it. This will ensure that a person who initially chooses increments and then wishes to change this to a lump sum will not be penalised.

7.13 Secondly, these Regulations provide that an amount equal to the gross amount of the lump sum, or an interim payment made on account of a final lump sum, will be treated as disregarded capital. This disregard will apply for the person's lifetime.

[8] This is a somewhat simplified description: in fact, as the assumed income would count as qualifying income for the purposes of the savings credit element of State Pension Credit, the net reduction in the amount of State Pension Credit otherwise payable would be slightly less.

[9] The Housing Benefit (General) Regulations 1987 (SI 1987/1971; the Council Tax Benefit (General) Regulations 1992 (SI 1992/1814); the State Pension Credit Regulations 2002 (SI 2002/1792).

Consultation

7.14 The proposals contained in these Regulations were considered by the Social Security Advisory Committee on 3rd August 2005. The Committee was content with the proposals and agreed not to consult on them. The Local Authority Associations have also been consulted on the proposals which affect Housing Benefit and Council Tax Benefit, and generally welcomed them, subject only to concerns about how Local Authorities would administer the lump sum disregard. The Department has written to the Associations to provide more detail about the arrangements the Department will put in place which we feel will meet these concerns.

8. Impact

8.1 A Regulatory Impact assessment has not been prepared for this instrument as it has no impact on business, charities or voluntary bodies.

8.2 The public sector impact comprises administration and programme costs. It is not possible to disaggregate the cost of the proposals contained in these Regulations from the overall costs of the new deferral arrangements introduced by the Pensions Act 2004. The overall set-up costs are estimated at around £7 million, and include the cost of new technology to support the calculation of the lump sum option. It is anticipated that the changes will not result in the need for additional staff. The overall programme costs in the first three years ending March 2008 are estimated at £10m/£25m/£60, peaking at £115m in 2010/11 and declining in the long term.

9. Contact

Helen Gadd at the Department for Work and Pensions can answer any queries regarding the instrument. Tel: 020 7712 2569 or e-mail: Helen.Gadd@dwp.gsi.gov.uk.