The administration of state pensions: not as simple as it sounds

Personal tax



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The administration of state pensions is unnecessarily complex, leading to understandable confusion among many recipients. What can we do to make it simpler?

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About 12.6 million adults received the state pension in February 2023 (see bit.ly/3YS4w5T). That number has increased by just over 1% per annum in recent years. 2.9 million individuals receive the post 2016 new state pension. In August 2022, 1.4 million people received pension credit, representing a total of 1.6 million beneficiaries (including partners). Two thirds of pension credit claimants are women.

Claiming the state pension

The state pension is administered by the Department of Work and Pensions. It is reliant upon information provided by HMRC, which keeps national insurance records and no doubt also shares address data. Typically, DWP writes to potential claimants about four months before their 66th birthday to invite them to claim online – although claimants may request a paper form.

Claims made online are acknowledged by email, but all other correspondence is paper. Letters are written to inform the claimant when their pension will start and how much will be paid. The letters simply specify the amount and do not provide any detail on how it has been calculated, so it is hard to check whether the correct amount is being paid. If no claim is made, DWP will not pay the pension and will instead modestly increase the payable amount, depending on how long the claim is deferred.

The claim form simply tells the prospective pensioner that payment will be made four weeks in arrears to their nominated bank account. However, Moneybox's Paul Lewis has pointed out that it is possible to receive it weekly, by requesting this in the 'other information' box.

Paying the pension every four weeks, instead of monthly, adds unnecessary confusion for pensioners. Most people during their working lives have been paid either weekly or monthly. Many bills are set up on a monthly basis; e.g. utilities, council tax, car and house insurance. Presumably the reason that the DWP doesn't offer a monthly option is that the underlying systems are too old to manage.

The new state pension requires at least 10 years' contributions, and the full payment requires 35 years' contributions.

During 2019, a new DWP computer system called 'Get Your State Pension' came online to handle state pension claims. Unfortunately, DWP is not yet able to include claim system data in its published statistics for state pension; instead, it provides estimates based on payment systems data.

Missing money

In Spring 2020, significant errors in pension payments were brought to the DWP's attention by Sir Steve Webb, the former Pensions Minister, and Tanya Jefferies of ThisIsMoney.co.uk, as well as individual pensioners. The DWP started exploring the 'potential for error' in basic state pension from April 2020, and confirmed there was

a significant issue in August 2020 when it ran a full scan of its system.

In January 2021, the DWP launched an exercise to review around 400,000 cases ‘at risk’ of underpayment to confirm the extent of the issue and reimburse affected pensioners. It recorded a £1 billion provision in 2020/21 in respect of an estimated 132,000 pensioners.

The National Audit Office published a report in September 2021 (see bit.ly/3Z7GSSH), explaining what had happened.

> ‘The Department’s administration of state pension has limited automation and requires the use of multiple systems and interpretation of complex rules… The Department’s pension caseworkers must review information across at least three systems, understand which of the state pension rules apply to each claim and then accurately interpret them in order to assess a pensioner’s eligibility. These rules are only fully understood by a small group of specialists… The underpayments were due to repeated human error over many years, some level of which was almost inevitable given the system’s high degree of manual review and complex rules.’

The DWP manages pensions with several systems:

- The main Pension Service Computer System, which holds the award and calculates payments, was launched in 1988 and is still used to manage the live state pension caseload. It is a ‘legacy system’, which means software or hardware that is no longer cost-effective or is now considered to be above the acceptable risk threshold (see bit.ly/3YS704d).
- The Customer Account Management system, launched in 2006, holds the claimant’s case record history and personal details. There is a similar system for international recipients.
- HMRC keeps the National Insurance Record System, which records contributions.

DWP then commenced its first full review of state pension fraud and error since 2005/06, which confirmed claimant fraud at 0.00% and error at 0.1%. However, official error amounted to 0.5%, compared to an original estimate of 0.3%. This increase was mainly due to errors in National Insurance records, administered by HMRC. This relates to Home Responsibilities Protection, which reduces the number

of qualifying years needed for a basic state pension; for example, when people did not work due to childcare or other caring responsibilities. Errors were identified where periods of Home Responsibilities Protection were not accurately recorded. HMRC needs to identify affected cases, before DWP can estimate the total value of any underpayment and correct payments.

The result of this exercise is that DWP now estimates it underpaid £1.46 billion to 237,000 pensioners (mainly women) and will need to review around 700,000 potentially affected cases. It hopes to complete this by the end of 2024 and has taken on over 1,000 staff to assist.

Taxing the pension

The state pension is taxable – although not everyone knows that. The position is made a bit more confusing as all state pension recipients also receive two tax-exempt amounts: the outdated £10 Christmas bonus and the Winter Fuel allowance (or cost of living allowance as it became in autumn 2022). Pension credit – the top-up for those on low incomes – is also tax-exempt.

HMRC statistics estimate that 7.3 million recipients of the state pension pay income tax on it (see bit.ly/3YRKh8n). The Office of Tax Simplification carried out a review of pensioner taxation in 2012 (see bit.ly/3klCtgb) and noted that (in 2012) 2 million pensioners had been included in self assessment. However, at the time HMRC couldn't identify any reason why over 411,000 pensioners had been included and a further 305,000 were included solely because they received the tapered age allowance (now withdrawn).

Simple assessment has been used by HMRC to charge tax on pensioners to reduce the need to file a self assessment tax return. In many ways, this is helpful – but it is very much a system operated by HMRC, which initiates the process (a taxpayer cannot request a simple assessment). Recipients of a simple assessment have 60 days to inform HMRC if they think it is incorrect and then 30 days to appeal against a final notice from HMRC. Arguably, this level of control by HMRC suggests the Department should carry the responsibility of getting it right, but of course HMRC does not always have full information about an individual's circumstances.

The simple assessment form needs to be easier for individuals to check. It does list some sources but it's confusing. It has a caption for 'State Pension/State Benefits',

which doesn’t seem right, given that state benefits are tax-exempt. The notes don’t explain that the £10 Christmas bonus, the Winter Fuel allowance and pension credit are exempt. There is also an ‘Adjustments’ section with no explanation of the adjustments actually made. (There is a general note which misses out one of the adjustments sometimes relevant to pensioners – the recovery of gift aid on donations exceeding taxable income.)

The way in which the state pension is taxed is also confusing for individuals. The amount taxed is the amount due for the year, even though part of it paid in the year relates to the previous tax year and, of course, part received in the following tax year needs to be added on. The notes attached to the full Self Assessment return tell the taxpayer to: ‘Add up the amount you were entitled to receive from 6 April 2021 to 5 April 2022… Add up your amounts carefully.’ The notes also mention the tax-exempt benefits. However, the simple assessment form leaves out all this important information – which surely triggers unnecessary letters or calls to the helpline.

How could the state pension be simpler?

DWP should advise pensioners how their pension award has been calculated – rather than making it very hard to check. DWP should also offer monthly or weekly payments, instead of four-weekly payments. The related tax step would be to make amounts received in a tax year actually taxable in that year.

DWP should advise pensioners of the taxable amount in their annual pension award letter. Ideally, the letter would give the taxable amount both for the current and the previous year. Instead, the letter unhelpfully makes no mention of tax at all. It’s almost as if DWP lives in a parallel universe from HMRC – when we all know that the two departments rely heavily on each other.

The £10 Christmas bonus should be abolished. It’s too small to make a difference. Consideration should be given to making the winter fuel payment taxable and permanent. The letter advising pensioners of the amount they will receive should mention its tax status.

DWP could offer to communicate with pensioners by email. Given that DWP is very keen to encourage new claimants to claim online – and most 65 year olds will be used to a world of computers, email and smartphones – sticking to paper is unhelpful. Over time, opt-in pensioners could reduce DWP costs and communicate in

a manner that suits them.

State pension information should be included by HMRC in the Personal Tax Account and its forthcoming successor, the single customer account. HMRC receives this information from DWP; passing it on to customers would seem to be a good idea. Having the ability to make changes in the Tax Account which feed back to DWP would also be helpful and secure – such as change of address or bank account.