DRN-3598555

The complaint

Mr W complains that advice given to him by Lighthouse Advisory Services Limited ("LCL") about his pension savings in 2014 was based on a fundamental misunderstanding of the regulations concerning the application of lifetime allowances ("LTA"). And he further complains that LCL failed to make him aware of its limitations in providing financial advice when he made it aware that he owned property in Ireland, and resided there for part of the year.

What happened

I issued a provisional decision on this complaint in May 2022. In that decision I explained why I thought part of the complaint should be upheld and what LCL needed to do in order to put things right. Both parties have received a copy of my provisional decision but, for completeness and so those findings form part of this decision, I include some extracts from it below. In my decision I said;

> *In December 2010 Mr W retired and took pension benefits from his occupational pension scheme ("OPS"). Subsequently he was offered, and accepted, a new role that would provide him with a substantial annual income. As that new income was significantly in excess of his normal expenditure (after accounting for his pension income from the OPS) he sought advice from LCL about making additional pension contributions to minimise his liability to income tax.*
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> *Mr W was provided with advice by LCL in February 2014. As part of its advice LCL identified that Mr W would be able to make a pension contribution of £100,971 in that tax year, when considering his income and past allowances that were carried forward. But in April 2014 legislation would reduce the LTA available from £1.5M to £1.25. LCL identified that, after considering the value of Mr W's occupational pension, and his other pension savings, making that contribution would place him in excess of the new LTA limit.*
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> *So LCL recommended that Mr W apply for fixed protection (FP2014) to retain his LTA at £1.5M. But the downside of making that application was that Mr W gave up the ability to make future pension contributions.*
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> *In 2020 Mr W complained that LCL's calculations of his LTA position in 2014 had been incorrect. Rather than exceeding the LTA, Mr W says that his true position left him with approximately £300,000 of unused allowance (based on the lower £1.25M allowance) after his additional contribution had been made. So he says there was no need to take the FP2014 and that he could have continued to make pension contributions for a number of years, and so benefitted from the associated income tax relief.*
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> *In 2020 Mr W was living in his second home in Ireland at the start of the coronavirus pandemic. Due to restrictions on travel Mr W told LCL that he though it possible that he would remain in Ireland for the remainder of the year, and potentially beyond, and*

so his tax residence might change. He sought advice from LCL about the income tax implications of that change.

At that time LCL provided Mr W with some new terms and conditions. Those made Mr W aware that LCL did not have the required permissions to provide him with advice when he was in any overseas location, regardless of whether that location was in the European Economic Area (EEA). Mr W says he cannot find any reference to that restriction in any earlier terms and conditions he'd been provided with. But since LCL assured him the new terms did not change their previous working relationship he assumes they had been present from the start. And since LCL was aware that he spent at least part of each year abroad he thinks LCL acted unreasonably in accepting him as a client and taking an annual advice charge.

As my starting point for considering this complaint I have looked at the advice that was provided to Mr W by LCL in 2014. And in particular I have reviewed in detail the calculations that LCL performed to assess Mr W's current utilisation of his pensions LTA. Having done so, I entirely agree with Mr W's conclusion that the basic premise of that assessment was incorrect.

Mr W had already taken some pension benefits in 2010. Those were in the form of an annuity provided by his OPS. When those benefits were taken the scheme administrator was required to calculate the equivalent value of the benefits so they can be tested, both at that time and in future, against the relevant LTA. In 2010 the scheme administrator calculated Mr W's pension benefits to be valued at £1,077,924. And at that time, since the LTA was set at £1.8M, those benefits equated to 59.88% of the LTA.

In April 2012 the LTA was reduced to £1.5M. And, as I've noted earlier, the LTA was reduced once again in April 2014, to £1.25M. But the relevant legislation, contained in the Finance Act 2004 states that;

> *The correct method for calculating LTA usage requires the past crystallised amount be indexed at the same rate the standard LTA has been indexed.*

So, following the reduction of the LTA in April 2014, a proportionate reduction in the value of Mr W pension benefits already taken should have been applied. That means those OPS benefits should have been determined to have a value of £748,500.

At that time Mr W held other pension savings valued at £94,693. And as I said earlier LCL had advised him to make a one-off pension contribution of £100,971. So taken together LCL should have concluded that Mr W had remaining headroom of £305,778 before he reached the new, lower, LTA limit.

LCL's calculations were flawed – instead it concluded that making the additional contribution would place Mr W above the revised LTA limit. It had failed to apply the required indexation to Mr W's previously taken pension benefits. Whilst I accept that LCL is entirely correct in saying its advisor had gathered the correct information, and was aware of the pension benefits Mr W had already taken, it seems beyond question that the advisor based their recommendation on incorrect analysis.

But that in itself doesn't mean that the recommendation was incorrect – or that Mr W has lost out. I have no way of knowing for certain what Mr W's decision would have been had the correct information been provided to him. But Mr W has provided us, and LCL, with what appears to be well considered and honest testimony about his likely decision. I entirely accept that testimony is provided with the benefit of hindsight

– and there is a possibility that Mr W's testimony might be influenced by later changes in legislation and recent investment performance. But I have no reasons to doubt what he says, and think it reasonable to use that testimony as the basis for my decision.

Mr W has told us that, had the true LTA position been explained to him in 2014, he would not have applied for FP2014, and would have continued making pension contributions. And given what he has told us about his income at the time, and the clear rationale that he provided to LCL about wanting to minimise his taxation liability, I think that what Mr W has said is entirely plausible.

Mr W has said that he would have expected to make further pension contributions of £125,000 over the following years. It appears to me those would have been affordable based on his income, and allowable under the relevant legislation. I don't think that making contributions of that amount, and considering the likely investment returns, would mean that Mr W would have been at risk of breaching the LTA even after it was reduced further in 2016. I accept that Mr W would have still had some considerable time before he was required to take his pension benefits at age 75. But that wouldn't have prevented him from crystalising his remaining pension savings earlier than that and so creating a new benefit crystallisation event, and further recalculation of his OPS benefits.

So I do think it is likely that Mr W has lost out as a result of the incorrect information he was given by LCL in 2014. But for that incorrect information I think he would have continued to make pension contributions amounting to £125,000 and benefitted from the relevant tax relief on those contributions. I think a sum equivalent to that tax relief should be paid to Mr W as compensation.

In saying that, I am mindful that Mr W did gain some benefit from the advice he was given by LCL in 2014. I understand that he still retains his FP2014 LTA of £1.5M. So at the point he decides to crystalise his remaining benefits he might avoid a taxation charge that would otherwise have been due. But I'm satisfied that Mr W would have taken appropriate action, if required, to mitigate that taxation charge had he not had the benefit of the increased LTA. So I don't intend to make any allowance for that benefit in the redress I direct below.

I turn now to whether Mr W was treated unfairly by LCL by it continuing to advise him when it knew that he spent part of the year outside the UK. But I'm sorry to tell Mr W that I don't think this part of the complaint should be upheld.

Until 2020 it seems to me that Mr W considered himself to be resident in the UK, both in general terms and for taxation. Whilst it is clear that he visited his second home regularly I don't think that reasonably meant LCL was unable to service him as a client. It was only in 2020 when circumstances led to a more permanent change in Mr W's living arrangements that its clause relating to overseas clients became applicable. I don't know whether that clause applied in the past – but I don't think Mr W has lost out if it did. His dealings with the firm before 2020 had been from the UK. And so LCL was reasonably able to provide the advisory services to him.

I invited both parties to provide us with any further comments or evidence in response to my provisional decision. Both Mr W and LCL have said that they accept my provisional findings. But they have both also provided some additional information in response to my decision.

Mr W has confirmed that he was an additional rate taxpayer during the period he would have made the additional pension contributions. And since then he has remained a higher rate taxpayer. He has confirmed that it would be reasonable for him to make pension contributions now utilising his last three years allowance. And he says that he has sufficient headroom against the LTA to do so, and so relinquish the protection he has through FP2014.

LCL has asked if Mr W would be able to provide detail of the investment performance of his pension savings to allow it to calculate the compensation he is due. Mr W has advised he doesn't hold that information. So both parties have agreed it would be reasonable to direct that the compensation be based on a benchmark calculation rather than the actual returns.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

Given that both parties have accepted my provisional findings, I see no reason to alter those conclusions. I think it is likely that Mr W has lost out as a result of the incorrect information he was given by LCL in 2014. But for that incorrect information I think he would have continued to make pension contributions amounting to £125,000 and benefitted from the relevant tax relief on those contributions. So LCL needs to put things right.

Putting things right

As I explained in my provisional decision, I think that LCL's error meant that Mr W was prevented from making additional pension contributions amounting to £125,000 over the period 2015 to 2018. Although it is true that Mr W will have still enjoyed the use of those funds, he will not have benefitted from the tax relief that he might have otherwise received. Mr W has provided us with extensive evidence to show that his earnings and expenditure were such that he could afford contributions of this amount. Rather than adding these amounts to his pension he has instead made other, less tax efficient, investments.

The evidence I have seen demonstrates that Mr W was an additional rate taxpayer (45%) during that period. Mr W has confirmed that this is a correct assessment.

LCL needs to pay compensation to Mr W equivalent to the tax relief he would have received. For simplicity I have assumed that Mr W would have made each contribution towards the end of each tax year when his earnings and tax affairs could be best assessed – so I have assumed here that contributions of £31,250 would have been made on 31 March between 2015 and 2018 inclusive. For ease I will assume that the tax relief would be received around two months later. So LCL should use dates of 31 May each year to calculate the investment returns and interest I detail below.

I intend to direct LCL to pay Mr W a total of £56,250 to reflect the tax relief he has lost. That comprises a total of 45% tax relief on total contributions of £125,000

The basic rate portion of that tax relief (£25,000) would have been added to Mr W's pension savings. So LCL should add compensatory investment returns to this amount, based on the benchmark that both parties have accepted, and calculated from the date each tax relief payment would have been claimed (as set out above) to the date of my final decision. The benchmark that should be used is the FTSE UK Private Investors Income total return index (or the FTSE WMA Stock Market Income Total Return Index prior to 1 March 2017).

But that part of the tax relief would have been added to Mr W's pension. And that would have provided a taxable income. Therefore this part of the compensation should be reduced to notionally allow for any income tax that would otherwise have been paid.

The notional allowance should be calculated using Mr W's expected marginal rate of tax in retirement. Mr W has confirmed he is likely to be a higher rate taxpayer so the reduction should equal the current higher rate of tax (40%). However, as Mr W would have been able to take an additional tax-free lump sum, the reduction should be applied to 75% of that part of the compensation resulting in a total overall reduction of 30%.

Should that part of the compensation not be paid to Mr W within 28 days of his acceptance of my final decision, LCL should add further interest at a rate of 8% per annum from the date of my final decision to the date of settlement. HM Revenue & Customs requires LCL to take off tax from this interest (if it is required to be paid). LCL must give Mr W a certificate showing how much tax it's taken off if he asks for one.

Mr W would have needed to reclaim the remaining £31,250 over the three years in question through self-assessment, and I'll assume that this would have been received at the same time as the tax relief would have been applied within the pension plan. Mr W would have received this in the form of a tax rebate, which he could have used as he saw fit. And so LCL should pay Mr W the tax rebates he would have received, with the addition of 8% simple interest from the date that they would have been received (as set out above) up to the date of settlement.

Although Mr W gave up paid employment in 2018, and has since not been in receipt of qualifying earnings, he would nevertheless have been able to contribute £2,880 annually and receive tax relief. So since Mr W has confirmed the Money Purchase Annual Allowance hasn't been triggered, and he has made no other pension contributions, he would also be entitled to use three past years of this allowance carried forward. And so these contributions could now be made in lieu of those which he would otherwise have made up to 2018.

Since headroom still exists against the LTA, LCL may deduct from the total loss the amount which Mr W would now be able to receive as tax relief from such pension contributions. Those deductions should be based on an income tax rate of 40%.

LCL should provide Mr W with details of its calculations in a clear and understandable format.

My final decision

My final decision is that I uphold Mr W's complaint and direct Lighthouse Advisory Services Limited to put things right as detailed above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr W to accept or reject my decision before 15 August 2022.

Paul Reilly
Ombudsman