DRN-3676978

The complaint

The estate of Mrs B complain that Armstrong Watson Financial Planning Limited ("Armstrong Watson"), mis-sold an Enterprise Investment Scheme.

What happened

In 2010 Armstrong Watson advised the late Mrs B to invest £200,000 into an Octopus Eureka Enterprise Investment Scheme (OEIS), for the purpose of inheritance tax relief. In 2011, Armstrong Watson recommended further investment of £40,000. When Mrs B passed away in 2016, the estate was only able to withdraw £38,000. The remaining £94,000 was illiquid. The estate maintain that significant capital losses were sustained. Since the complaint has been with our service, some additional payment have been made from the investment.

The estate maintain that Mrs B was risk averse, was unaware of the risk of illiquidity of capital after her passing and had wanted to retain access to her funds during her lifetime. Armstrong Watson say that the recommendations were suitable for Mrs B's needs as they met her objectives of inheritance tax relief and income provision. They maintain that the risks were properly explained at the time and it was Mrs B's choice to proceed with investments despite her cautious attitude to risk to gain tax advantages. Armstrong Watson highlighted that Mrs B's daughter attended meetings when the proposals were discussed.

Our investigator considered the complaint. She thought Mrs B had capacity to withstand capital losses, having a further £270,000 in cash, £100,000 in NS&I bonds and £630,000 in other investments. As to objectives, our investigator thought that the OEIS did provide income tax relief and inheritance tax relief, so this was partially in line with Mrs B's objectives. However, our investigator was not persuaded that the investment was in line with Mrs B's attitude to risk. Mrs B had limited investment experience and was a cautious investor. Our investigator was not satisfied that the high-risk nature of the OEIS had been explained to her. Mrs B had wanted to retain access to her funds and it wasn't clear that the illiquid nature of the investment was understood and it did not meet her objectives for funds to pass to her family on her death. Our investigator concluded that Mrs B was exposed to more risk than she wanted to take. To put things right, our investigator recommended that the estate be compensated for the return the capital sums would have achieved had they been invested in half in the FTSE Total Income Return and half in fixed rate bonds, less any tax relief received.

Armstrong Watson didn't agree with the view, they maintained that the recommendations were suitable for Mrs B. Mrs B chose to take higher risk to gain tax advantages and her daughter attended meetings with her. That Mrs B sought similar advice in 2011 was indicative of her understanding of the risks. Armstrong Watson say that the 50/50 benchmark gave an element of investment above Mrs B's attitude to risk. Considering the tax relief and funds paid out from the scheme, the estate did not sustain a loss. Armstrong Watson maintain that a fair assessment would require a comparison between the actual position the estate finds itself in and the position it would have been in but for the investment. Credit should be given for the IHT liability that would have been incurred on the whole estate but for the EIS. Armstrong Watson calculated the value of the estate using the comparator figures

but as the investment was in an EIS at the time of death, they deducted 40% to reflect inheritance tax liability and maintained that this should be reflected in any compensation payment.

The estate of Mrs B accepted that credit should be given for actual tax relief received but not for the notional figure on the benchmarked value. The parties have attempted to negotiate without success.

Our investigator wrote a further view in which she endorsed some figures. The parties still disagreed so the matter came to me for a decision. I considered all the available evidence and arguments to decide what was fair and reasonable in the circumstances of the complaint. I issued a provisional decision on 9 March 2023, provisionally upholding the complaint.

I considered the information about Mrs B's circumstances. Mrs B was 86 years of age at the time advice was given in 2010. Mrs B held over £1,200,000 in assets, a large proportion of which was held in cash following a house sale. She had an annual income of over £82,000. Her objective was to reduce the amount of inheritance tax payable on her estate. Mrs B's attitude to risk was described as very low on assessment. The recommendation letters also showed that Mrs B was looking to keep control of her assets and receive an income from them. This was the principal reason for rejecting the alternative option of gifting.

Armstrong Watson made two recommendations, £300,000 into a discounted gift trust, which did not form the basis of the complaint and £200,000 into the OEIS, which formed the basis of the complaint.

The OEIS was recommended as it would provide inheritance tax relief if held for two years by the date of death. 20% income tax relief was available if the investment was held for at least three years. It was noted that the recommendation was outside Mrs B's attitude to risk. Later the suitability report went on to states, *" the EIS is completely based on growth assets and is a high-risk investment strategy . . It has been recommended purely as a Tax planning strategy . ."* The adviser recorded that Mrs B was comfortable with the recommendation as it met her Inheritance Tax Mitigation.

I thought it was clear that the investment was considerably outside Mrs B's attitude to risk. And I noted that was also in the context of the discounted gift trust described as being outside Mrs B's comfort zone. I was not persuaded that it was made clear to Mrs B that she was placing all of £200,000 at high risk. There was nothing within the suitability report to say that Mrs B stood to lose all her capital if the investment failed. Rather, the letter said the investment would lead to a £80,000 saving on inheritance tax, but this assumed the capital sum would retain its value. Neither was it made clear that the funds would become illiquid and would be tied into the investment for at least four years, if not longer. That was a material risk factor and relevant consideration, as it was clear that Mrs B wanted to retain access to her funds. Further, I was not persuaded that it was made clear that the inheritance tax relief would be lost if Mrs B passed away within two years of investment.

I was also persuaded by the testimony of Mrs B's daughter who attended the meetings with the adviser. She recalled that the level of risk exposure was not made clear, Mrs B explained that she was risk averse and the focus of the meetings was on tax breaks. It was not explained that funds risked being tied up for years. The focus on tax relief over and above risk was also consistent with a tax planning report, which Mrs B had received from Armstrong Watson in February 2010. The report said there were some issues or risk to address highlighted the tax efficiencies with an EIS, said to be to reduce risk as far as possible and preserve the value of tax reliefs without seeking substantial growth in the

investment. Further, notes in financial planning questionnaire, dated February 2010, again focused on tax relief but no mention was made of increased risk exposure.

As to the 2011 recommendation Armstrong Watson advised Mrs B to invest another £150,000 into inheritance tax efficient schemes, namely £110,000 into an inheritance tax service product (about which no complaint has been made) and an additional £40,000 into the OEIS.

Save that Mrs B was older and now held £200,000 in high risk investments, I considered that her circumstances were broadly the same as at 2011. Again, Armstrong Watson recorded that Mrs B had a very cautious attitude to risk and her objectives were inheritance tax and income tax efficiency. The report did state that the OEIS was a high-risk strategy but I was not persuaded it was made clear to Mrs B that she stood to lose all her capital if the investment failed. Rather, the letter focused on tax relief, stating the investment would lead to a £16,000 saving on inheritance tax, which was misleading as it assumed the capital sum would retain its value. The report also said that by investing £40,000, Mrs B would meet achieve tax relief of £12,000 that would meet her tax liability of 2011/2012. In my view, it was not made clear that the funds would become illiquid once invested and would be tied into the investment for at least four years, if not longer. That was a material risk factor and a relevant consideration, as it was clear that Mrs B wanted to retain access to her funds and give access to her capital to her beneficiaries. Again, I was also persuaded by the testimony of Mrs B's daughter who attended the meetings with the adviser. She recalled that the level of risk exposure and risk of long-time illiquidity was not made clear.

Whilst more risks were embedded in appendices to the suitability reports, there was nothing to show they were clearly explained to Mrs B at the time, nor did they form part of the reasoning in the core recommendations. I was persuaded that it was more likely than not that Mrs B would have relied upon what she was told in the meetings and, as I set out above, I considered that the daughter's recollections were likely to be accurate and were consistent with the notes from the time, which didn't address the risks.

On balance, I was not persuaded that potential tax reliefs were more important to Mrs B than the risk to her capital. So, overall and on balance, I was not persuaded that the recommendation was suitable for her. Also, if the high risk of capital loss and risk of longer term illiquid had been made clear, I was not persuaded that Mrs B would have invested in the OEIS. Whilst Mrs B had capacity for loss, it was clear that her focus was on preserving her inheritance and passing as much of her estate as possible to her family. The adviser appeared to give no consideration to the alternative option of Mrs B retaining funds on deposit and the estate paying inheritance tax.

In light of these findings, I thought it was fair and reasonable for Armstrong Watson to put things right.

I was mindful that had it not been for the unsuitable advice, Mrs B/the estate wouldn't have had the benefit of any tax relief received and the estate wouldn't have whatever value (if any) the EIS now had.

I was not persuaded that Mrs B would have invested in the EIS, which meant any tax relief *already* received would need to be off-set. As the benchmark I selected would not have been in a tax efficient wrapper, I concluded that Armstrong Watson should not be deducting any further tax. The redress recommended, effectively unwound the investment as if it wasn't made and a comparator investment was made instead. I directed Armstrong Watson to calculate the redress in line with the methodology and to provide clear calculations for the estate, to set expectations, I explained that this was in line with our usual process. I

considered that it would be for the estate to declare any outstanding inheritance tax liability and it was a matter for the executors to take tax advice if they wished to do so.

I recommended that Armstrong Watson pay the difference between the fair and actual value, where the fair value would be the average return from fixed rate bonds from the time the investment started to date of my decision, taking into account any withdrawals. If the funds remained illiquid, the actual value could be assumed as zero but credit would also have to be given for any tax relief available to Mrs B and the estate. Either Armstrong Watson could take ownership of the investment or if that was not possible, they could request an undertaking from the estate to repay any amount it might receive from the investment in the future.

Both parties have now responded to my provisional decision.

The estate agree with the merits findings, however, they maintain that Mrs B had a higher risk appetite, such that a 50/50 benchmark would be appropriate or a return in line with a Rathbones investment or investment in agricultural land holdings. The estate say it is fair that credit should be given for only a percentage of tax relief received. They maintain that all trail commission and fees received by Armstrong Watson from Octopus should be refunded to the estate and likewise the cost of advice should be repaid. The estate maintain that all costs for legal advice should be covered by Armstrong Watson and it is inappropriate for them to undertake the calculations.

Armstrong Watson have said nothing further about the merits. They broadly agree with the benchmark and method of calculation but say credit should be given for all inheritance tax that would have been payable but for the EIS. They say the redress places the estate back in a financially better position because the estate have had the benefit of the EIS without the risk. They maintain that a 40% deduction should be made from any final award.

I've now reviewed all the information provided and have reached a final decision.

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.

The parties haven't provided any further comments or evidence in respect of my findings on the merits. Accordingly, I uphold the complaint for the same reasons set out in my provisional decision and above.

There is ongoing disagreement as to the redress payable. First, to be clear, my decision puts the parties into the position as if the EIS had not been made. Whilst I have noted the comments from the estate as to other investments Mrs B could have made, I have made my decision based upon the information available at the time of assessment of her attitude to risk. The documents from the time record that Mrs B had a very low appetite for risk. As I explained in my provisional decision, I am not able to say precisely now how Mrs B would have invested but I consider that she would have invested differently. A fixed rate bond benchmark would be in line with her attitude to risk and it remains my view that it is a fair and reasonable comparator.

It is then appropriate for credit to be given for any withdrawals and any tax relief received. As explained in the provisional decision, it is for the estate to provide evidence of the tax relief availed of and to provide that to Armstrong Watson. If, no such information is provided, Armstrong Watson are entitled to deduct tax relief at the marginal rate of tax.

I do not agree with the submissions of Armstrong Watson, that the decision gives the estate the benefit of an EIS without the risk. I also do not agree with the estate's view that a percentage of the tax relief received should be deducted.

The redress puts the estate in the position as if a different investment was made. The options available as to whether Armstrong Watson takes ownership of the EIS are set out in the methodology. As I have clearly stated the redress assumes no tax efficient wrapper was used because if appropriate advice had been given, I consider that an EIS would not have been recommended. I have directed that the estate must give credit for any tax relief received to date, that includes giving credit for any applicable inheritance tax relief received to date. The balance is payable to the estate; liability for any additional inheritance tax on that balance falls to the estate to pay. It is for the estate to deal with any tax liability with HMRC. It is not for Armstrong Watson to deduct/withhold it.

I appreciate that the estate wishes the advice costs to be covered, but as I have explained advice was sought for tax efficient investments generally and advice would have been sought in any event, so it remains my view that it is not fair and reasonable to ask Armstrong Watson to refund the cost of advice. Further, no new information has been provided about legal fees. It remains my view that some fees would have been incurred in any event, so I make no separate award.

I note the comments about refunding trail commission and fees paid by the EIS provider. The redress unwinds the advice, to put the estate in the position as if the investment had not been made, so the estate will not lose out. It would not be appropriate to award these figures in addition to the redress set out. I remind he parties that this service provides a dispute resolution service only, it has no regulatory or punitive powers, which are matters for the regulator. It not part of this service's function to penalise a business.

Finally, in line with our usual process, it is Armstrong Watson to provide calculations in a simple format to the estate, which they have agreed to do.

Putting things right

For the reasons given in my provisional decision and above, it is my view that it is fair and reasonable for Armstrong Watson to put things right as follows:

Given the information I've considered, I think Mrs B would have invested differently. I've considered what I think is fair and reasonable given his circumstances and objectives when she invested. Armstrong Watson must:

- Compare the performance of the investment with that of the benchmark shown below and pay the difference between the fair value and the actual value of the investment. If the actual value is greater than the fair value, no compensation is payable.

- Armstrong Watson should also pay interest as set out below.

Investment name	Status	benchmark	from ("start date")	To ("end date")	Additional interest
Octopus EIS	Still exists in part, but illiquid	Average rate from fixed rate	Date of investment	Date of my final decision	8% simple per year from date of

		bonds			decision to date of settlement (if compensation is not paid within 28 days of the business being notified of acceptance)

actual value
This means the actual amount payable from the investment at the end date. If at the end date the investment is illiquid (meaning it could not be surrendered or readily sold on the open market), it may be difficult to work out what the actual value is. In such a case the actual value should be assumed to be zero. This is provided the estate agrees to Armstrong Watson taking ownership of the investment, if it wished to. If it is not possible for Armstrong Watson to take ownership, then it can request an undertaking from the estate that it repays to Armstrong Watson any amount it might receive from the investment in future.

Armstrong Watson may also add to the actual value any available tax reliefs Mrs B and the estate have received to date by virtue of making the investment. They may ask for evidence of this, or assume all available reliefs have been availed at Mrs B's marginal rate of tax.

For ease Armstrong Watson can calculate the value of the available relief and add it to the actual value as one figure at the end.

fair value
This is what the investment would have been worth at the end date had it produced a return using the benchmark.

To arrive at the *fair value* when using the fixed rate bonds as the benchmark, Armstrong Watson should use the monthly average rate for one-year fixed-rate bonds as published by the Bank of England. The rate for each month is that shown as at the end of the previous month. Those rates should be applied to the investment on an annually compounded basis.

Any withdrawal, income or other distribution paid out of the investments should be deducted from the fair value calculation at the point it was actually paid so it ceases to accrue any return in the calculation from that point on. If there are a large number of regular payments, to keep calculations simpler, I'll accept if Armstrong Watson totals all those payments and deducts that figure at the end to determine the fair value instead of deducting periodically. If any distributions or income were automatically paid out into a portfolio and left uninvested, they must be deducted at the end to determine the fair value, and not periodically.

why is this remedy suitable?

I decided on this method of compensation because:

- The contemporaneous risk assessment identified Mrs B as having a very low risk appetite. The average rate for fixed rate bonds would be a fair measure for someone who wanted to achieve a reasonable return without risk to their capital.

My final decision

Where I uphold a complaint, I can make a money award requiring a financial business to pay compensation of up to £160,000, plus any interest and/or costs that I consider appropriate. If I consider that fair compensation exceeds £160,000, I may recommend that Armstrong Watson pays the balance.

Determination and award: I uphold the complaint. I consider that fair compensation should be calculated as set out above. My final decision is that Armstrong Watson should pay the amount produced by that calculation up to the maximum of £160,000 (including distress or inconvenience but excluding costs) plus any interest on the balance as set out above. Armstrong Watson should provide details of its calculations to the estate in a clear, simple format.

Recommendation: If the amount produced by the calculation of fair compensation exceeds £160,000, I recommend that Armstrong Watson pay the balance plus any interest on the balance as set out above.

If Armstrong Watson does not pay the recommended amount, then any investment currently illiquid should be retained by the estate. This is until any future benefit that he may receive from the investment together with the compensation paid by Armstrong Watson (excluding any interest) equates to the full fair compensation as set out above.

Armstrong Watson may request an undertaking from the estate that either it repays to Armstrong Watson any amount it may receive from the investment thereafter, or if possible transfers the investment to Armstrong Watson at that point.

This recommendation is not part of my determination or award. It does not bind Armstrong Watson. It is unlikely that the estate can accept my decision and go to court to ask for the balance. The estate may want to consider getting independent legal advice before deciding whether to accept this decision.

Under the rules of the Financial Ombudsman Service, I'm required to ask the estate of Mrs B to accept or reject my decision before 28 April 2023.

Sarah Tozzi
Ombudsman