DRN-3835844

The complaint

Mr B has complained that Warren & Co (Complete Financial Solutions) Ltd advised him to make pension contributions in excess of his "relevant" earnings for the tax years 2018/19 and 2020/21. As a result, Mr B has incurred an annual allowance charge from HMRC.

What happened

Mr B approached Warren & Co in 2018 for pension advice. He had received an inheritance of £58,000 and wanted to use it to fund his pension. In the suitability report, issued on 20 August 2018, the adviser said:

"You asked me what the maximum amount that you could potentially contribute into a pension plan was and I have advised you that because you earn £42,000 gross per annum then the maximum amount that you could contribute into a pension and receive tax relief on the contribution, would be £40,000 gross".

The Suitability Report was based on information gathered in a fact-find meeting on 19 July 2018. According to the Suitability Report Mr B's circumstances were as follows:

- He was employed as a company director
- He had income of £42,000 per annum
- He had two existing Personal Pensions with Aviva, but had not contributed to them for some time
- He also had a final salary pension from a previous employer

Based on this information, the adviser recommended that Mr B should invest £40,000 gross (£32,000 net) into a pension, to match the annual allowance for the 2018/19 tax year. The adviser noted that Mr B could 'carry forward' unused tax relief from previous years if he wanted to contribute a higher sum. According to the Suitability Report, Mr B preferred not to use carry forward, but the adviser recommended further contributions be made in the following tax year.

Based on a cheque on file, Mr B invested £30,000 into the pension around 31 August 2018.

Also, in August 2018, Warren & Co recommended an Income Protection policy for Mr B. The application form recorded his personal taxable income as £42,000. The benefit selected was £1,870 per month.

A further review of Mr B's pension arrangements took place on 14 January 2020, in which the fact-find completed in August 2018 was updated. Handwritten notes were added to the fact find, but it's unclear whether these notes were originally added in August 2018, or whether all the notes were added in January 2020.

The notes included the comment: *"Mr B says he has taxable PAYE income of approx. £43,000 for the 2019/20 tax year".* The adviser further noted that he recommended Mr B speak to his accountant before making any new pension contributions and that he discussed *"drawing dividends from his limited company instead of PAYE earnings to increase tax efficiency and reduce NI".*

The fact find was signed by Mr B on 14 January 2020.

A short Suitability Letter was issued on 5 May 2020. It recorded Mr B's income as being £43,000 and said that he was interested in investing £18,750 gross (£15,000 net). No actual recommendations were made in the one page letter, but Mr B was charged an initial fee of £375 after making the contribution.

Mr B mentioned these contributions to his accountant, who explained that because a significant proportion of his income was made up of dividends, this limited the amount of tax relievable pension contributions he could make. According to Mr B, this resulted in an annual allowance charge of £5,739.80 for tax year 2019/20 and £3,705 in 2020/21.

Mr B complained to Warren & Co in February 2021. In its final response letter issued on 11 March 2021, Warren & Co declined to uphold the complaint. It said that the documents it held, some of which Mr B had signed, confirmed his income as being PAYE. It further said that it had advised him to discuss taking dividends with his accountant.

Dissatisfied with the response, Mr B referred the matter to this service. Our investigator thought that it should be upheld, saying the following in summary:

- It was agreed by all parties that, following the inheritance, Mr B wished to maximise his pension contributions.

- In accordance with the requirements of COB 5.2.5 from the FCA's handbook, Warren & Co needed to "know its customer", which involved obtaining sufficient personal information which would be relevant to the services it would provide.

- Mr B also needed to provide accurate information about his circumstances, but this would rely on Warren & Co having asked the right questions. And it was of crucial importance that it understood the nature of Mr B's income.

- Mr B had been a company director since March 2001, and although he took a proportion of his income as dividends, he told the investigator that he hadn't understood that these weren't considered earned income and so didn't contribute to the "relevant" income for pension contribution purposes.

- Mr B didn't recall being asked questions relating to the nature of his income during the fact finding process, but he was aware of part of it being in dividends and would have provided this information if requested.

- On the basis that Warren & Co knew that Mr B was a company director, this should have led to a conversation about the nature of his income, or to it liaising with Mr B's accountant.

- Had the risks of contributing in excess of the annual allowance been set out to Mr B, he would have taken steps to gather the necessary information. But these risks weren't contained within the suitability report.

- But even if Mr B received income entirely on a PAYE basis, it couldn't have been known that his whole of year earnings would support the £30,000 net contribution as the advice was given at the end of August 2018 - only six months into the financial year. It was therefore essential that Mr B's accountant should be involved.

- Although Warren & Co was relying on the notes added to the suitability report to demonstrate that it recommended the involvement of an accountant, it was unclear as to when these were added. But a reference to the 2019/20 tax year suggested that they were made after the second review – after the £30,000 contribution in 2018.

- Warren & Co had also queried as to why Mr B's accountant hadn't picked up on this before, but the pension contributions were made from Mr B's personal finances, and so they wouldn't be aware of them unless specifically mentioned by Mr B.

- The advice in 2020 was very much a "rubber stamp" of that given in 2018. The letter was very short and was based on income of approximately £43,000.

- Warren & Co had said that Mr B could be deemed to be a sophisticated investor, but he was provided services as a retail customer, and was reliant upon Warren & Co for specialist pensions advice.

- Whilst Warren & Co had pointed to the £42,000 income recorded for an income protection policy established in 2018 as supporting the position that the advice was suitable, this only cast into doubt the suitability of that protection policy. The maximum level of monthly benefit under the policy was capped at 60% of personal taxable income, which would exclude dividends. So it was again vital that Warren & Co understood Mr B's income position, as Mr B could have been paying for a level of benefit which he'd be unable to claim.

In recommending a manner of calculating whether redress was due to Mr B, the investigator said it was likely that, by invoking unused tax relief from other years, Mr B could have made the full £45,000 contribution between 2018/19 and 2020/21 and received tax relief.

He therefore proposed that Warren & Co repay the annual allowance charges he's paid, along with interest, but with no deduction on the growth which the contributions might have accrued, as he would have been able to make the full £45,000 contributions in a different format to that recommended by Warren & Co.

He further said that Warren & Co should pay Mr B the amount of £500 in respect of the trouble and upset caused by the unsuitable advice, and that Mr B had needed to encash another pension to pay the unexpected annual allowance charges.

Warren & Co made the following points in response:

- As Mr B only had PAYE income of £8,314 in 2018/19, the most he could have contributed was a net amount of £6,651 and no "carry forward" would have been available because he didn't use up all of his annual allowance in the 2018/19 tax year.

- The only way he could have made a £30,000 contribution in 2018/19 was if his PAYE earnings had been at least £30,000.

- There had been several discussions about how Mr B was paid, in particular around dividends, and he'd confirmed that he was paid by PAYE.

- It didn't understand how Mr B had made a loss, as he'd received £22,500 tax relief on his pension contributions, and as the annual allowance charge had been £9,444.80, he'd made a "profit" of £13,055.20. And this didn't include the fund growth on both the contributions and the added tax relief.

- It also queried the apparent contradiction between the stated position that Mr B had needed to pay the tax charge out of his own pocket, and that he'd needed to encash pension funds to pay it. Mr B could in fact have switched his Royal London pension plan into flexi access drawdown at a cost of £210 and then withdrawn enough money to cover the tax charge through accessing his tax free cash.

- He could have withdrawn the £9,444.80 charge just from the tax relief that he received on his pension contributions.

The investigator considered these points and agreed that Mr B couldn't have invested the whole £45,000 and received tax relief due to the carry forward rules. And so he said that the benefit from growth on the overall contribution should therefore be taken into account.

He also noted the comment relating to the conversations with Mr B about his income, but he wasn't persuaded that Mr B would have insisted that his income was entirely on the basis of PAYE. He also remained of the view that the contribution of £30,000 in August 2018 had been premature, given that it was only halfway into the tax year.

With regard to the matter of whether Mr B had suffered a loss, he acknowledged that Mr B had received tax relief of £22,500, but he thought that Warren & Co would need to compare Mr B's actual situation with that he would otherwise have been in, but for the unsuitable advice. This may, he said, need to involve an actuary, due to Mr B having obtained fund growth on contributions he wouldn't have made if he'd been suitably advised.

And as to Warren & Co's query relating to how Mr B had paid the tax charge, the investigator said that it was out of his own pocket, but that he'd needed to access pension benefits to pay this. And those funds were therefore not longer available for their intended purpose.

The investigator amended his redress proposal, saying that Warren & Co would need to establish Mr B's relevant earnings for the tax years 2018/19, 2019/20 and 2020/21 and the maximum amount he could have contributed with those relevant earnings.

If he could have contributed the full £45,000, then no growth on those contributions should be used to offset the loss on the tax charge, he said. But if the maximum tax relievable contributions had been lower that £45,000, then Mr B had received growth on extra contributions which wouldn't have been made if he'd been suitably advised, and this should be used to offset the tax charge loss.

Th investigator said that, in the first instance, any loss should be paid into Mr B's pension plan, but if this wasn't possible or had implications for his annual allowance or any protections in place, this should be paid directly to him with a notional deduction for the (assumed basic rate) income tax he would have otherwise paid on the pension benefit.

Warren & Co considered the investigator's points, and said that Mr B had been a company director for many years and was fully aware of how he was paid and how his pension contributions were calculated.

Further, it said, Mr B had confirmed his income in a fact find document.

It remained of the view that Mr B hadn't lost out financially and that he had in fact made a substantial gain. However, as a gesture of goodwill, it said that it would offer Mr B £500 to cover the trouble and upset caused, plus a return of the fee that it received from the product provider, amounting to £1,200. This, it said, would be in full and final settlement of the matter.

The investigator put the offer to Mr B, but he declined to accept it. As such, as agreement hadn't been reached on the matter, it was referred to me for review.

I issued a provisional decision on the matter on 31 October 2022, in which I set out my reasons as to why I thought the complaint should be upheld. The following is an extract from that decision:

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

And having done so, I've reached similar conclusions to the investigator, and for broadly the same reasons. But the redress calculation I'm proposing is slightly different, as set out below.

I agree with Warren & Co in that Mr B is more likely than not to have been aware of how he was paid, but I don't think this automatically reads across into an understanding of what this meant for his pension contributions. The annual allowance and what might constitute relevant earnings aren't straightforward matters, and are issues which a consumer such as Mr B might quite reasonably be reliant upon a firm such as Warren & Co to navigate on his behalf.

Further, Mr B may have been a company director, but I don't think this would necessarily bestow upon him any particular knowledge of pension matters. And if it did, it seems unlikely that he would have needed to pay for the services of Warren & Co in the first place.

I also acknowledge that Mr B confirmed his income in the fact find, but I can't see that he confirmed anywhere that he was being paid on an exclusively PAYE basis. And I agree with the investigator in that, had he been directly asked that question, he would have been in a position to clarify the matter or direct it to his accountant if necessary.

I think that Warren & Co needed to do more here to determine Mr B's actual source of income, and so, as with the investigator, I think the complaint should be upheld.

I've then thought carefully about the manner of calculating whether Mr B has incurred a loss, and I think Warren & Co makes a good point about the prospect of the combination of the contributions themselves, along with the tax relief and the associated growth on both, possibly more than offsetting the loss which Mr B might have incurred through needing to draw upon his pension plan to fund the tax charges. And I also acknowledge the offer it made to Mr B towards resolving the matter.

But there's only one way of being certain of whether Mr B has suffered a loss which exceeds the offer made by Warren & Co, and that is to piece together what should have happened and compare it with what has actually happened.

<u>Putting things right</u>

And so to that end, Warren & Co should determine the notional value of Mr B's pension plan, as at the date of any final decision along these lines, had he contributed the maximum amount possible on the basis of his relevant earnings for the appropriate tax years here, so 2018/19 to 2020/21, and on the basis of investment on the dates that he actually made the *contributions, and a hypothetical investment date for 2019/20 being the maximum possible on 31 August 2019 (a year after the contribution in 2018/19).*

This calculation should include the tax relief which would have been received on the basis of those contributions, and the relevant investment dates of that tax relief. Warren & Co will likely need to approach the pension provider to construct the notional value as directed here.

If these contributions would have been lower than those actually made by Mr B, it's likely that Mr B would have invested the difference until he was later able to contribute it to his pension plan. And so in response to this provisional decision, I'd be grateful if Mr B would provide details of any savings plan/vehicle which he may have been using to hold excess/emergency funds which weren't being directed into the pension plan.

Warren & Co will then need to calculate the cumulative growth, according to that savings plan/vehicle, on the difference between the amounts which Mr B should have contributed according to his relevant earnings and what he actually contributed, from the date that the difference in amounts would have been invested, to either the date that they would have been removed to fund the pension payments, or if any excess amount of it would have needed to be retained in savings, to the date of any final decision along these lines.

That total notional value should then be compared to the actual value of Mr B's pension policy, as at the date of any final decision along these lines, which will take into account all of the relevant factors which have taken place, i.e. the actual contributions, the actual tax relief received and the actual withdrawal to pay for the tax charge.

If the notional amount is higher, then Mr B will have suffered a loss, and as directed by the investigator, this should in the first instance be paid into Mr B's pension plan if possible, subject to annual allowance restrictions or any protections in place, and taking account of any available tax relief and charges which might be levied.

If it can't be paid to the pension plan, it should be paid to Mr B directly, but with the same notional basic rate deduction as recommended by the investigator on 75% of the compensation – so an overall deduction of 15%.

I also agree that this will have been a worrying period for Mr B, and the prospect of needing to pay a tax charge will I'm sure have been quite stressful. Mr B has also needed to draw upon his pension savings to pay the tax charge. And so I agree that an amount of £500 is probably about right here. I leave it to Warren & Co to decide whether it also refunds the fee received from the pension provider – this doesn't form part of my proposed award as I think the above calculation should properly determine whether a loss has occurred here, and as this reflects a situation of what should have happened, i.e. suitable advice, Mr B would reasonably have paid a fee for this."

In response, Mr B said that he held a stocks and shares Individual Savings Account (ISA), but otherwise would have invested non-pension contributions into National Savings and Investments (NS&I).

Warren & Co said the following:

- It didn't have the details of Mr B's taxable income for the 2019/20 and 2020/21 tax years, which means that it couldn't calculate exactly the pension contributions which Mr B would have made in those tax years.

- But it had used an average of his taxable income over the previous four years - £6,961 for 2015/16, £12,579 for 2016/2017, £8,995 for 2017/18 and £8,314 for

2018/19 – to determine an average taxable gross income of £9,212. It had used this to assume the maximum pension contributions for the 2019/20 and 2020/21 tax years.

- Mr B could therefore have made a maximum net pension contribution of £7,369 in 2019/20 and 2020/21, and £6,651 for 2018/19.

- This equated to a maximum overall pension contribution over the three tax years of £21,390 net, and £26,738 gross. Mr B could therefore have received tax relief over the three years of £5,348.

- Mr B actually made contributions of £30,000 net (£37,500 gross) in the 2018/19 tax year, £30,000 (£37,500 gross) in the 2019/20 tax year, £15,000 (£18,750 gross) in the 2020/21 tax year and £15,000 (£18,750 gross) in the 2020/21 tax year.

- This amounted to a total of £90,000 net, and £112,500 gross, and so Mr B benefitted from £22,500 tax relief over those tax years.

- Mr B had therefore benefitted from an additional tax relief of £17,152 (£22,500 - £5,358) by making the contributions he did, rather than those he ought to have done according to his actual assumed taxable income for those years.

- It couldn't provide a current valuation of Mr B's pension fund as it no longer held the servicing rights to Mr B's plan. But it had tried to reconstruct the value, based upon Mr B's actual and notional contributions and investment in the Governed Portfolio 8 with Royal London.

- Based upon performance figures of 6.45% between March 2018 and March 2019, -10.64% between March 2019 and March 2020, 24.99% between March 2020 and March 2021, and 13.31% between March 2021 and March 2022, then according to the assumed notional contributions he could have made, the fund value would have been around £31,386 by the end of March 2021.

- As Mr B didn't have any other investments, such as an ISA, into which he could have redirected his overpaid pension contributions, it could only assume that they would have remained on deposit.

- The Bank interest rate in September 2018 was around 0.75% pa gross, and so the additional £68,610 which had been overpaid to the pension would have been valued at around £70,164.

- The total notional value of Mr B's pension fund and the money held on deposit would therefore be £101,550.

- In terms of the likely actual value of the pension fund, Mr B invested £37,500 gross into his pension in the 2018/19 tax year, and this could have been valued at around £38,707 by the end of March 2019.

- The pension fund would then have been valued at around £34,589, assuming fund performance of -10.64%, as Mr B didn't invest an additional pension contribution of £37,500 gross until March 2020 – near the end of the 2019/20 tax year.

- Mr B then invested an additional £37,500 gross at the beginning of the 2020/21 tax year.

- This meant that the potential fund value of his pension could have been around £142,122 by April 2021.

- The potential difference in the pension fund value between the actual contributions Mr B made over the three tax years and the maximum contributions he should have made amounted to £40,572, this being £142,122 - £101,550.

- Mr B had needed to pay an annual allowance charge of £9,445, so Mr B had likely benefitted by around £31,127. And so it appeared that Mr B hadn't made a financial loss by making the contributions he did.

- The initial fees and annual management charge deducted by Royal London hadn't been taken into account in the calculations, but a further relevant point was that Mr B received a 0.4% reduction in the annual management charge as his plan exceeded £32,800 in 2018. If Mr B had contributed the maximum that his taxable income would allow, the annual management charge would have been 0.9% pa.

- A further point to bear in mind was that, as a mutual company, Royal London distributes its profits back to its policyholders each year via its profit share scheme, and this allocation was determined by the size of the pension fund. And so Mr B would have benefited further from the higher pension fund value.

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.

I'm grateful to both parties for the further information provided. I note that Warren & Co hasn't specifically commented on the merits of the case, instead focussing on the calculation to determine whether Mr B has incurred a financial loss.

And so it follows that my conclusions as to why the complaint should be upheld remain the same. I think that Warren & Co could and should have done more to determine Mr B's actual source of income.

But it has nevertheless made a persuasive case for there being no ultimate loss to Mr B as a result of the overpaid pension contributions, albeit using certain assumptions as to taxable income for the relevant tax years and fund growth within the pension plan.

I think to satisfy Mr B that he hasn't incurred a loss based on the actual income and growth figures, Warren & Co should undertake the calculation based upon those real figures. This will mean that it should request the income details from Mr B, along with his authority to seek the actual plan value from Royal London. This will then factor in fund growth, after the effect of any plan charges, along with any benefit Mr B will have received from the profit share scheme.

As to the alternative investment vehicle which Mr B would have used to redirect the overpaid pension contributions, although Warren & Co has said that Mr B didn't have an ISA, Mr B has provided evidence of an ISA he currently holds. And so it seems reasonable to me that, even if he didn't have an ISA in the relevant tax years, he would have opened one to receive the redirected pension contributions. And I further think it's reasonable to assume he would have invested in the same kind of ISA as he currently holds, and in the same funds.

If Mr B did already hold an ISA, however, he should provide Warren & Co with details as to its funding level in the relevant tax years. Mr B has indicated that, if the contributions hadn't been paid into an ISA, he would instead have invested them in NS&I, which seems broadly consistent with Warren & Co's assumption that the funds would have been retained on deposit.

There were several options within NS&I, but I think the most likely and comparative investment would have been the fixed rate bonds. Mr B wouldn't have had the facility of instant access within the pension plan, nor would he have received an income as would have been available from NS&I's income bonds.

Putting things right

Warren & Co (Complete Financial Solutions) Ltd should undertake the direction as set out in the provisional decision, but taking into account what I've said above about the alternative investment vehicle for the redirected pension contributions.

The calculation should be undertaken as at the date of this final decision. On the basis of the information Warren & Co (Complete Financial Solutions) Ltd has provided, I think it's unlikely that Mr B will have suffered a financial loss, but if the calculation shows that he has, the compensation should be paid within 30 days of Warren & Co (Complete Financial Solutions) Ltd being notified of Mr B's acceptance of this decision.

If it isn't, simple interest at 8% pa should be added to the compensation amount from the date of this decision to the date of settlement.

My final decision

My final decision is that I uphold the complaint and direct Warren & Co (Complete Financial Solutions) Ltd to undertake the above.

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr B to accept or reject my decision before 4 January 2023.

Philip Miller
Ombudsman