DRN-4952048

The complaint

Mr D complains, in summary, that Quilter Financial Services Ltd failed to provide appropriate advice about his pension contributions. This resulted in him overpaying into his pension and incurring a tax charge.

What happened

I issued my provisional decision on this complaint on 24 July 2024. The background and circumstances to the complaint and the reasons for my provisional decision to uphold it were set out in that decision. I've copied the relevant parts of it below and it forms part of this final decision.

Copy of Provisional Decision

Mr D's complaint was considered by one of our investigators. He sent his assessment of it to both parties on 9 January 2024. The background and circumstances to the complaint were set out in the investigator's assessment. I've summarised this below, along with other evidence I think is material to deciding the fair outcome of the complaint.

Mr D was advised by Quilter to start a personal pension. He made a lump sum contribution of £45,000, and started regular monthly contributions of £1,500 (net) in April 2019.

Mr D subsequently had various contact with Quilter's adviser (and his own accountant) over the following years. This included:

***25 March 2019** - Adviser to Mr D – "In preparation for our meeting on Friday this week I am attaching a copy of my Financial Strategy report for your perusal.*

I will run through the report with you when we meet up (and answer any questions you have) but one of the main aspects of the advice relates to your earnings and the fact that in the current and previous tax years you have been subject to the new pension taper rules (for higher earners). Even so, there is still enough headroom to facilitate the new lump sum and regular contribution into your new scheme, but this is something that we will need to keep an eye on going forward."

***17 September 2019 –** Adviser to Mr D **–** "Please see attached maximum funding calculation - are you around so we can discuss over the telephone?"*

***15 October 2019 –** an annual review sent by the adviser to Mr D set out that Mr D was on target to earn 'circa £250,000' and as a result he was likely to be a higher rate taxpayer. It went into detail about his annual allowance for the 2019/20 tax year and covered the use of carry forward and the implications of the taper rules. It ended by saying: "On the basis that you will need to retain part of your 2017/2018 carry forward to accommodate next years' monthly contributions (assuming that you are still subject to the taper rules), the data suggests that you have unused allowance of £8,495 (G) or £6,795 (N) in respect of the 2016/2017 tax year that should be utilised before the end of the current tax year."*

4 November 2019 - *Mr D e-mailed his adviser asking him to provide information about his pension to his accountant.*

4 November 2019 *- The adviser e-mailed the accountant and included: "…To clarify, the lump sum of £56,250 gross was applied to [Mr D's] pension scheme on 1st April 2019 (2018/2019 tax year) and the regular contribution of £1,875 gross (£1,500 net) didn't start until 20th April 2019 (2019/2020 tax year).*

As I'm sure you know, [Mr D] also benefits from some pension input from his…. Occupational Pension Scheme (around £3,000 per annum) so we obtained pension input data from the Trustees of [the OPS] from the 2015/2016 tax years onward, to enable us to complete a Carry Forward assessment taking into consideration the taper rules and the results are attached. As you can see, [Mr D] has some Carry Forward allowance to play with."

8 December 2020 *– Accountant to adviser: "I am in the process of completing [Mr D's] 2019/20 tax return and should be grateful if you would confirm the total net pension contributions made by [Mr D] in 2019/20. In addition, could you confirm whether a pension charge is applicable in this year. I have the old mutual 2018/19 growth statement but not the 2019/20. I also have the [OPS] 2019/20 statements."*

8 December 2020 *- Adviser to accountant and Mr D "Please see attached spreadsheet from Old Mutual Wealth identifying that [Mr D] made contributions totalling £30,995 (Gross) in the 2019/2020 tax year to his pension scheme – this equates to £24,796 net of basic rate tax relief. Although [Mr D] was affected by the taper rules in the 2019/2020 tax year (his annual allowance dropped to £10,000) because he had unused relief from previous tax years, he was able to make these contributions without incurring a pension charge."*

25 February 2021 *– Mr D to adviser – "As we are getting near the end of our billing year and the tax year, I thought it sensible that drop you a quick line on pension contributions.*

I'd guess my earnings should be at least £250k, probably nearer 300k, this year so I'm guessing I will have a limited contribution allowance? If it is more than the £1.5k net that I'm currently contributing is there a point in me maintain it at that level?

26 February 2021 *– Adviser to accountant – "I heard from [Mr D] yesterday that his projected earnings in the 2020/2021 tax year are circa £280k and this is obviously going to put some pressure on his annual allowance.*

I am in the process of completing a Carry Forward assessment to see where we are. I have the contribution numbers for Old Mutual but if you have them could you please let me have the pension input amounts for [Mr D's] [OPS] for the 2018/19 and 2019/2020 tax years.

Could you also confirm [Mr D's] total gross income in respect of the 2019/2020 tax years."

2 March 2021 *- Adviser to Mr D and accountant: "Thanks for sending over the up-to-data earnings data - as you can see, I have re-run the figures in the context of [Mr D's] annual allowance and have taken into consideration the revised taper rules. In terms of the income and pension input, all figures are known apart from the current tax year so in this respect, I have projected total income at £280,000 for [Mr D] and I have estimated pension input from [Mr D's OPS] at £3,500 – clearly neither figure is going to be 100% accurate but they will give us a good steer.*

On the face of it and based on total income of £280,000 in the current tax year, [Mr D] still has a little wriggle room with the annual allowance – he currently has £13,935 to play with *over and above what he is due to pay into his pension with Old Mutual Wealth in between now and the end of the current tax year."*

***2 March 2021** – Mr D to adviser and accountant: "If I have properly understood the calculations, what I am being advised is that I would still be able to make additional pension contributions of circa £14k that would attract the usual tax relief benefits for pension contributions? Also, just so as I'm clear, are those contributions effectively using up what remains of any historically accrued rollover allowances (so I should consider using those now) and not simply utilising what I'm entitled this year in any event?"*

***2 March 2021** - Adviser to Mr D and accountant: "You are right on both counts – the carry forward from the 2017/2018 tax year will not be available to you once we are operating in the 2021/2022 tax year. The difficulty you have though is that if your earnings in the current tax year end up exceeding the projected figure of £280,000 the carry forward allowance of £13,935 will be quickly eroded (because of the taper rules) and depending on what your final income figure is, you may end up having contributed too much. My inclination is that if there is a chance that your earnings could exceed £280,000 you should not make a further pension contribution at this time, so that we at least have a bit of wriggle room."*

***2 March 2021** – Mr D to adviser and accountant: "Does the taper work on a pound for pound basis i.e., for every pound of earnings over the £280k projection I lose a pound of allocation? If so, it does sound as though I should hold off on the contribution if the earnings could be closer to £295k.*

Am I right that if I did want to make a contribution (even if for a lesser amount) I'd have to have paid that over by the end of the tax year?"

***3 March 2021** - Accountant to Mr D and adviser: "Yes, I would agree with you, as the income levels for 2020/21 are currently unknown, and based on your computations, if [Mr D] wishes to avoid the risk of having a charge, a further contribution should not be made.*

Mr D has said that he contacted the adviser in July 2021 and told him that profits for that current year looked to be at least what they had been in the previous year i.e. possibly £300k, which was why he'd contacted him for advice about a further lump sum investment. And that the adviser sent him an Annual Review dated 18 July 2021 in which he referred to Mr D's then monthly pension contribution, the reduction in available taper relief caused by his consistently high earnings, with the adviser saying "You are aware of this, and my advice is that we continue to monitor the position in conjunction with your accountants.''

***18 January 2022** - Adviser to accountant: "Thank you for providing [Mr D's] income figure for the 2020/2021 tax year. The original projection that we were working on (as a steer) was £280,000 (G) so the actual figure of £314,753 is a lot higher and significantly impacts the annual allowance for the tax year in question. Taking into consideration the taper rules the allowance for the 2020/2021 tax year has reduced to just £4,000 however, as you can see [Mr D] does have sufficient carry forward available from previous tax years to accommodate the pension input. In respect of the 2021/2022 tax year however, [Mr D] has no further carry forward available which means that if his income is likely to exceed £240,000 (G) we may need to talk about his funding strategy so please feel free to let me know your thoughts regarding this matter."*

***23 January 2022** - Adviser to Mr D: "…The carry forward analysis that we carried out last week suggests that you no longer have any pension carry forward from previous tax years available to you for the 2021/2022 tax year. This still leaves you with this year's allowance of £40,000 (which is more than enough to accommodate your Quilter and [OPS] pension input of circa £25,000 (combined) however, this annual allowance is of course subject to the taper* *rules. In a nutshell, if your total income exceeds £240,000 in the current tax year it will start to eat into your annual allowance so it would be useful to know what your earnings are likely to be (in advance of the end of the tax year) and whether you have any capacity (or desire) to push some of your income into the 2022/2023 tax year, to help retain your pension annual allowance for the current tax year. Do you have some free time this week so we can talk through your options [Mr D]?"*

25 January 2022 *- Mr D to adviser: "I hadn't heard directly from [the accountant] on this issue, but I have just received my tax return. I would expect my earnings to be not too dissimilar this year, perhaps a little lower. I can perhaps get a better idea from my Finance Director if that helps albeit there are a few variables in there, principally how well my partners perform!"*

26 January 2022 *- Adviser to Mr D: "As discussed, to avoid (as best we can) a situation where your pension scheme contributions exceed your annual allowance (after taper) I suggest that in the short term you suspend pension contributions."*

26 January 2022 *– Mr D to adviser: "Yes please proceed as per your email."*

25 January 2023 *– Mr D to accountant: "… if I've correctly understood your letter, the balance due relates to £8,350 of pension charges for that year, which has come as a complete surprise, and an increased payment on account for next year to reflect this charge. I will be speaking to [the adviser] (Quilter) about how I've incurred that charge…"*

Our investigator didn't think Mr D's complaint should be upheld. Mr D didn't agree with the investigator's findings, and provided further evidence and arguments to consider. Quilter Financial Services Ltd made no further comment.

What I've provisionally 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.

It's clear that the adviser was actively involved in advising Mr D on the level of his pension contributions and how they were affected by the tapered annual allowance and carry forward. A lot of correspondence was exchanged between the adviser and Mr D about his contributions, some of which I outlined above. However I note in particular that in March 2019, when originally advising on setting up the pension and making regular contributions and a lump sum, the adviser recognised the impact of the taper rules and said:

"Even so, there is still enough headroom to facilitate the new lump sum and regular contribution into your new scheme, but this is something that we will need to keep an eye on going forward."

The annual review (dated 15 October 2019) set out that Mr D was on target to earn 'circa £250,000'. It went into detail about Mr D's annual allowance for the 2019/20 tax year, and covered the use of carry forward and the implications of the taper rules. It included:

"On the basis that you will need to retain part of your 2017/2018 carry forward to accommodate next years' monthly contributions (assuming that you are still subject to the taper rules)."

The adviser had again recognised the impact of the taper rules and carry forward, and in particular relative to accommodating the regular contributions for the following tax year.

There were several further exchanges about Mr D's pension contributions in 2019 and 2020. The adviser's e-mail dated 8 December 2020 included:

"Please see attached spreadsheet from Old Mutual Wealth identifying that [Mr D] made contributions totalling £30,995 (Gross) in the 2019/2020 tax year to his pension scheme – this equates to £24,796 net of basic rate tax relief. Although [Mr D] was affected by the taper rules in the 2019/2020 tax year (his annual allowance dropped to £10,000) because he had unused relief from previous tax years, he was able to make these contributions without incurring a pension charge."

So again the adviser was aware of the impact of the taper rules, that Mr D's annual allowance had dropped to £10,000 for 2019/2020, and that he was able to make the level of contributions he did by utilising carry forward.

Further exchanges between the adviser and Mr D near the end of the 2020/21 tax year included Mr D's e-mail to the adviser dated 25 February 2021 where he said:

"I'd guess my earnings should be at least £250k, probably nearer 300k, this year so I'm guessing I will have a limited contribution allowance? If it is more than the £1.5k net that I'm currently contributing is there a point in me maintain it at that level?"

On 26 February 2021 the adviser said to the accountant:

"I heard from [Mr D] yesterday that his projected earnings in the 2020/2021 tax year are circa £280k and this is obviously going to put some pressure on his annual allowance."

and

"On the face of it and based on total income of £280,000 in the current tax year, [Mr D] still has a little wriggle room with the annual allowance – he currently has £13,935 to play with over and above what he is due to pay into his pension with Old Mutual Wealth in between now and the end of the current tax year."

And then on 2 March 2021 the adviser's e-mail to Mr D included:

"The difficulty you have though is that if your earnings in the current tax year end up exceeding the projected figure of £280,000 the carry forward allowance of £13,935 will be quickly eroded (because of the taper rules) and depending on what your final income figure is, you may end up having contributed too much. My inclination is that if there is a chance that your earnings could exceed £280,000 you should not make a further pension contribution at this time, so that we at least have a bit of wriggle room."

I accept that the adviser said not to make a further pension contribution. But that was about a lump sum contribution, and in relation to the 2020/21 tax year.

Mr D circumstances meant the contributions he could make to his pension were subject to quite complex rules, and Mr D clearly relied on the adviser's expertise in deciding on the level of contributions. The adviser had acknowledged right from the off the amount of contributions was "…something that we will need to keep an eye on going forward." He'd clearly been heavily involved in advising Mr D on what contributions he could make.

Approaching the end of the 2020/21 tax year, the adviser was aware that Mr D was affected by the taper rules in the 2019/2020 tax year, and his annual allowance that year had dropped to £10,000 (but he hadn't incurred a 'pension charge' by utilising carry forward). The adviser was aware Mr D's earnings for the 2020/21 tax year were around £280,000, but *possibly more – Mr D had indicated nearer £300,000. He recognised this was "obviously going to put some pressure on [Mr D's] annual allowance." And that depending on that final figure, Mr D may already have already overpaid into his pension (for 2020/21). The adviser was aware that the input value of Mr D's regular contributions and OPS was approximately £25,000, and that he had no carry forward available for the 2021/22 tax year.*

In my opinion, set against this background, it ought to have been reasonably evident to the adviser that there was a real risk of Mr D breaching the annual allowance going forward if his income remained at similar levels. The adviser had identified the risks of overpayment, and taper relief was always going to have an impact on the regular contributions once carry forward wasn't available and given Mr D's income. Whilst I accept that there was no guarantee that Mr D's income in 2021/22 would match or exceed the 2020/21 figure, there was clearly always a real possibility.

The regulator's Conduct of Business Rules required the adviser to act in accordance with the best interests of Mr D. In my opinion the risk of overpayment going forward was clearly foreseeable in the context of all the circumstances at that time, and closely related to the advice that the adviser was giving about the 2020/21 lump sum contribution.

In the circumstances, I think the adviser should have considered the position with regards to the regular contributions at the end of the 2020/21 tax year when he was advising Mr D about the lump sum. As I've said, I accept that Mr D's income for 2021/22 would not have been known at that time. But I think there was always a clear possibility it would be at a similar level, which could lead to problems in overpayments. The prudent option would therefore have been to cease making regular contributions and assess the position near to the end of the 2021/22 tax year, and to make a lump sum payment if there was headroom to do so.

Accordingly, I think Mr D's complaint should succeed.

Putting things right

My understanding is that Mr D overpaid £18,556 into his pension. The £8,350 charge is – effectively - the return of the tax relief that was given on that contribution. If that £18,556 hadn't been paid into the pension income tax would have been paid on it. So I don't think that's a 'loss' that Mr D has suffered.

Mr D has effectively repaid the income tax that would have been paid on the £18,556 had it not been paid into the pension. But he now has £18,556 that is in the pension and subject to income tax when it's withdrawn (or 75% of it after taking the tax-free lump sum).

There are both advantages and disadvantages to having that money in the pension. It will enjoy tax-free growth, and may not form part of Mr D's Estate for inheritance tax purposes. But it will likely be subject to income tax on part of the pension when benefits are taken from it. An ISA – which also provides a tax-free growth for example, (if Mr D had ISA allowance available) - has more flexibility when taking benefits and won't be subject to income tax. But all in all it's difficult to replicate the position that Mr D would otherwise have been in had the money not been paid into the pension.

Mr D has said he would have invested in different funds outside of the pension. However, my understanding is the underlying investment in the pension wasn't unsuitable. Which funds provided the better return is only seen with the benefit of hindsight. So I don't intend to base compensation on a comparison with a different investment.

In my opinion Mr D's losses flow from 75% of the value of the capital invested being within *the pension wrapper and so likely being subject to income tax (depending on the Mr D's circumstances when/if it is taken) when Mr D withdraws the money. Mr D has said he is likely to be a basic rate taxpayer in retirement. So he will likely pay income tax at the rate of 20% on 75% of the capital – which equates to 15% on the whole amount. So I intend to award Mr D £2,783 – which is 15% of the overpayment into the pension (based on my understanding of the overpayment being £18,556).*

The £2,783 should be revalued in line with the performance of Mr D's pension from 31 March 2022 (I have used this date for pragmatic purposes as the date the last regular contribution would have been made for that tax year) to the date of a final decision. Interest at the rate of 8% simple per annum should then be added to that compensation payable at the date of final decision to the date of settlement, but only if settlement isn't made within 28 days of us notifying Quilter Financial Services Ltd of Mr D's acceptance of a final decision.

I also intend to order that Quilter Financial Services Ltd pays Mr D £250 for the distress and inconvenience caused to him having to pay the unexpected tax charge and dealing with the matter.

I asked Mr D and Quilter to let me have any further evidence or arguments that they wanted me to consider before I made my final decision.

Mr D said, in summary, that he agreed with the decision's conclusions. However he didn't agree with the remedy.

Mr D said the decision found that the advice to pay money into his pension wasn't in his best interest and so couldn't have been suitable. The pension contributions were primarily made for the purposes of the wider tax mitigation strategy underlying the investments outlined in his complaint. The means of minimising income tax liabilities through investments was of paramount concern and underpinned the reason why payments were being made into the pension funds.

Mr D said there was direct evidence of what he would have done if he'd been properly advised. He provided evidence showing investments he made in Venture Capital Trusts (VCTs) in March 2023 and 2024. He said he reclaimed 30% tax relief and received dividends tax free. He said the advice on both occasions was given shortly before the end of the tax year and after considering what, if any, pension contributions he should make. Mr D said because of the very concerns identified in his complaint about overpayments, the advice was not to make any further pension contributions and to invest in the tax efficient VCTs.

Mr D said if he'd been properly advised by Quilter he would have invested in VCTs. So he would have received 30% tax relief of the £18,566 - £5,556 rather than paying 40% tax which he did. He said he therefore claimed the £5,566.

Quilter said it had no additional comments to make.

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.

Having done so, I've seen no reason to depart from the findings set out in my provisional decision.

I've considered the evidence and arguments that Mr D has provided to say if the contributions hadn't been invested in the pension they would have been invested in a VCT –

given the tax benefits being consistent with his aims of tax mitigation.

In my provisional decision I said that the adviser should have spotted Mr D may likely have a problem with overpayments if he continued paying his regular contributions. And so he should have alerted Mr D to cease making them.

I accept that Mr D invested in VCTs in March 2023 and 24. When Mr D complained to us he said he thought compensation should be based on the lost opportunity to invest in other investments the adviser had advised him to make and referred to two investments, but not specifically that he would otherwise have invested in a VCT. I accept he was referring to the tax penalty. However Mr D invested a lump sum in November 2021, so closer to the time that the adviser should have alerted him to cease regular contributions. I don't think Mr D's circumstances would likely have been materially different apart from he may have had a larger sum to invest. Mr D didn't invest in a VCT.

I recognise that this wasn't at the end of a tax year and Mr D may have had different objectives. And that Mr D may consider if he'd been properly advised he would have invested in a VCT. However VCTs present significant risks. And I'm not considering the suitability of other advice given here. I accept that reasonable alternative arguments can be made about where Mr D would otherwise have invested. However, I don't agree it's clear. Ultimately, I have to decide on what I think is fair compensation. And for the reasons I set out in my provisional decision, I think what I intended to award is fair in the particular circumstances.

Putting things right

My understanding is that Mr D overpaid £18,556 into his pension. Mr D has said he is likely to be a basic rate taxpayer in retirement. So he will likely pay income tax at the rate of 20% on 75% of the capital – which equates to 15% on the whole amount. So this comes to £2,783 – which is 15% of the overpayment into the pension (based on my understanding of the overpayment being £18,556).

The £2,783 should be revalued in line with the performance of Mr D's pension from 31 March 2022 to the date of a final decision. Interest at the rate of 8% simple per annum should then be added to that compensation payable at the date of final decision to the date of settlement, but only if settlement isn't made within 28 days of us notifying Quilter Financial Services Ltd of Mr D's acceptance of a final decision.

I also order Quilter Financial Services Ltd to pay Mr D £250 for the distress and inconvenience caused to him having to pay the unexpected tax charge and dealing with the matter.

My final decision

My final decision is that I uphold Mr D's complaint.

Quilter Financial Services Ltd should calculate and pay compensation to Mr D as I have set out above under "Putting things right".

Under the rules of the Financial Ombudsman Service, I'm required to ask Mr D to accept or reject my decision before 18 September 2024.

David Ashley
Ombudsman