DRN-4174125

The complaint

Mr C complains that Standard Life Assurance Limited incorrectly interpreted an Earmarking Order, provided him with inaccurate advice and caused him a financial loss.

What happened

Mr C had a Self-Invested Personal Pension (SIPP) with Standard Life. He had transferred his pension from an occupational pension scheme (OPS) to the SIPP in 2009. At the time of the transfer he says Standard Life was informed that there was an Earmarking Order which applied to his pension. The Order stated, among other things, that Mr C was to pay his former spouse (who I'll refer to as 'W') 50% of the maximum tax free lump sum and then 33% of the retirement pension payable monthly under the terms of his OPS.

He appointed a new independent financial adviser (IFA) in or about 2014. At that time the new IFA contacted Standard Life to query whether it was aware of the Earmarking Order. It said it was not aware of the Order but that it would mark its records accordingly.

In 2021, Mr C wanted to bring his pension into payment. At this stage, he says Standard Life informed his IFA that it could not make monthly payments to W. It was able to pay her 50% of the maximum tax free cash available but it could only pay her 33% of the residual pension as a lump sum. After further discussions with his IFA, Mr C agreed to proceed on this basis.

Standard Life paid W 50% of the maximum tax free cash sum. It then processed a payment for 33% of the residual value of Mr C's pension fund. It deducted tax from this amount. Standard Life then said it had made an error. It said the payment to W should've been equal to 33% of the residual pension value – after tax had been deducted. It processed a further payment from which it also deducted tax at source.

Mr C says that as a result of what happened his residual pension was depleted by almost 55% and a significant amount of tax had been deducted at source and paid to HMRC. He thought this was incorrect.

He complained to Standard Life. By way of summary he said:

- Standard Life should have told him at the outset that it couldn't process periodic payments to W as set out in the Earmarking Order;
- Standard Life told his IFA that he had to pay W's share of the residual pension amount net of tax. He queried whether this was accurate.
- Standard Life told his IFA he could account for any tax due on the amount paid to W in his normal tax returns. If that had happened he would have had to pay tax at his marginal rate of tax which was 20% of part of the sum due to W. The difference in the tax that he'd had to pay as a result of what happened was over £8,000.
- Standard Life had used an emergency tax code for the first payment it had made to W – even though it knew or should have known his actual tax code from other information it held on its systems.

- Had he been correctly informed about how Standard Life would process the payment, he could've made alternative arrangements and/or applied to have the Earmarking Order varied.

Standard Life investigated his complaint. It said it had set up a separate SIPP in 2009 for the pension funds which had the Earmarking Order attached. It said it had not provided any advice in connection with the transfer but it would have expected his IFA at the time to have discussed with him what his intentions were regarding accessing his benefits.

Standard Life said the Earmarking Order had been made prior to 2015. It was fair to say that at that time most people accessed their pension benefits by way of an annuity and that appeared to be the basis on which the Order had been written. When Mr C's IFA contacted Standard Life in 2021, it had made clear that if Mr C wanted to avail of the drawdown option, the residual pension would have to paid to W as a lump sum.

Standard Life said there was no evidence to support Mr C's belief that Standard Life had told his IFA he could account for tax on the payment to W using his normal tax returns or that tax would not be deducted at source.

Standard Life said it had acted in good faith when it processed the request to pay W 33% of the residual fund and relied on industry guidance about how that payment should be calculated. Although it acknowledged that it had initially made a mistake when making the payment it had been able to correct that error by making the additional payment to W. Standard Life did not accept it had done anything wrong.

Mr C did not agree. He referred his complaint to our service. Our investigator initially thought that the complaint should be dealt with by The Pensions Ombudsman Service (TPO). But after discussions with the TPO it was agreed that our service should look into the complaint.

Our investigator said there was no documentary evidence to back up the suggestion that Standard Life had told Mr C's IFA that no tax would be deducted at source from the payment he'd requested. He thought it was the adviser's responsibility to provide Mr C with appropriate advice and not Standard Life's. The Earmarking Order was silent on the tax treatment of the income paid to W. Our investigator thought that Standard Life had provided the income amount he'd requested. The tax regime required income tax to be deducted at source and he didn't think there was any other way Standard Life could've complied with Mr C's request.

Mr C did not accept what our investigator said. So, the complaint has been passed to me to decide.

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.

There is no dispute between the parties regarding the payment of 50% of the tax free lump sum. The dispute here is about how the rest of the payment to W was made. In this regard, the Earmarking Order specified as follows:

> *"…direct the Pension Scheme [which was the OPS] to pay or cause to be paid as from the date of the retirement, periodical payments at the rate of 33% of the pension payable under the terms of the Order."*

After the date that the Earmarking Order was made several things changed.

In 2009, Mr C decided to transfer his pension from his OPS to Standard Life. He was able to do that provided he put the new provider on notice of the terms of the Earmarking Order. Although there was initially some doubt about whether this had happened, Standard Life now accepts that it was put on notice of the Earmarking Order.

In 2015, pension freedoms legislation was introduced. This meant, among other things, that Mr C would have greater choice about what he could do when he decided to retire. For example, in addition to taking up to a maximum of 25% tax free cash, he could use the residual sum to purchase an annuity, make regular drawdowns of income or drawdown either one lump sum (for the whole amount) or several smaller lump sums. The residual sum would be treated as taxable income when it was drawn down.

In 2021 Mr C decided to bring his pension into payment. He sought advice at that time from his IFA. Mr C told the IFA he wanted to settle things under the Earmarking Order.

The IFA considered the various options that were open to Mr C, given the fact that there was an Earmarking Order. He contacted Standard Life in April 2021.

Mr C says that as a result of what Standard Life told his IFA he was forced to pay W 33% of his residual pension as a lump sum rather than as periodical payments. And he says Standard Life shouldn't have grossed up the payment of this lump sum. He's had to pay "avoidable tax" as a result. I've considered what Mr C has said:

<u>*The information provided by Standard Life to Mr C's IFA*</u>

In April 2021, Mr C's IFA asked Standard Life a series of questions about the Earmarking Order including the following:

> *"[W] is also entitled to 33% of any pension payments – Does this mean that if he took an income withdrawal of £3,000 pa, you would make an additional withdrawal of £1,000 pa and pay her?*
> *I was under the impression with Earmarking Orders that he effectively controls when payments are triggered.*
> *Could he defer benefits indefinitely if he wanted to? ….*
> *If he decided to commence Drawdown, could he take tax-free cash only?...*
> *If he decides to claim the benefits…what are the logistics? Do we request benefits in the usual way."*

Standard Life's response included the following:

> *"You are correct that the Earmarking Order against Mr C's pension plan will only become operative whenever he decides to take his benefits. The Earmarking Order does not transfer legal ownership whole or part of his pension plan to [W], however when he takes his benefits we are legally obliged to pay the proportion earmarked to [W]….*
> *Mr C can defer taking his benefits for as long as he wishes…*
> *We don't normally accept transfers with Earmarking Orders into our SIPPs, mainly because of the income drawdown option which is not available on some of our legacy products that only offer annuity on retirement. Should Mr C take income drawdown we would pay [W] 33% of the remaining pension fund as a lump rather than deducting 33% from each income withdrawal he makes.*
> *If {he} opts for a flexi-income drawdown he can take the tax-free cash lump sum only, leaving the remaining pension fund invested until he decides to draw down an income…*

If you have any further questions, please do not hesitate to contact me…"

In response to this Mr C's IFA raised a follow up question. He asked:

"I think I'm right in saying that any drawdown income payments paid to [W] still belong to [Mr C] for tax purposes. Therefore, however small, an income payment paid to [Mr C] will result in a large addition to his income for this year…"

Standard Life responded by saying:

"That's correct, as the member [Mr C] remains liable for income tax on the whole pension, the ex-spouse has no liability at all – see attached link explaining HMRC's guidance on Taxation of Attachment orders…"

I've set out the exchanges with Standard Life in some detail because this explains the context in which Standard Life was providing the information it did. The information it provided was a direct response to the specific questions it was being asked.

I'd just point out that Standard Life did not say it could not comply with the terms of the Earmarking Order if Mr C chose to annuitise the residual pension. It appears that Mr C's IFA was not recommending that he should do that. None of the specific questions raised by the IFA were about taking an annuity.

Mr C's IFA recommended that he should take the tax free lump sum (50% of which would be paid to W) and then avail of the income drawdown option. Standard Life indicated that if he took this option 33% of the residual pension would be paid to W as a lump sum.

Having read the email exchanges in April 2021, I've not seen any evidence that Standard Life provided any advice about what option Mr C should pursue. The email exchange did set out that if he chose the income drawdown option, which is what he ultimately did do, W would be paid her share of the residual amount as a lump sum.

Mr C says that Standard Life should have told him that by choosing the income drawdown option, it would reduce his residual pension 'pot' by almost 55%, deduct tax from this amount at source and then pay the net sum to W. He says Standard Life has accepted it failed to give his IFA this information.

As mentioned above Standard Life responded to specific questions it was being asked. It did not give Mr C any advice about what he should do. The IFA was referred to the HMRC website for further information about taxation of Attachment Orders.

Having read all of the correspondence, although there's no evidence Standard Life was asked about how the tax would be collected, I'm persuaded there was an understanding (by all the parties) that W would receive the full 33% share of the residual pension as a lump sum "in her hand" and that Mr C would be liable to pay the tax on this amount. Mr C's IFA confirmed this to him in an email dated 21 April 2021 in which he said:

"I checked this out with Standard Life who confirmed that the Order instructs them to pay 33% tax free direct to [W]"

After the payments were made Mr C's IFA complained about the fact that tax had been deducted at source – but he didn't say that he hadn't expected W to be paid an amount equal to 33% of the residual pension amount "in her hand". In an email to Standard Life dated 2 September 2021 the IFA said:

> *"…[W] also received 33% of the remaining fund which was paid as a one-off amount of [specific amount paid to W] – that's all good."*

So, I think the IFA's understanding and expectation was that W would get the payment amount she ultimately received.

Mr C has since queried whether that is a correct interpretation of the rules that apply to Earmarking Orders.

He also says that although he accepted he was liable for the income tax on the payment, Standard Life told his IFA that he could account for this on his usual tax returns. It did not tell him that the payment would be grossed up and tax deducted at source using an emergency tax code. I'll comment on these points below.

The interpretation of the Earmarking Order

Mr C says that Standard Life's interpretation of the Earmarking Order was incorrect. He says the Order required him to pay W 50% of the tax free lump sum and 33% of the residual pension. There was nothing in the Order that required him to pay W anything more than that.

By interpreting the Order in the way that it did, Standard Life had used almost 55% of the residual pension amount to make the payment to W. Mr C says that not all providers interpret Earmarking Orders in this way.

Ultimately, it would be a matter for a court to determine whether Standard Life's interpretation of the Earmarking Order was correct here. And, I can see that Mr C has separately also raised the issue about how the payment was taxed, directly with HMRC.

As mentioned above, I think Mr C and his advisers were aware before the payment was made that Standard Life intended to make the payment so that W got 33% of the value of the residual fund "in her hand" and that it was Mr C who was liable for the tax on this amount. That's what his IFA told him in the email dated 21 April 2021. He didn't challenge this interpretation until after the payment was made.

When considering whether a business has acted fairly and reasonably we take into account the law, codes and good practice. Standard Life says that its approach to the interpretation of the Earmarking Order was based on industry guidance which stated:

> *"A key point is whether the Earmarking % to be allocated to the ex-spouse should be a percentage of the net benefit after tax. If the order does not specify that it applies to the net benefit after deduction of income tax, the earmarking percentage will apply to the gross benefits, but the member will still be liable for the whole of the tax payable."*

The Earmarking Order here was silent concerning whether the 33% earmarked for W should apply to the net benefit after deduction of income tax. If Mr C wanted confirmation concerning that then he would've needed to go back to court to ask for clarification or a variation of the Order. I don't think it was Standard Life's responsibility to tell him to do that, especially when he didn't challenge its interpretation prior to the payment having been made.

So, I'm persuaded, on balance, Standard Life acted fairly and reasonably when it relied on industry guidance about how to interpret the Earmarking Order.

Standard Life deducted tax at source before making the payment to W

Mr C says that Standard Life told his IFA that the payment to W would be paid as a lump sum and he would pay tax on this amount through his normal tax returns. This is important since the way that the payment was processed - by grossing up the amount and deducting tax at source – meant that Mr C says he's paid over £8,000 of "avoidable tax" and his residual pension has been depleted by more than the earmarked share.

Mr C's IFA says that although he has a clear recollection that Standard Life told him Mr C could account for the tax on his tax returns, he doesn't have anything in writing.

Whilst it is the case that Standard Life subsequently (in September) said it had "forgot to mention that all pension payments are taxed at source…" It's not clear when it was acknowledging that this omission had been made. The September exchange of emails happened after the payment had been made and the IFA was asking questions at that time about how the total deduction from the pension had been arrived at. But, in any event, there's no documentary evidence to show that in April Standard Life was asked about whether tax would be deducted at source.

There's also no documentary evidence to show that Standard Life said Mr C could account for income tax on the payment through his usual tax returns. I'm not persuaded, on balance, that if Standard Life had been asked these questions, it would have said anything other than that it was obliged to deduct tax at source from all pension payments. So, having considered everything, I don't think Standard Life gave misleading information to Mr C or his IFA about the fact that the payment would be grossed up.

Mr C has also raised a query about the tax coding Standard Life used. The initial payment it made used an emergency tax coding even though Mr C says that Standard Life had his actual tax code. He says this also meant that more tax was deducted at source than would otherwise have been the case.

Standard Life says that, in line with its usual procedures for the first payment being made out of any pension, it used an emergency tax coding. It was then advised by HMRC of Mr C's tax code so that it could be applied to any subsequent payments.

Having considered what the usual procedures were, I'm not persuaded that Standard Life made an error when it applied the emergency tax coding - even though it may have had a tax coding on other plans Mr C held with it. It is also the case that Mr C was able to apply for a refund of any tax he'd overpaid as a result of the emergency tax code being used.

<u>Mr C says he didn't authorise the payment that was taken from his pension</u>

Mr C says he only authorised a payment of 33% of the residual pension to be paid to W. He says Standard Life had no authority to make any payments to her which exceeded that amount.

It is the case that Standard Life made two payments from Mr C's pension. Both amounts meant that W ultimately received 33% of the value of the residual pension value "in her hand."

Standard Life was obliged to comply with the terms of the Earmarking Order. It had already told Mr C and his adviser that meant it would pay 33% of the residual amount as a lump sum to W. Mr C wanted to "settle" the matter with W. So, I'm persuaded that he wanted the full 33% lump sum payment to be made to her. And, as mentioned above Mr C and his advisers understood that to mean Standard Life would make a payment to W so that she got 33% of the value of the residual pension as a lump sum "in her hand."

Having considered everything, I’m not persuaded on balance that Standard Life did anything wrong here or that it acted unfairly or unreasonably.

My final decision

For the reasons given above, I do not uphold this complaint about Standard Life Assurance Limited.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr C to accept or reject my decision before 17 August 2023.

Irene Martin
Ombudsman