DRN-4214546

The complaint

Mr E complains that the monthly annuity payments he receives from Phoenix Life Assurance Limited (Phoenix) are taxed. He complains that they are compensation payments for a previous mis-sale and as such should be free of any income tax liability.

The complaint stems from advice given by a business for which Phoenix is now responsible, so for clarity I'll refer to all actions as being undertaken by Phoenix itself.

What happened

In 1990 Mr E's late wife was advised by Phoenix to commence payments into a personal pension plan (PPP). She was, at that time, employed by a company which offered an occupational pension scheme (OPS).

In 1993 Mr E's wife passed away. As the beneficiary of the PPP Mr E received two death benefit lump sums in 1994.

In October 1994, the then regulator, the Securities and Investment Board (SIB) established an industry-wide review of particular pension business which had been carried out by authorised firms between 29 April 1988 and 30 June 1994. It was generally known as the "Pensions Review".

The advice that Mr E's late wife had received in 1990 was included in that review, and the review concluded that she ought to have been advised to be part of her OPS, and the PPP had been mis-sold. As a result of the advice she had lost valuable secure benefits. Following the review, in March 1996 Mr E, as his late wife's beneficiary, was offered:

- £73,127.61 – this represented the tax-free lump sum and pension payments he ought to have received, plus interest;
- An annuity of £7,525.32 gross per year, payable monthly in advance.

Phoenix informed Mr E that the annuity payments would be paid net of tax at his marginal rate.

These annuity payments, increasing annually by inflation (measured by the Retail Price Index) and having had income tax deducted, were made from 15 April 1996.

In July 2022 Mr E complained to Phoenix. He made several complaint points, but the one relevant to this decision was that he said the annuity payments ought to have been treated as 'compensation' for his wife being mis-sold the PPP, and as such the payments should not have incurred a tax deduction. He said that Phoenix should have been responsible for making good any tax due, and he should have received the monthly amounts gross.

But Phoenix didn't uphold this complaint. It said the annuity was set up to pay the spousal benefits that he was entitled to under the Pension Review. This was an annuity which is taxed accordingly, and it was unable to provide Mr E with tax advice.

Unhappy with this response, Mr E referred his complaint to our Service where it was considered by an Investigator. And having done so, our Investigator didn't think Mr E's complaint should be upheld. He thought that the payments made were in the form of an annuity, and as such were liable for income tax calculated at Mr E's marginal rate. And Phoenix had been fair as it had followed the tax-deduction instructions given to it by the Tax Office (HMRC).

But Mr E didn't agree. He maintained that the payments made as part of the Pensions Review were 'compensation' or 'redress' and as such were free of tax liability. As no agreement could be reached the complaint has been referred to me for 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.

Mr E has made a number of detailed points and provided a lot of evidence, and I have looked at it all. We're an informal dispute resolution service, set up as a free alternative to the courts. In deciding this complaint I've focussed on what I consider to be the heart of the matter, rather than commenting on every issue in turn. This isn't intended as a discourtesy to Mr E, rather it reflects the informal nature of our Service, its remit and my role in it. And some of the issues raised have been considered previously. This decision focusses purely on the dispute over the tax deductions from the monthly payments to Mr E.

And having considered everything, I find myself in agreement with the view of the Investigator, for broadly the same reasons. I'm satisfied that Phoenix have been fair in its answer to this complaint. I understand that this will come as a great disappointment to Mr E, so I'll explain my reasoning.

The purpose of the Pension Review was to establish if the advice Mr E's late wife had been given by Phoenix in 1990 was appropriate, and if not, to establish if she'd suffered a financial loss as a result. Very sadly Mr E's wife died before the review was carried out, so Mr E, as her beneficiary, was the person who was found to have lost out financially.

A loss calculation was carried out under the direction and supervision of the then regulator, the SIB. As I've set out in the background, a lump sum payment was made to Mr E and ongoing monthly payments commenced in April 1996. The calculation methodology has been previously considered by this Service so I will not be commenting on this further. But I will consider Mr E's complaint that the monthly payments have been paid to him net of tax, and he thinks this is wrong.

The purpose of the Pensions Review was to identify those people who had been misadvised to open a PPP when they would have been better off staying in or joining their occupational pension scheme.

The review established that Mr E, as his late-wife's beneficiary, had lost out financially as a result of her being misadvised. So the calculations carried out aimed to put Mr E as closely as possible in the position he would have been had his late-wife been properly advised. So the lump-sum payment made, and the monthly payments which commenced in April 1996, were intended to replicate the payments he ought to have received.

But monthly pension payments are considered as income, and the payments Mr E received as a result of the Pensions Review calculation are no different. Tax (at his marginal rate) would have been deducted from any monthly pension payments he would have received had his late wife been part of her OPS, and the annuity payments calculated were designed to replicate, as closely as possible, those OPS payments. So the monthly payments are not compensation – they are pension annuity payments, and as such are liable for the appropriate level of income tax deduction.

So Phoenix has acted fairly in informing HMRC that the payments were in the form of a pension annuity, and has also acted fairly in following the tax instructions given to it by HMRC.

My final decision

I do not uphold this complaint.

Under the rules of the Financial Ombudsman Service, I’m required to ask Mr E to accept or reject my decision before 14 August 2023.

Chris Riggs
Ombudsman