

Ombudsman's Determination

Applicant	Mr E
Scheme	New Airways Pension Scheme (the Scheme)
Respondents	British Airways plc (BA)

Outcome

1. I do not uphold Mr E's complaint and no further action is required by BA.
2. My reasons for reaching this decision are explained in more detail below.

Complaint summary

3. Mr E complained that the process used by BA to calculate part of his pension under the Scheme was unfair as it had caused him to incur a substantial tax charge that could have been avoided.

Background information, including submissions from the parties

4. In July 1989 Mr E joined BA and became a member of the Scheme, a defined benefit arrangement. He was appointed to senior management in September 1997.
5. Between June 1996 and September 2003 Mr E held several training and management appointments with BA. He received extra emoluments while he was performing those duties.
6. Under the rules of the Scheme, Mr E's pension was calculated as a fraction of his Retiring Pay for each year of his pensionable service. Retiring Pay was calculated as the average of the best two years of pensionable pay in the five years preceding the cessation of active membership or normal retirement age (**the Five Year Window**). This meant that the extra emoluments would not count towards Retiring Pay if they were paid outside the Five Year Window (for example, if they were paid ten years before the date of leaving the Scheme).
7. In 1996 BA decided to implement a more generous practice, on a discretionary basis (not written into the Scheme rules): if it transpired that the period during which the training/management emoluments were received fell outside the Five Year Window, the member would be credited with an additional period of pensionable service which

would be added to his existing pensionable service when his Scheme exit calculation was made, on leaving or retirement. This applied to any extra emolument which ceased to be paid after 30 September 1996. BA was responsible for informing British Airways Pension Services Ltd (BAPSL) that the member had ceased to receive the extra emoluments.

8. In June 1999 BA informed BAPSL of the extra emoluments that had been paid to Mr E in 1996 and 1997.
9. The Finance Act 2004 provided for a tax charge on payments which exceeded the annual allowance.
10. In September 2006 Mr E asked BAPSL how his training/management duties would affect his pension. BAPSL asked BA to clarify the periods for which the extra emoluments applied. On 20 June 2007 BAPSL wrote to Mr E to confirm his extra emoluments paid between 1996 and 2003, and stated that these produced an additional service credit totalling 2.33 years.
11. Mr E's pensionable service ended on 31 March 2017, when he opted out of active membership of the Scheme and became a deferred pensioner. The service credit of 2.33 years increased his deferred annual pension from £64,643 to £70,235. This caused his cash equivalent transfer value (**CETV**) to increase from £1,763,643 to £1,927,692.
12. Mr E decided to transfer his benefits from the Scheme to St James Place, another pension provider. On 10 July 2017 St James Place sent a completed "scheme pays agreement" to BAPSL, under which Mr E requested the Scheme to pay, on his behalf, an annual allowance tax charge of £17,419 that HM Revenue & Customs (**HMRC**) had imposed on him. This payment by the Scheme reduced Mr E's CETV to £1,910,980. The CETV was then paid by the Scheme to St James Place.
13. Mr E complained under the Scheme's internal dispute resolution procedure (**IDRP**) that after the annual allowance and lifetime allowance had been introduced by legislation, the Scheme should have identified the unfair result of the practice of granting service credits on date of leaving. He said:

"At the point that LTA [lifetime allowance] and AA [annual allowance] charges came in, it should have been possible for those with previous training and management roles but no longer in post to have the corresponding extra service adjustment phased in over time to avoid AA exceedance...As it stands I am liable for a significant tax bill for service accrued in 2002 and before (but accounted for as I leave the scheme now) simply because of the scheme's chosen method of accounting for prior service in additional roles – something that is beyond the intent of the legislation and patently unfair."

14. In its stage 1 IDRP decision, dated 1 November 2017, BAPSL's Head of Trustee Governance & Secretariat rejected the complaint. She said that the service credit was included upon leaving/retirement because it was only at that point that a correct assessment could be made as to whether the training/management emoluments should be included or excluded from Retiring Pay, as defined. Also, BA had not routinely notified BAPSL when training/management duties had started or ended. The procedure adopted under BA's discretionary powers meant that the service credit was not included in calculations during the period of active membership. Mr E's suggested alternative approach (to account for the emoluments throughout the period of active membership) could result in tax charges arising during active membership, even though the emoluments later fell outside the Five Year Window. She also cited the Pensions Ombudsman's determination in the case of Mr N (PO-9344), where it was held that the employer was under no obligation to pay benefits in a way that was most tax efficient for a member, as what would be most tax efficient could be different for different members.
15. Mr E appealed unsuccessfully under stage 2 of the IDRP. In its response on 13 March 2018, the Chair of the Trustee Operations Committee said that the Committee had reviewed all the information provided and agreed with the points made in the stage 1 decision. He also said that the service credit of 2.33 years had been calculated correctly in 2017 when Mr E's pensionable service terminated; the service credit had not accrued before the annual allowance and lifetime allowance were introduced.
16. Mr E then contacted us.

Adjudicator's Opinion

17. Mr E's complaint was considered by one of our Adjudicators, who concluded that no further action was required by BA. The Adjudicator's findings are summarised briefly below:-
 - BA's decision, in 1996, to change its discretionary practice and award additional service credits for training/management duties had the effect of increasing the member's pension entitlement if the emoluments for those duties fell outside the Five Year Window for calculating Retiring Pay.
 - As a consequence, Mr E's CETV in 2017 was increased by about £150,000. However, he was unhappy that the approach taken by BA had led to an annual allowance tax charge of over £17,000. This amount was deducted from his CETV when he transferred his benefits to St James Place, under the "scheme pays agreement", so he did not have to meet the tax charge out of his own pocket.
 - BA had explained that under its discretionary approach the assessment of the additional service credit took place upon leaving/retirement, not earlier, because

it was only on leaving/retirement that a proper assessment could be made as to whether the training/management emoluments should be included in or excluded from the calculation of Retiring Pay.

- When the annual allowance and lifetime allowance were introduced by legislation, BA could have adopted a different approach, as suggested by Mr E, effectively to smooth the additional service credit over the relevant period of active membership. However, BA had no obligation to do that, and adopting that alternative approach could have had the disadvantage of triggering annual allowance tax charges for active members that would not otherwise have arisen for them. Therefore, in the Adjudicator's view, the "wait and see" approach adopted by BA was not unreasonable, bearing in mind the Scheme definition of Retiring Pay.
- It was therefore the Adjudicator's opinion that this complaint should not be upheld.

18. Mr E did not accept the Adjudicator's Opinion, and the complaint was passed to me to consider. Mr E and the Scheme Secretary provided their further comments which do not change the outcome. I agree with the Adjudicator's Opinion and I will therefore only respond to the key points made by Mr E and the Scheme Secretary for completeness.
19. Mr E is unhappy that he has incurred a tax charge, and said that the Scheme should have set up a "refund mechanism" with HMRC, so that the annual allowance tax charges could be reduced. He also pointed out that when he signed his management contract the annual allowance had not been introduced.
20. The Scheme Secretary requested that the Scheme, or the trustees of the Scheme, should be named as the respondent in place of BA.

Ombudsman's decision

21. With regard to Mr E's comments, BA's discretionary practice provided additional service credits only at the date of leaving the Scheme or retiring, when it was known for certain that the training/management emoluments fell outside the Five Year Window. BA's practice was adopted before the introduction of legislation which provided for the annual allowance and lifetime allowance. After that legislation was introduced, BA could have taken steps to modify its discretionary approach to minimise Mr E's tax liability. However, BA had no obligation to do that. Mr E's tax liability is essentially a matter between him and HMRC. Furthermore, an alternative approach as suggested by Mr E may have triggered annual allowance charges that would not otherwise have arisen.
22. The Scheme, administered by its trustees, had no obligation to introduce the "refund mechanism" suggested by Mr E.

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23. With regard to the Scheme Secretary's comments, Mr E's complaint is about the discretionary practice operated by BA, which does not form part of the rules of the Scheme, so it is unnecessary for the trustees to be named as respondents. I should add that the Scheme itself has no legal personality, so it would be inappropriate for the Scheme to be named as a respondent.
24. Therefore, I do not uphold Mr E's complaint.

Karen Johnston

Deputy Pensions Ombudsman
29 March 2019