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BRIEFING

"Lamborghini Pensions"

Trustee in the driving seat

As the Queen announces the Government's plans for greater flexibility for pensioners with respect to their pension pots, the implications of the planned reforms for trustees in bankruptcy are far reaching. Simeon Gilchrist and James Elliott examine the Government's proposed changes and the court's approach to pensions upon insolvency.

Historical position

Historically it was the case that in the absence of an effective forfeiture clause a trustee in bankruptcy (TIB) was able to assert claims against a bankrupt's uncrystallised pension rights, which automatically formed part of the bankruptcy estate and vested in the TIB immediately upon his appointment in accordance with section 306(1), ***Insolvency Act 1986*** (the "Act"). In essence, the pension was no more than a tax efficient savings pot.

Income payments order (IPO)

This position meant that it was possible for a TIB to collect in a bankrupt's pension rights as he/she saw fit, including making an application to court pursuant to section 310 of the Act for an order (IPO) requiring a bankrupt to contribute to his/her debts from drawn or undrawn pension income for a period of three years from the date of the bankruptcy order.

That position changed upon the introduction of the ***Welfare Reform and Pensions Act 1999*** and ***Welfare Reform and Pensions (Northern Ireland) Order 1989*** (together "WRPA") which provided that a bankrupt's approved pension arrangements could not form part of his/her bankruptcy estate. Section 11(1), WRPA states:

"Where a bankruptcy order is made against a person on a petition presented after the coming into force of this section, any rights of his under an approved pension arrangement are excluded from his estate."

Section 11(2) WRPA makes clear that an "approved" pension is one of the following:

- any pension scheme registered under the tax legislation (in essence, schemes tax-approved by HM Revenue and Customs)
- an annuity purchased in relation to a tax-approved pension scheme
- an occupational pension scheme set up by a government outside the UK for the benefit, or primarily the benefit, of its employees.

The provisions of WRPA did not affect the TIB's ability to apply for an IPO in respect of a bankrupt's income, meaning that any pension already drawn by a bankrupt and thus forming part of 'income' for the purposes of section 310 could be validly pursued by a TIB. In respect of uncrystallised pension rights, the position remained that such rights in respect of undrawn pension were considered to be excluded from the estate.

Raithatha v Williamson

The High Court ruling in ***Raithatha v Williamson*** [2012] EWCH 909 (Ch) represented an unexpected change to the post–WRPA landscape, albeit one welcomed by TIBs.

There the court refused to grant a bankrupt immunity from claims against pension entitlements by a TIB pursuant to an IPO, even though he had not chosen to draw his pension prior to or during his bankruptcy.

The bankrupt asserted that his rights under the pension scheme did not constitute an entitlement to income until he elected to draw the pension. Furthermore he sought to argue that payment of a lump sum did not fall within the definition of 'in the nature of income' for the purposes of section 310(7) of the Act and that his rights in respect of the pension did not form part of his bankruptcy estate for the purposes of section 11, WRPA.

Allowing the TIB's application the court rejected the above arguments and held that even undrawn pension rights could fall into account as income for the purposes of an IPO notwithstanding that such rights ordinarily fell outside a bankrupt's estate.

Whilst the court recognised that the bankrupt's entitlement to elect to draw pension and his entitlement to the income itself were distinct, it held that both were capable of being termed 'pension income' for the purposes of an IPO. Further the court rejected the argument that a one-off lump sum fell outside section 310(7) of the Act as it held that such payments did not have to be periodical or regular to be 'in the nature of income'.

Budget 2014: a new era or full circle?

The implications of *Raithatha* were mitigated given the existing legislation compelling pensioners to purchase an annuity, which had the effect of restricting the total amount which could be brought into account by a TIB, typically leaving only the tax free lump sum of 25% of the fund and the income stream from the annuity. However that is due to change following George Osborne's 2014 Budget, in which legislation has been proposed whereby the present restriction in respect of the maximum sum of pension capable of being drawn down by pensioners is due to be scrapped, meaning that a pensioner could elect to withdraw his/her entire pension fund as cash, subject to the specific rules of each scheme.

As Pensions Minister Steve Webb made clear: *"If people do buy a Lamborghini but know that they'll end up just living on the state pension, that becomes their choice"*.

Such a change in the law could have far reaching implications for TIBs. Until any successful appeal, the High Court's interpretation in *Raithatha* remains good law and against that background the proposed legislative framework could permit a TIB an unfettered ability to apply for an IPO pursuant to section 310 of the Act for an order that takes into account the ability of the bankrupt to draw the entirety of his/her pension pot, effectively producing a benefit for the bankruptcy estate.

It remains to be seen how Parliament will address the widespread changes for which the recent Budget caters and the extent to which future legislation in respect of those changes might rein in the extent of TIBs' powers with regard to pensions. A consultation entitled "Freedom and choice in pensions" has been published by the Government which is due to close on 11 June 2014 and can be accessed at the following link.

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