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WARNING: The information in this case study was correct at the date of issue (June 2021) and may have changed.

Jane's case study, covering:

- > Divorce
- > Mechanics of sharing assets

The following is based on our understanding of current taxation, legislation and HM Revenue & Customs (HMRC) practice, all of which are liable to change without notice. The impact of taxation (and any tax reliefs) depends on individual circumstances.

Jane

Jane is a 43 year old who works for an IT company, she has a successful career and three children (ages 5, 3 and 1). Unfortunately, she and her husband have decided that their relationship is at an end and they are seeking to divorce after sixteen years of marriage.

- Her husband, Jack (46), is a customer service adviser in a bank.
- Jane and Jack live in Manchester.
- She has a good salary but Jane and Jack have a lot of expenditure as they pay for childcare for 4 days a week (Jane's mum Margaret looks after the children the other day).

Jane needs to work out the financial implications of her divorce including the impact on her and her husband's pensions.

Jane and Jack's current assets and liabilities

Asset	Jane	Jack	Joint
House			£225,000 - £120,000 mortgage outstanding
Defined contribution occupational pension scheme	£42,000 (6% employer and 6% employee contribution)	£270,000 (CETV)	
Shares	£24,000 (base £11,000) Yield 3.5%		
Cash ISA		£5,000	
Onshore bond			£11,000

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Jane and Jack's current income and expenditure

Income	Expenditure
Salary (Jane) – £58,000	Childcare – £16,000
Salary (Jack) – £36,000	Mortgage – £7,200
Share dividends – £840	General household expenditure – £24,000
Child benefit £2,501.20	

Jack has recently moved out and it is important to look at the advice requirements on an individual basis for Jane who is the client.

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Solution

Throughout this case study we investigate:

- Divorce
- Mechanics of sharing assets

Divorce

Splitting the assets Jane and Jack will need a solicitor to deal with the divorce due to the complexity of the financial arrangements and the fact that they have children under 16. However, financial advice at this time is also crucial.

Often couples know the value of assets such as investments and houses but they don't know the value of their pensions and these could be the largest asset to be dealt with on divorce. Jane and Jack will need to sit down with their solicitors, not only to discuss how their children's welfare will be dealt with but also to consider how their assets should be split on their divorce.

As Jane and Jack live in Manchester, the law of England and Wales applies and all reference in this case study is to the law of England and Wales. For more information on how the law in Scotland works please see the tech centre article on divorce mentioned in 'Further support' at the end of this case study.

Asset Value for the purpose of divorce

- House £105,000 equity
 - Jane's pension scheme £42,000 fund value
 - Jack's pension scheme £270,000 CETV
 - Jane's shares £24,000
 - Jack's cash ISA £5,000
 - Onshore bond £11,000
- Total £457,000**

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There are 3 ways in which pensions can be dealt with on divorce; offsetting, earmarking (attachment) order or pension sharing order. Jane's solicitor explains the three options as;

1. Offsetting

This involves getting the value (usually the cash equivalent or transfer value) of the pension benefits as at the date of the divorce. This value would then be included in the total value of the matrimonial estate to be divided on divorce.

The value of the pension is offset against other assets. Pre April 2015 pensions were not usually valued on a pound for pound basis with other assets, due to the lack of access to the full value. In practice the value apportioned could be anything between 25% and 80% of the fund value and it could depend on how close retirement was.

This was discussed in the case of Maskell v Maskell [2001]. The County Court Judge had suggested that the pension could be compared on a like for like basis. On appeal, Lord Justice Hope stated that the judge had made the "elementary mistake of confusing present capital with a right to financial benefits on retirement, only 25 per cent of which maximum could be taken in capital terms, the other 75 per cent being taken as an annuity stream".

However, for those "silver divorcees" who are over 55, there is now total access to defined contribution pension funds. This may lead to value parity with other assets. If so, the tax and future contribution issues surrounding accessing flexibility may need to be addressed in the settlement.

Once the value has been decided then the ex-spouse receives another asset, or share of another asset instead of a share of the pension. For example, this might mean the ex-spouse receiving a larger share of the matrimonial home to compensate for the pension share. Offsetting is common especially for those clients with many assets. Also, clients who value their pensions may be willing to give up access to more liquid assets to retain control of their pension.

For Jane and Jack, offsetting might not be the obvious choice. Although Jack is the lower earner, his final salary scheme makes up more than 59% of the total assets. If it was decided that a 50% split was needed then not only would Jack have no disposable assets and no way of buying another property due to the lack of a deposit, but he would also need to find some money to give to Jane.

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2. Attachment order

An attachment order (also commonly referred to as earmarking) is effectively deferred maintenance. This is not as common as it was before the introduction of pension sharing due to the disadvantages.

The court instructs the member to get a valuation of the pension benefits. The court will use the CETV basis, and all pension benefits, including those earned before marriage, are taken into account (except any already earmarked from an earlier divorce). The benefits that can be earmarked in England and Wales and Northern Ireland are;

- a specified percentage of the pension benefits when the member starts to draw his benefits.
- lump sum available when benefits are accessed
- a specified percentage of any lump sum death benefit in the event of the death of the member before retirement.

There are disadvantages to attachment orders. The main one is that there is no “clean break”. In addition, the order lapses on the;

- remarriage of the ex-spouse in relation to pension payments
- death of the member (unless the Court Order specifies otherwise)

The ex-spouse has no control over when benefits are taken and what investments the fund is in. The pension is taxed as the member's income and attached payments are paid after tax. If the member is a higher rate taxpayer and the ex-spouse is a non or basic rate taxpayer then this could mean less cash for the ex-spouse.

In addition, the method of valuation for divorces could have serious consequences for those who marry late in their working life or for those who have been divorced more than once.

Pension flexibility has had a significant impact on the application of attachment orders – potentially leaving scope to circumvent the requirements set out in the order, unless the details in the order are very specific. However, very specific orders can also mean that providers can't allow the member to go into drawdown.

For these reasons, an attachment order would not be a sensible option for Jane and Jack.

3. Pension Sharing

The aim of pension sharing is to separate the ex-spouse's pension entitlement from the member's pension so that there is a clean break, in contrast to earmarking. Pension sharing is available to couples divorcing throughout the UK, but isn't compulsory.

However, in both England and Wales, this can only be achieved by a court order which means there is an added cost implication.

The Court instructs the member to get a CETV along with certain other information about benefits. If a CETV has been provided within the last 12 months, that figure can be used. The Court will decide how much of the pension rights should be allocated to the ex-spouse and the member's pension rights will be reduced by a corresponding amount. This reduction is known as a 'Pension Debit'. This must be a percentage of the total value. This is then allocated to the ex-spouse and becomes a 'Pension Credit' if paid from uncrystallised funds and a disqualifying pension credit if this is paid from crystallised funds. The existing pension scheme can choose to allow the ex-spouse to join the scheme in her own right, OR to take the transfer value to another registered pension scheme.

This would seem the sensible option for Jane and Jack. It means that there is a clean break in pension terms. It would also allow Jack to still have access to some assets which could be sold.

Other assets

Jane owns some shares and Jack owns a cash ISA. The first question to discuss with the solicitor in relation to these assets is if the assets are actually a matrimonial asset. It is possible that they could be pre-acquired assets. There is no statutory definition of what a pre-acquired asset is and case law suggests that it can include a wide range of assets acquired in different circumstances including assets bought by one party before the marriage and assets gifted to or inherited by one spouse.

However, this can be a contentious issue for those with much larger assets and also inherited assets. It will be up to the court to determine if the assets are matrimonial property or non-matrimonial property and case law suggests that this is dependent on the facts of each case. Although generally a pre-acquired asset will not be taken into account, it does depend on the financial needs of the parties and other facts such as when the property came into existence, the length of the marriage, how it was treated during the marriage and so on.

The introduction of pension freedom also has an impact in this area. Dependents, nominees and successor flexi access drawdown can't be subject to a pension sharing order. However, if an adult child was the beneficiary of a large nominees drawdown and then income was withdrawn from that fund to fund family living expenses, it could be that it would be considered a matrimonial asset.

Although this scenario existed pre-freedoms for a dependant, it would have needed a bereaved spouse in dependant's drawdown to remarry and then get divorced and that was more unusual. However, the likelihood of an adult child divorcing is higher.

In this scenario, Jane received the shares through her work share scheme and the cash ISA was paid into from the couples joint account and therefore both Jane and Jack are happy that they are considered matrimonial property.

Jane and Jack's divorce – what has been decided

It has been established by case law that the sharing principle should apply on divorce. This means that assets will normally be divided equally between the two parties unless there is good reason not to do this. The court will consider a variety of different factors though and when children are involved then this will always be the first consideration. Other areas that are considered are length of the marriage, income and financial resources, financial needs, standard living during the marriage, contribution to the home and care of the children and so on.

With the help of their solicitors, Jane and Jack have agreed that they will split assets 50/50. They have also decided to share custody of the children 50/50. Jane has agreed to pay 3 out of the 4 days childcare costs as she is the higher earner. Jane will keep the matrimonial home but this means that Jack needs somewhere to live so he will need access to some cash to put down a deposit on a new home. The trade-off for this is giving up some of his final salary pension scheme.

The details of the split are as follows;

Asset	Jane	Jack
House	£105,000 equity	
Jane's pension scheme	£42,000 fund value	
Jack's pension scheme	£70,000 CETV	£200,000 CETV
Jane's shares	£11,500	£12,500
Jack's cash ISA		£5,000
Onshore bond		£11,000
Total	£228,500	£228,500

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Mechanics of sharing the assets

The court order has been granted and the assets now must be physically shared.

House

The mortgage for the house will need to be changed from joint names to Jane's name. The bank will also have to agree that Jane has the salary to pay the mortgage by herself. As Jane has a reasonable salary then this should be acceptable to the mortgage company. Her solicitor will need to be involved in drafting a new mortgage deed.

Jack's pension scheme

The scheme that Jack is a member of is a private sector defined benefit scheme. Jane can't become a member of the pension scheme and therefore she must transfer out. When the pension trustees receive the Pension Sharing order

- they have 3 weeks from receipt to appeal against any order/agreement
 - they can delay the start of the implementation period until charges are paid or whilst relevant information is outstanding (or whilst an appeal is being decided)
 - they have 4 months in which to implement the Pension Sharing Order.
- This implementation period involves discharging the Pension Debit/Credit by way of an internal or external transfer.

It is very important that Jane instructs the trustees quickly where she wants the pension money to go. Once the trustees have this requirement satisfied, and any other requirements, then the order can be implemented.

Jane's financial adviser advises that her occupational scheme will not allow transfers in so she asks for the transfer to be paid into a private pension. For annual allowance purposes this is not a contribution.

Jane's shares and onshore bond

A proportion of the shares are being assigned from Jane to Jack and the bond is moving from joint ownership to being owned by Jack. This will not cause a CGT issue as the assignment is not for money or money's worth where the Court has made an Order:

- > Formally ratifying an agreement reached by the parties that deals with the transfer of assets including the policy, or
 - > For ancillary relief under the Matrimonial Causes Act 1973 (or financial provision under the Family Law (Scotland) Act 1985) which results in a transfer of rights under the policy
- from one spouse to another.

Other issues

Expression of wish forms and wills

At the point of separation, Jane's solicitor and financial adviser advise her to consider making a will and amending her expression of wish form for the pension scheme to make sure that her wishes are known.

In relation to the expression of wish form, a separated spouse is still technically a dependant in HMRC terms. Jane's occupational scheme is set up on a discretionary basis and the scheme administrator will investigate before deciding who should benefit. An up to date expression of wish form will help them with this task. If Jane died she might not want Jack to receive any death benefits and instead the whole benefit be shared between her dependent children.

However, she might want Jack to benefit as well as the children as he would have to look after the children and pay all of the childcare. It is important that Jane carefully considers this.

When the pension credit moves into the new personal pension which Jane is setting up then she will need to complete another expression of wish form and she should keep it up to date especially when her children reach the age of 23. This is due to the fact that it allows the scheme administrator to offer the full range of death benefits available.

If she died with one child over 23 and two children under 23 but no expression of wish form then the two dependent children could receive dependant's drawdown but the child over 23 would only be entitled to a lump sum.

Jane also needs to consider making a will. If Jane died without a will before the divorce was finalised then the law of intestacy states that the first £250,000 of her estate and all personal chattels would pass to Jack together with one half of the rest of the estate. This may not be what she would want to happen. If she would like the children to benefit then she needs to decide who should look after the money for them until they are old enough.

Summary

Going through a divorce is a difficult time emotionally and financially. Legal advice is crucial at the point of the divorce but financial advice is also necessary and the impact of good financial advice will have an impact for years to come. For Jane this means help in dealing with the additional pension which she will receive from Jack, making sure that the assets are dealt with correctly when they are split and thinking about her retirement plans and what might happen if she died.

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Further support:

<https://www.pruadviser.co.uk/knowledge-literature/knowledge-library/pensions-and-divorce/>

<https://www.pruadviser.co.uk/knowledge-literature/knowledge-library/pension-divorce-qa/>

<https://www.pruadviser.co.uk/pdf/financial-planning-for-pensions-and-divorce.pdf>

[https://www.nuffieldfoundation.org/sites/default/files/files/Guide To The Treatment of Pensions on Divorce-Digital\(1\).pdf](https://www.nuffieldfoundation.org/sites/default/files/files/Guide To The Treatment of Pensions on Divorce-Digital(1).pdf)

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