
Pensions and divorce

A Technical Guide





In divorce settlements, more often than not, there are two large assets to be considered – the main residence and any pension rights. After the matrimonial home, the pension fund is, for many people, the most substantial financial investment they will ever make. It is also a resource which is most likely to be lost to one party (traditionally the wife/civil partner) on divorce if no action is taken. In terms of dividing these two resources on divorce, each has its own problems – the residence is mainly indivisible and the pension rights require real expertise and a professional crystal ball to value, as the ultimate value of the pension on retirement is likely to be unknown at the point of divorce.

Since the Matrimonial Causes Act 1973 (**MCA1973**), courts in England and Wales have had the power to take the value of personal and occupational pensions into account when settling the matrimonial estate, although this is not compulsory. The Matrimonial Causes (Northern Ireland) Order 1978 gave similar provisions to courts in Northern Ireland, and the Family Law (Scotland) Act 1985 set out the principles to be applied in Scotland.

There are key differences between the law for Scotland and for the rest of the UK. While an attempt has been made to point these out where appropriate, not every difference can be taken account of in this document and specialist advice may be needed.

The present law on the subject of pensions remains complicated. There are various ways in which courts may deal with a pension on divorce. These can be summarised as follows:

- Offsetting (regardless of the date of the petition)
- Pension attachment/earmarking (where the petition was filed on or after 1 July 1996)
- Pension sharing (where the petition was filed on or after 1 December 2000)

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Principles behind the courts decisions

In reaching a financial settlement on divorce, it is clear that identification of fault has no part to play in how the assets are apportioned. The law will recognise the part played by both parties in creating wealth, whether it be directly (such as salary and bonus) or by enabling the spouse or civil partner to create the wealth by, for instance, running a home.

With regard to considering any pension assets, pensions are part of the overall exercise to be performed under the Matrimonial Causes Act 1973. Following **White v White**¹, the courts will be concerned with equality of outcome and overall fairness, taking into account the contributions of both parties.

A pension fund is a resource like any other. Although capital assets and pension assets are different in nature, the value of any pensions must be included in any list of assets supplied to the court. This is typically supplied in a court form referred to as Form E. For more detail, see section '**The legal divorce procedure**' (page 13). This allows the court's attention to be focused on the totality of the parties' assets. The courts do not, however, have to make an order in respect of pension benefits. The options on division of pension benefits are considered along with other options available to distribute the marital assets.

In ascertaining the value of the pensions to be used, in principle the courts must rely on the cash equivalent transfer method for the purposes of this calculation (referred to as a **cash equivalent transfer value** or **CETV**). They may be persuaded to take other matters into account, if supported by expert evidence. For instance, the CETV method may provide an inadequate indication of the value of future expectations for death-in-service or discretionary benefits.

The valuation is typically undertaken to show the value of the pension at the date of divorce or thereabouts or date of official separation in Scotland (i.e. it is not usual to attempt to project the level of pension that will have accrued by retirement).

In Scotland, the courts have historically only tended to take into account **benefits earned during the marriage**. However, in McDonald v Newton, it was decided that the period of membership in regulation 4 of the 2000 pension sharing regulations refers to the period of the person's membership of the pension arrangement, irrespective of the type of membership. The effect is that rather than being able to calculate the value of the pension looking at active membership only, parties will now have to rely upon the Courts to use their flexibility and discretion in relation to proportions of a pension valuation that may have accrued from contributions made pre-marriage. Outside of Scotland, the courts will not apportion/ carve out the benefits in accordance with the period of the marriage. This means that **all** pension benefits, including those earned before the marriage, are taken into account (except any already earmarked from an earlier divorce).

These are complicated issues and specialist input may be needed.

Offsetting

Offsetting is arguably the simplest and cleanest method of dealing with pension benefits on divorce. In this scenario, the court will start from a consideration of all of the couple's assets, that is, including the value of all non-pension and pension assets and any income being received, before deciding how to divide the couple's matrimonial estate.

Once the values have been established, the value of the pension rights can then be weighed/offset against other matrimonial assets, such as the family home or other savings. In essence, the ex-spouse/former civil partner gets another asset, or share of another asset (up to the appropriate value of the share of the pension) instead of a share of the pension.

As an example:

The court has decided to split all of a couple's assets 50/50. The husband has a pension through his work but his wife does not. The pension fund is worth £150,000 and the couple's home is worth £300,000. The court decides that the husband can keep his pension arrangement in his own right but his wife is then entitled to £225,000 of the house proceeds.

This method was initially used as the courts were unable to compel the pension holder to set aside any of their pension benefit for their ex-spouse/former civil partner.

Benefits

The main benefits of this approach are:

- It keeps the resulting transactions relatively simple along with a cleaner break
- Depending on the circumstances, the solution may be better suited to meet the couple's individual circumstances, especially when both parties are financially successful and each has substantial pension provision
- One party may have a need for the use of other assets (for example, a home)
- If one party is likely to die before retirement, it may be preferable to receive a benefit now by way of other assets
- If the pension is small, making a pension sharing order will likely be expensive/disproportionate
- Offsetting orders are unaffected by remarriage or death

Drawbacks

The main drawbacks with this approach are:

- One of the parties may be left with little or no provision for retirement. Depending on their proximity to retirement this could be quite disadvantageous for them
- It may also not fully account for the tax situation of the respective assets, that is, the pension benefits taken will most likely be paid minus tax on 75% of the funds



Attachment orders/earmarking

This method was introduced under the Pensions Act 1995 for divorce petitions filed on or after 1 July 1996 (or 19 August 1996 in Scotland). It may also be used for annulment and judicial separation.

Earmarking refers to an attachment order made by the court which requires a proportion of the pension benefits to be paid directly to an ex-spouse/former civil partner, instead of to the member. It is in effect a form of deferred maintenance. The benefits continue to be held in the original member's plan until the member starts drawing an income (and/or when they die), when the benefits will be paid to the respective parties in the proportions required by the earmarking order.

Earmarking orders in **England, Wales and Northern Ireland** may be made against a member's:

- pension commencement lump sum
- pension income
- death-in-service lump sum death benefits

In Scotland, only the tax-free cash lump sum and lump sum death benefits can be earmarked rather than pension income.

The amount is specified at the time of the divorce but either party can apply to the court to have the amount varied. In practice, an agreement in principle is likely to be made between the parties before being ratified by the courts. Earmarking cannot take place without the courts' involvement. More about the process for financial settlement on divorce is explained later in this guide.

As an example:

An attachment order could be added to a member's pension stipulating that when they retire and draw income from the pension, 50% of the income they receive must be paid to their ex-spouse/former civil partner.

Where an earmarking order includes lump sum death benefits, the order can compel the inclusion of the ex-spouse/former civil partner as a beneficiary, thereby overriding the normal discretion that administrators/trustees have over the selection of beneficiaries who receive death benefits. This power does not extend to the redirection of dependant's pensions on the member's death.

State Pension benefits, including State Second Pension (S2P), cannot be made the subject of earmarking orders. While a divorced person can claim the contribution record of the ex-partner for the basic State Pension, it is not possible to do the same for any state earnings related pension scheme (SERPS)/(S2P) benefits. This will also not be possible for the new single-tier State Pension, although pension sharing will be available if there is a protected payment.

If the member subsequently transfers any of their pension benefits that have been subject to an earmarking order, the scheme trustees would have to inform the new trustees/providers of the earmarking order. They must also notify the ex-spouse/former civil partner within 21 days of the transfer.

When the member dies after commencing benefits, the pension to the ex-spouse/former civil partner will also cease. There are normally no subsequent widow's benefits either, though this could be included in the earmarking order, particularly if the ex-spouse/former civil partner was clearly financially dependent on the member pre-divorce.

The court could decide, as in the case of **T v T**², to defer deciding on an earmarking order until nearer the member's actual retirement date.

² T v T (Financial Relief: Pensions) [1998] 1 FLR 1073 HC

Benefits

The main benefits of this approach are:

- It allows for both the tax-free cash benefit and the pension income benefit to be earmarked
- Death-in-service benefits can also be earmarked
- An earmarking order may be used in cases of judicial separation, not just on divorce
- If the member transfers pension rights, the earmarking order will follow the member's rights to the new arrangement
- The ex-spouse/former civil partner is not reliant on their ex-partner to arrange payment but rather on an independent third party
- The ex-spouse/former civil partner will have some provision in retirement

On the whole, as a remedy it is largely unsatisfactory and is seldom used in recent years, in view of its inherent drawbacks.

Drawbacks

The main drawbacks of this approach are:

- It does not allow a clean break between the divorcing couple and the couple may need to keep in touch many years after the divorce
- The ex-spouse/former civil partner will need to keep the scheme trustees advised of any changes in his or her circumstances
- Earmarking orders in respect of pension benefits (including a pension in payment) cease on the remarriage of the party receiving the award
- If the member or ex-spouse/former civil partner dies, the earmarking order/payments of any pension will cease

- Where benefits are defined contribution, the investment risk profile of the member and/or the objectives at retirement may be different to those of the ex-spouse/former civil partner. This can cause serious issues if the member has a high-risk strategy and a market crash leads to a significant fall in the fund value near retirement, thereby reducing the resulting benefits just as they are due to be paid
- The basis of benefits under the member's scheme may change between the time the court order on divorce is made and when the member retires, so there is no certainty for the ex-spouse as to how much they will receive
- There can be no certainty over when the member will draw his or her benefits, if at all. The earmarking order cannot require the member to draw such benefits on a particular date
- Any earmarked pension benefit payable to the ex-spouse/former civil partner is treated as part of the member's pension entitlement for lifetime allowance purposes
- The member retains the liability for the income tax on the whole pension, even the part of the pension that is earmarked to the ex-spouse/former civil partner, meaning they may have to pay tax on an income they will not be in receipt of. (If the member is a high rate taxpayer this may be particularly disadvantageous for both parties as the pension the ex-spouse/former civil partner receives will be net of tax based on the member's tax position)
- Although there is no further tax liability on the ex-spouse/former civil partner in relation to the income received, the ex-spouse/former civil partner cannot reclaim the tax deducted, even if they are a non-taxpayer
- The form of benefits provided to the ex-spouse must match those taken by the member



Pension sharing

Introduced in the Welfare Reform and Pensions Act 1999, pension sharing enabled the courts to split pension rights between a husband and wife or civil partners at the time of the divorce. The legislation became effective on 1 December 2000 for divorce and annulment proceedings starting on or after that date. It does not apply retrospectively.

The primary objective of pension sharing was to give couples and the courts greater flexibility and choice, by allowing pension rights to be treated in a way which provides for the fairest overall settlement of assets in each case.

The aim of pension sharing is to separate the ex-spouse's/former civil partner's pension entitlement from the member's pension so that there is a clean break.

In England and Wales, a pension sharing order can only be expressed as a percentage of the cash equivalent transfer value (CETV) as defined in the Matrimonial Causes Act 1973, s.21A(b) and subsequently clarified in **H v H**.³

In Scotland, a monetary amount or a percentage of the CETV can be specified. This is particularly important given that the value of the pension may have changed substantially between the point of separation and the date that the pension debit (see next paragraph) is actioned.

When a pension sharing order is issued a 'pension debit' will be created in relation to the member's rights (that is, the amount to be deducted) and an equivalent 'pension credit' will be provided for the ex-spouse/former civil partner.

Pension sharing orders can be made in respect of:

- Occupational schemes, including AVCs
- Registered individual pension schemes (for example, personal pensions, stakeholder pension, retirement annuity contracts and section 32s)
- Statutory schemes (for example, public sector schemes)
- Unapproved schemes (for example, employer-financed retirement benefit schemes)
- State earnings related pension scheme (SERPS) and State Second Pension (S2P), where State Pension age was reached before 6 April 2016

They can be ordered against active, deferred and pensioner members and will apply to contracted-out benefits in the same way as they would to other benefits.

The following pensions **cannot** be shared:

- Basic State Pension
- Graduated pension
- Widow or widower's pension that is in payment

In a defined contribution arrangement, the pension debit is simply a reduction in the value of the pension holder's fund.

Where defined benefit schemes are involved, matters become more complicated. The pension debit equates to a proportion of the benefits that would be payable to the member at their Normal Scheme Retirement Date. Ordinarily the pension would therefore be a split of the CETV calculated in the normal way (that is, with the scheme benefits revalued to the date of retirement and deducted back from the final benefits and the cost capitalised). However, alternative approaches are possible.

Couples divorcing in Scotland can reach a pension share agreement by a court order or by completing a registered Minutes of Agreement. However, in both England and Wales, this can be achieved only by a court order.

The options available to the ex-spouse/former civil partner will depend on the type of scheme to which the member belonged and the rules of that scheme.

All providers of funded pension arrangements (excluding those transferred to the Pension Protection Fund (PPF) and any pensions already in payment), must allow the ex-spouse/former civil partner to transfer a pension credit to another registered pension scheme of the ex-spouse's/former civil partner's choosing, subject to the receiving pension arrangement being able to accept the transfer.

Where the individual is a member of an unfunded pension scheme (for example, most public sector schemes such as the Civil Service scheme and the Teachers' scheme), the pension credit rights in respect of the ex-spouse/former civil partner must be retained under the scheme.

Other schemes may at their discretion offer the ex-spouse/former civil partner membership of the scheme in their own right. In this instance they would enact an 'internal transfer'. Where this is offered, the pension credit benefits are not required to be on the same basis as those in the scheme. For example, the pension credit may be on a defined contribution basis even though the scheme is a defined benefit or career average scheme.

Schemes are however permitted to insist on a transfer out. In this instance, the member will initially be given the choice of selecting the receiving scheme. Where a choice is not forthcoming from the ex-spouse/former civil partner, the scheme may give notice that they intend to transfer the benefits to a default s.32 arrangement of their choosing. A transfer to a personal pension cannot be used as a default under current legislation.

If a pension credit is awarded in relation to a scheme that has been transferred to the PPF, the PPF will pay compensation to the ex-spouse/former civil partner, who will not be allowed to transfer out of the scheme.

The ex-spouse/former civil partner could become entitled to a share of the pension holder's SERPS/S2P benefit (a 'shared additional pension'), but this would not be transferable in any way.

The new single-tier State Pension was introduced in April 2016. Pension sharing cannot be applied to the new single-tier pension. However, existing sharing orders will be honoured and the new rules allow for the sharing of protected payments when these are awarded. Protected payments apply when the value of the current State Pension benefits in April 2016 exceed the value of the State Pension when the new rules are applied.

Pension Schemes are permitted to charge for dealing with the administration of pension sharing orders. This is to protect the scheme from the cost involved in administering pension sharing being borne by the scheme, other members or the taxpayer. The court order should state how any charges are to be apportioned and, if silent, these are to be borne by the member.

The Regulations do not specify limits on the charges, but, if the scheme requires charges to be paid, the divorcing couple must be notified of the applicable charges before the order/agreement is made. The scheme will usually seek to only charge what is reasonable in order to comply with statutory requirements relating to charges and to avoid complaints.

Costs not directly relating to the implementation of a specific divorce order, for example, amending the scheme rules, training administration staff and altering computer systems, will be borne by the scheme and may not be charged to the divorcing couple.

The Pensions and Lifetime Savings Association (PLSA) produces a table of recommended charges to be used as a guide to the industry. This can be found on the PLSA website. Schemes are not required to follow the PLSA rates.

The process undertaken by pension providers/trustees on receipt of a pension sharing order is explained later in this guide.

Once transferred, there are generally no restrictions on how pension credit benefits can be taken other than any standard legislative and tax requirements, such as the minimum pension age being met and any rules under the new scheme that may apply.

The pension sharing order may be made where the member has already commenced benefits, for instance where the member has already entered drawdown and taken their Pension Commencement Lump Sum (PCLS). These are called disqualifying pension credits. Here, the ex-spouse/former civil partner receives the pension credit as an uncrystallised benefit with no PCLS entitlement. If they are 55 or over they can put the pension into income drawdown and take income, but will not receive any PCLS.

Annual allowance

A pension credit will not be tested against the non-member ex-spouse/former civil partner's annual allowance provided it comes from another registered pension scheme. Any contributions made to the pension prior to the implementation of the pension sharing order would be tested against the member's annual allowance for the relevant pension input period in question.

More detail on how pension sharing interacts with the lifetime allowance is provided on page 12.

Advantages of pension sharing:

- It achieves a clean break
- It helps to ensure both parties will have pension provision available in retirement
- Provides security for the non-pension member ex-spouse/former civil partner who will have ownership of their own scheme, which is not in any way dependent on the member
- A share of the capital is provided, which may be needed to help one party re-house or meet other immediate financial commitments (subject to being over normal minimum pension age and the pension not being in payment already)
- Each party will receive the full benefit of any pension contributions they make following the split
- Remarriage, death or other change in circumstances will not affect the order

Disadvantages of pension sharing:

- The member's future lump sum and income provision will be reduced
- The actual debit (the reduction in pension as a result of the order) will not be known until retirement
- An implementation fee will be payable to the pension provider which can be significant and may be disproportionate to the benefits of the pension
- The non-pension member ex-spouse/former civil partner may not be able to receive the pension until the date specified by the rules of the member's pension scheme, or the rules of any scheme the pension credit is transferred to
- It may be difficult to split some pensions. For instance a Small Self-Administered Pension Scheme (SSAS) could have investments in commercial property which is used by the members' business, making it difficult to obtain an accurate valuation and implement the order. The scheme may need to raise money in order to pay out the non-member ex-spouse/former civil partner, and where there are other members, the other members will need to give agreement to the pension sharing order
- For high earners, care may be needed because of the effect the pension credit has on the recipient's lifetime allowance, that is, adding additional funds – which need to be tested for lifetime allowance (LTA) purposes – could mean they become liable to an LTA charge when tested (see Page 15 for more details on LTA implications)



Impact of pension freedoms

Offsetting

When establishing the value to apply to pension assets during the divorce procedure, it has been commonplace to discount the value of a pension in view of the uncertainty of its true eventual value – this is particularly relevant when assessing the value of pensions and annuities already in payment.

As those divorcees aged 55 or over now have complete access to any defined contribution pension funds, there is less of an argument for discounting the value of those assets. This could lead to greater parity of value when comparing against other assets.

Earmarking orders

When earmarking orders were created, full access to defined contribution pensions was not available. As a result, unless the details in the earmarking order are very clear and specific, pension freedoms could have unintended consequences for the recipient. The rationale for this is that it may allow the pension member, in certain scenarios, to circumvent the original intentions set out in the order. For example, if the earmarking order doesn't specify exactly when and how benefits must be taken, and/or doesn't specify a requirement to take the PCLS, then the order could potentially be circumvented by taking an Uncrystallised Fund Pension Lump Sum (UFPLS) (which doesn't technically include a PCLS). Then, if there are no pension funds left to crystallise, there is no income left to be covered by an income earmarking order.

In consultation paper 15/30 the Financial Conduct Authority (FCA) acknowledged the potential implications of pension freedoms as set out above. In Policy statement 16/12 (the FCA's feedback to the responses it received on CP15/30 and final rules and guidance), the FCA reiterated the need for advisers to enquire as to the existence of any pension attachment/earmarking orders and take these into account when providing advice to their clients. There was also a requirement for pension providers to ensure they are complying with the obligations of the orders and making sure they provide notices to other parties where relevant events occur, such as transfers and significant reductions in benefits. In terms of altering the rules, the FCA responded by stating that ultimately it is for the courts to vary any attachment order that may not work as intended should the member take advantage of the pension freedoms to access the pension benefits, and that their guidance will help ensure that attachment orders are taken into account by both providers and advisers.

It may therefore be worth revisiting clients who have an earmarking order in force and, if necessary, considering a return to the courts to get the order's intention clarified. There are no time restrictions on doing this, though inevitably there is an element of cost involved.

This issue was consulted on by the Department for Work and Pensions (DWP) in November 2015 and it was proposed that schemes should be required to notify a former spouse when a member applies to take their benefits flexibly. This was proposed to give the former spouse time to apply to court to vary the earmarking order if the outcome was not what the original order intended. The responses indicated various views and so the DWP has delayed any amendment to the current position.



Pension sharing

As explained above, the ex-spouse/former civil partner will have complete control as to how they use the proceeds they receive as a pension credit. That being said, the options available in terms of accessing the pension after age 55 will depend on the options available in the scheme that the pension credit is moved to. Some schemes, like occupational schemes, do not offer full access to all the freedoms and will be subject to their own rules on points such as consents and minimum age requirements. Therefore, if the ex-spouse/former civil partner has an intended and quick need to access the pension, consideration of where the pension credit will be moved to following the split will be important.

In addition, after April 2015, the ex-spouse/former civil partner may prefer to have cash rather than a share of a pension fund. If the member is over 55, this is possible, even if the ex-spouse/former civil partner is much younger, as the right to access the pension fund is linked to the member's age.

The courts could therefore decide for monies to be paid from the pension now instead of the pension being shared as an UFPLS, or a series of UFPLS, for instance. However, that could result in serious tax implications for the member and also restrict tax relief on future contributions to defined contribution pension arrangements (because of the Money Purchase Annual Allowance).

Considerations when reviewing options with reference to pension freedom reforms

Two key considerations on deciding which option to proceed with are how tax and any planned future contributions could be impacted by accessing pensions under the freedom reforms.

Tax and future contribution issues (that is, the impact of the money purchase annual allowance) when utilising this flexibility, will of course, need to be considered as part of the settlement discussions.

Tax

The tax applied to a withdrawal from a pension scheme will depend on the option taken. For example:

- For payment of an UFPLS, 25% of the sum taken is tax-free and 75% is taxed as income
- For payment of a PCLS and scheme pension or annuity, 25% of the overall value of the accrued benefits may be taken as a PCLS (tax-free lump sum) with the pension being chargeable to income tax
- For flexi-access drawdown, pension income is chargeable to income tax

A significant withdrawal from a pension therefore has the potential to attract income tax at a higher rate than the relief on the original contribution, especially where the total income for the year exceeds £100,000, resulting in the reduction/loss of a personal allowance. A withdrawal that pushes income over £50,000 in a tax year will start to cause the loss of Child Benefit.

However, the introduction of the flexible options enables individuals to consider the amount of pension income (and total income including pension) that they will receive in a year and choose to only take a proportion of their accrued benefits so as to avoid paying higher rates of income tax.

Future contributions

If a pension member or the ex-spouse makes a taxable withdrawal from their pension fund using a flexible pension option, their annual allowance would be reduced from the current £40,000 to £4,000 for contributions to a defined contribution scheme. This will significantly reduce their ability to make future pension savings and is designed to restrict 'recycling' of pension income to take advantage of tax benefits. Individuals who are taking a flexible withdrawal while remaining an active contributor to a pension scheme, will need to tread carefully before deciding to take a withdrawal as it could impact on the tax efficiency of any pension contributions paid by an employer or the individual. In particular, individuals who remain in employment and will be in receipt of employer contributions (which could include auto enrolment membership i.e. where an employee joins a scheme automatically in order to meet the employer's auto enrolment obligations, subject to opting out).

Overseas aspects

The UK courts have no jurisdiction on overseas pension schemes and so it is very unlikely that an overseas-based pension scheme will recognise a pension sharing order or attachment order from a UK court. A pension attachment order may have more chance of being recognised and enforced, but local advice will be necessary. The 2016 case of *Goyal v Goyal* being the most recent authority on this.

It may therefore be more sensible, where there are other assets, to look first at other solutions while leaving the overseas pensions untouched. Failing this, it may be worth considering an agreement between the parties to make a joint approach to the relevant overseas court to implement a local form of pension sharing order.

Equally, courts dissolving a marriage outside the UK have no jurisdiction on UK-based pension schemes.

However, legislation does generally require UK courts, when taking account of UK pension benefits, to consider foreign divorce decrees in the same way as they would a domestic divorce.

In England, Wales and Northern Ireland the policyholder's ex-spouse/former civil partner could, following an overseas divorce, make an application for financial relief in the courts to get an earmarking or pension sharing order if they have suffered hardship by reason of the foreign divorce.

In Scotland a court order is not required to split a pension – it can be done by mutual agreement.

Finally, it may be possible to transfer a pension credit to an overseas pension scheme subject to meeting the specified conditions for such a transfer.



The legal divorce procedure

The process starts when one spouse/civil partner files a petition for divorce. This spouse/civil partner is now known as the **petitioner**. The divorce papers are filed by the petitioner in court – the court issues them and serves a copy on the other spouse/civil partner, known as the **respondent**.

Once the respondent has been served with the papers, they should return an Acknowledgement of Service to the court. The petitioner then requests that the court set a date for the decree nisi hearing. The decree nisi is then pronounced and sent to both parties. This is the first stage of the legal dissolution of the marriage. The decree nisi will be granted by the court if the initial application is successful.

At this stage, the parties to the divorce will usually decide whether to seek financial settlement through the courts or reach an informal settlement.

In order to finalise the divorce, the court must issue a further decree called the decree absolute. The petitioner may apply for this at any time from six weeks and a day after the pronouncement of the decree nisi.

Alternatively, the respondent may apply for the decree absolute three months after that period has expired. The marriage is officially ended when the decree absolute is granted. Accordingly, any agreement that is to be 'blessed' by the court, or agreed using the financial order proceedings, must be completed before the decree absolute is granted.

Financial settlement procedure

Many people going through the divorce process will not have to use the courts to sort out their finances. A divorce settlement can be reached through other means, such as through family mediation or collaborative law.

For those who do go through the courts a separate legal process known as **financial order proceedings** will take place.

The process begins with **Form A** being filed and served. The court then sets the date for the first **directions appointment (FDA)** and dates for the **completion of Form E**. (usually they must be submitted at least 35 days before the first appointment). **Form E** requires each party to disclose their full financial circumstances (called financial disclosure). This includes providing information about their pension rights.⁴ Once the **FDA documents** have been filed and served an estimate of costs will also need to be filed via **Form H**.

Often a financial agreement will be reached between the parties' solicitors and then simply ratified by the court.⁵ This can happen here or at the second hearing.

The second hearing is the **financial dispute resolution (FDR)** hearing – this is a without prejudice hearing where the judge will try to assist a settlement of financial issues. Most cases settle here or just after and the court makes a final order on the agreed terms.

⁴ Once the court instruction to complete Form E is made, each party has seven days to request the relevant information from the trustees of their pension arrangement(s). The member may use a valuation already obtained under the divorce, disclosure or cash equivalent legislation but the valuation date must not be more than 12 months before the date fixed for the first appointment.

⁵ It is good practice to send a copy of the draft pension order to the pension scheme administrator, prior to this going through the courts, to enable them to check that they will be able to implement the order once it is made final. See the next page for further information.

If terms can't be agreed here there will be a **final hearing** – the court will listen to evidence, grant orders and give reasons.

On receipt of a valuation request, the pension scheme provider/trustees have up to 6 weeks to supply the valuation where proceedings have commenced or up to three months where the scheme has not been notified that proceedings have commenced. It may be shorter if the court order dictates.

The following information must be provided by the pension scheme provider/trustees:

- The Cash Equivalent Transfer Value (CETV) of the pension rights accrued to date
- The pension benefits included in the valuation
- A statement summarising how the CETV has been calculated
- A schedule of any charges which will apply

For pension sharing orders it must also include details of:

- How the scheme treats any pension credits (scheme membership or external transfer)
- Whether the scheme offers membership to a person entitled to a pension credit, and if so, the types of benefits available (internal CETV and services provided)
- Whether the scheme intends to discharge its liability for a pension credit other than by offering membership to the ex-spouse/former civil partner (default option)

Earmarking process following the valuation request

If there is no pre-agreement, the court will consider what proportion of benefits should be earmarked.

Once determined, the court will issue an order setting out the terms of the attachment/earmarking.

Upon receipt of the earmarking order, the provider/trustees have 14 days to voice any objections to the order. Reasons why they may want to object include where the order states that the scheme/provider is to arrange for the split, rather than the member accessing the pension and passing on the attached/earmarked payments to the ex-spouse/former civil partner. In this instance it could mean that the provider has to deduct the tax and then split the net payment out between the member and ex-spouse/former civil partner, resulting in additional administration costs that the scheme is unable to recover.

If the pension benefits are subsequently transferred, the receiving scheme or provider must be given a copy of the attachment/earmarking order by the transferring scheme.

The ex-spouse/former civil partner should be informed of the transfer within 21 days.

Pension sharing process following the court order

Once the courts have decided how much of the pension rights should be allocated to the ex-spouse/former civil partner, the pension sharing order will take effect from:

- The date on which the Decree Absolute of Divorce or nullity is pronounced or, if later
- 21 days from the date of this order, unless an appeal has been lodged in time, in which case the effective date of the order determining that appeal
- The option that applies should be specified on the Pension Sharing Order but is often not in practice

Once the pension provider/trustees receive a Pension Sharing Order they have three weeks from receipt to appeal against any order/agreement.

To process a pension sharing order, certain information will be needed from the ex-spouse/former civil partner together with copies of certain documentation relating to the divorce. In broad terms the details required are:

- The full name (and details of all previous names used by that person), date of birth and National Insurance Number for the ex-spouse/former civil partner
- A copy of the final pension sharing annex (Form P1 which contains the specific terms of the pension sharing order)
- A copy of the decree absolute. If the divorce took place in Scotland the provider will require the decree of divorce (or decree nisi) or the completion of Minutes of Agreement

- Confirmation there is no appeal pending on the pension sharing order

- If the pension credit is to be transferred, details of the receiving scheme

Once the scheme is in receipt of all the required documentation and any charges that are outstanding, they then have four months to implement the pension sharing order. This implementation period involves discharging the pension debit/credit by way of an internal or external transfer.

The scheme is obliged to carry out an up-to-date valuation as part of the implementation process.

The date on which this is carried out will be the **transfer day**, which will be the latest of the date of the decree absolute, **28 days** after the date upon which the pension sharing order is made, and any date specified by the court on which the pension sharing order is to be effective.

The new valuation often causes confusion because the CETV will almost certainly have changed since the initial valuation was carried out during the negotiation process. When the percentage share is calculated the value of each part will therefore be different from the amounts that were expected and the divorcing parties often perceive this to be a mistake.



Lifetime allowance considerations

Offsetting

Where the pension is being offset against other assets, meaning the benefits will remain wholly intact, the lifetime allowance (LTA) position should be unaffected.

Earmarking

The level of benefits under an earmarking order will be tested against the original policyholder's available lifetime allowance – not the ex-spouse's/former civil partner's. This will be done at the point the benefits are put into payment. As a result, this may be a less attractive option for those with substantial funds. As earmarked benefits are tested against the original policyholder's lifetime allowance, if the original policyholder turned out to be close to their lifetime allowance, it would be difficult to replace the lost pension benefits. If they exceed the lifetime allowance they may have to pay a lifetime allowance charge on benefits they will not receive, and will not be able to save more to cover the loss of benefits.

Pension sharing

Pension debits and credits have to be taken into account for the purposes of an individual's lifetime allowance (LTA). Any pension credit established on or after A-day (6 April 2006) – in respect of benefits that are not yet in payment – will count against the ex-spouse's/former civil partner's LTA, and **not** against the **member's** LTA.

Pensions in payment after A-day may reduce the member's pension benefit as a result of a pension debit as follows:

- If debited from the member's capped drawdown fund a recalculation of the maximum limit will be undertaken immediately, but the new maximum income limit will not apply until the next pension year, unless this is the start of a new reference period
- If debited from an annuity, the annuity will be reduced

However, where a pension credit is paid in respect of a member's pension already in payment, that started after 5 April 2006, the ex-spouse/former civil partner is entitled to claim to have their LTA enhanced because the pension will already have been tested against the member's lifetime allowance. This includes pension credits received from a pension in drawdown.

⁶ If the pension credit rights were acquired between 6 April 2006 and 5 April 2012 and the relevant BCE is on or after 6 April 2012, the pension credit factor is applied to £1.8 million rather than the standard LTA. For pension credits acquired between 6 April 2012 and 5 April 2014 the pension credit factor is applied to £1.5 million, and between 6 April 2014 and 5 April 2016 the figure is £1.25 million. The SLA at the point of crystallisation by the recipient is used if it is higher and is also used for rights acquired after 6 April 2016. (Source: HMRC Pensions Tax Manual, section PTM095200.)

It is known as a Lifetime Allowance Enhancement factor and is calculated according to the following formula:

$$\frac{\text{APC}}{\text{SLA}}$$

Where:

APC = annual pension credit – that is, the value of the pension credit at the time it was acquired

SLA = the standard lifetime allowance at the time the rights were acquired

In this circumstance, the LTA enhancement factor is called the pension credit factor which is then applied to the standard LTA⁶ at any future benefit crystallisation events (BCEs) to provide the uplift to the individual for the purpose of that BCE.

As an example:

Joan receives a pension share of £50,000 in December 2016 from a pension already in drawdown by her ex-husband. The enhancement factor is 0.05 (£50,000/£1 million). If the individual is entitled to more than one enhancement factor, those factors are simply aggregated.

The application for an enhancement factor must be made to HMRC within five years of the 31 January following the end of the tax year in which the pension credit is received. It can be applied for using HMRC form APSS201.

The pension credit factor should not be confused with the **pre-commencement pension credit factor** which can be applied to pension sharing orders in existence on 5 April 2006. The deadline for those applications was 5 April 2009.

The LTA enhancement factor for a pre-commencement pension credit is calculated by dividing the value of the pension credit, indexed in line with RPI from the month it was acquired to April 2006 (IAPC), by the standard LTA for 2006/07 of £1.5 million (SLA).

If an individual is entitled to primary protection, he or she cannot become entitled to a pre-commencement pension credit factor, as those pension credit rights are already factored in to the primary protection factor.

A member, whose benefits have been reduced by a pension debit, can potentially make up the loss in respect of their allowance. However, caution should be exercised if the member has any form of transitional protection. This is explained in more detail below.

Special cases

Lifetime allowance protection

For the member who sees their pension reduce by the pension debit, there can be an impact on lifetime allowance protection.

Primary protection

Pension debits

The individual's Lifetime Allowance Enhancement Factor (LAEF) is recalculated to take into account the value of the benefits deducted under the pension debit. On incurring a pension debit, the individual must notify HMRC who will revise the calculation and issue a new certificate if protection has not been lost.

The calculation deducts the value of the pension debit from the value at 5 April 2006, and recalculates the enhancement factor. A reduced personal LTA then applies to all subsequent benefit crystallisation events.

The reduction of the rights (RR) takes place on the effective date of the order, defined by the Welfare Reform and Pensions Act 1999 as the 'transfer day'. (Not necessarily the same as the date the individual's rights are actually split.)

If a pension debit reduces the RR to below £1.5 million, then primary protection will be lost meaning the individual will revert to the standard lifetime allowance, as the factor would be 0.

The formula for primary protection is:

$$(RR - SLA) / SLA$$

Where:

RR = value of individual's pension rights at 5 April 2006

SLA = £1.5 million

Example:

Bob had £2 million of pension rights at April 2006. This equated to a 0.34 factor $[(£2 \text{ million} - £1.5 \text{ million}) / £1.5 \text{ million}]$. If a pension debit of £200,000 is made after A-day, the revised A-day value would be £1.8 million, and the factor would be 0.20 $[(£2 \text{ million} - £200,000 - £1.5 \text{ million}) / £1.5 \text{ million}]$.

Pension credits

Primary protection is unaffected by pension credits.

Enhanced protection

Pension debits

The application of a pension debit to a member's account won't in itself affect the member's enhanced protection status. On the other hand, any contribution or benefit accrual occurring after 6 April 2006, for a member with enhanced protection, will result in the loss of enhanced protection. Whether benefits can be rebuilt following a pension debit without losing the enhanced protection will depend on the type of the individual's arrangements. Any contribution into a money purchase arrangement (that isn't a cash balance one), constitutes relevant benefit accrual, meaning protection would be lost.

If the member is in a defined benefit or cash balance arrangement and subject to a pension debit after 6 April 2006, they may be able to rebuild their pension rights without losing enhanced protection. This is because accrual is based on increase in benefits not actual contributions made.

As the relevant benefit accrual test for these arrangements isn't performed until a BCE or transfer takes place, it's only at that point – that is, when the appropriate limit is tested – when it is determined whether enhanced protection has been lost due to rebuilding pension debit rights. However there is a risk that when benefits come into payment they'll be more than the allowable amount and enhanced protection may be lost. See HMRC Pensions Tax Manual, section PTM092430, for further details on the relevant benefit accrual test.

Pension credits

If someone receives a pension credit for a pension sharing order after 5 April 2006, the impact on their enhanced protection will depend on how the credit is received:

- If the pension credit is transferred into a new arrangement, the establishment of a new arrangement could trigger the loss of enhanced protection, unless the new arrangement is the same or another registered pension scheme is done in what are called 'permitted circumstances'
- If the pension credit is transferred into an existing money purchase arrangement, enhanced protection won't be lost, as this isn't a relevant contribution
- If the pension credit is transferred into an existing defined benefit or cash balance arrangement, enhanced protection may be lost at a later stage if relevant benefit accrual occurs

For individuals in an unfunded public sector scheme, receipt of a pension credit could cause an unpleasant prospect – his or her credit is not allowed to transfer out of the scheme (to a money purchase scheme) because of special restrictions on public sector schemes and a credit allocated to the existing scheme will be relevant benefit accrual.

Fixed protection 2012/2014/2016

Pension debits

A pension debit will not result in the member losing fixed protection and there is no requirement for the transfer to represent all of the member's benefits in the transferring arrangement. Provided that the other conditions are met, a partial transfer can be a permitted transfer, so that fixed protection 2012, 2014 or 2016 would not be lost.

However, in a similar way to enhanced protection, any attempt to restore the lost benefits by means of further contributions or benefit accrual would result in the loss of fixed protection.

Pension credits

The same conditions as for enhanced protection apply.

Individual protection 2014 or 2016

The individual's personalised LTA will be reduced to take into account the value of the benefits deducted under the pension debit if the transfer day (described below) occurs after 5 April 2014 for IP2014 and 6 April 2016 for IP2016.

In either case, their personalised LTA will either:

- (a) be reduced by an amount related to the amount of the pension debit and, therefore, the individual will have a lower personalised LTA, or
- (b) if the reduction would result in a figure of less than £1.25 million for IP2014 or £1 million for IP2016, protection would cease to apply and, therefore, the individual will revert to the standard LTA

In either case, the reduction in (a) will be 100% of the pension debit where the date of the pension debit is between 6 April 2014 and 5 April 2015 inclusive for IP 2014 or between 6 April 2016 and 5 April 2017 for IP 2016 (referred to as 'the first year').

Where the date of the pension debit is not in the first year, the amount used to calculate the reduction in (a) is scaled down by 5% for each full year that has elapsed since the first day of the relevant first year. For this purpose, the date of the pension debit is the transfer day (that is, the date that the relevant order or provision takes effect).

To help explain, here is an example provided by HMRC in their Pensions Tax Manual, section PTM094400:

Julie has IP 2014. The value of her pension savings on 5 April 2014 was £1.8 million. This is her relevant amount. As Julie's relevant amount exceeds £1.5 million, her protected lifetime allowance for IP 2014 is £1.5 million.

In March 2015, she crystallises benefits worth £1.4 million relying on IP 2014 to prevent a lifetime allowance charge arising as the **standard lifetime allowance** at that time is £1.25 million. This uses up 93.33% of Julie's protected lifetime allowance. So she has an unused lifetime allowance of 6.67%.

In December 2020, the value of Julie's remaining pension rights have risen to £600,000 but are reduced by a **pension debit** of £400,000 as a result of a pension sharing order with a transfer date of 15 August 2020. This leaves her with £200,000 of pension rights.

By 15 August 2020, six complete tax years have passed since tax year 2013-14. So the pension debit that is applied to her relevant amount is reduced by 30% to £280,000. Julie's £1.8 million relevant amount is therefore reduced to £1.52 million because of the reduced £280,000 pension debit.

Her protected lifetime allowance therefore remains at £1.5 million. Julie crystallises her remaining £200,000 pension rights in March 2021 when the standard lifetime allowance is still £1.25 million.

She has 6.67% remaining lifetime allowance available. Applying this percentage to her protected lifetime allowance of £1.5 million produces an amount of £100,050 as her available lifetime allowance. Julie is therefore subject to a lifetime allowance charge on £99,950.

On incurring a pension debit, the individual must notify HMRC who will revise the calculation and issue a new certificate if protection has not been lost. HMRC must be notified within 60 days of the date of the pension debit for this purpose. If a new certificate is issued, the lower personalised LTA will be effective from the date of the pension debit. Any BCE that has occurred before the date of the pension debit will be unaffected. In other words, the revised personalised LTA does not apply retrospectively so benefits in excess of the lifetime allowance, but already taken under the protection of IP2014 or IP 2016, will not now be subject to a lifetime allowance charge.



Summary

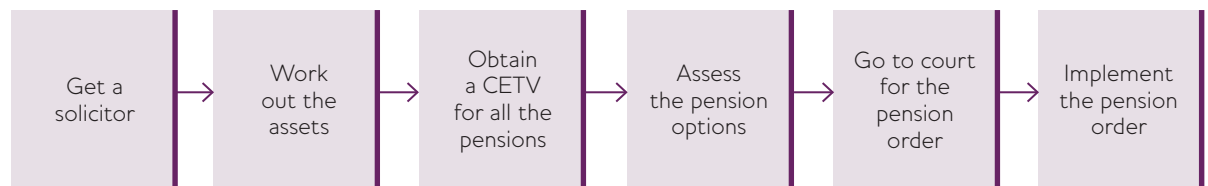
In many cases, 'pension wealth' can be greater than 'property wealth' or other assets, but as you can see within this guide, it is a complex area. It is no surprise that it forms a crucial part of divorce settlements and therefore getting the correct advice is essential.

To recap:

There are three methods in which pension assets may be accounted for in the divorce process:

- **Pension offsetting** – an equivalently valued non-pension asset is given over to the non-pension owning ex-spouse/former civil partner, that is, an offsetting capital sum
- **Pension earmarking** – provides an ex-spouse/former civil partner with a share of a pension scheme member's pension rights on divorce – the ex-spouse's/former civil partner's share is paid when the member draws benefits. This is now called attachment
- **Pension sharing** – splits the pension arrangements with the pension share expressed as a percentage of the CETV. Upon the split a pension debit and a pension credit results:
 - **Pension debit** – the amount of benefit rights given up by a member and allocated to the member's ex-spouse/ former civil partner when a pension sharing order is made in respect of that member
 - **Pension credit** – the amount of benefit rights directly or indirectly attributable to the ex-spouse/former civil partner when the pension sharing order is made

Procedurally



Using a professional Financial Adviser, alongside professional legal divorce advisers, can be helpful with many aspects of a divorce financial settlement. From a pension perspective this can include the initial evaluation of the value of pension benefits – that is, a defined benefit scheme may benefit from favourable discretionary increases, and a defined contribution scheme may have specific policy terms such as guaranteed annuity rates, exit charges and so on. Also, assessing which option is best regarding offsetting, earmarking or sharing, with a view to achieving equality of income following the divorce, and considering implications on any LTA protection. Finally providing advice with regard to rebuilding benefits for retirement.

Important information

The suitability of various options for pensions on divorce will depend on the particular circumstances of each individual. Different options may have different effects for tax purposes, different implications for pension provision and different impacts on other assets and financial planning, as well as different legal impacts on the distribution of assets on divorce.

This guide provides information and is only intended to provide an overview of the current law in this area and does not constitute financial advice, tax advice or legal advice, or provide any recommendations. This is a complicated area, and individuals going through a divorce should take tailored, appropriate advice about their financial settlement on divorce and future tax and financial planning.

This document represents a summary of our understanding of the law at the date of its last review (August 2019). Tax limits, allowances and rules are often subject to change and may change in future. Individuals should check that tax limits, allowances and rules have not changed.





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