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HERITAGE SIPP

Guide to Pensions Sharing

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Divorce is a stressful time, both emotionally and practically. Dividing up the shared assets is one of the toughest parts of a separation. Pensions are often of huge value and significant when planning for the future. Deciding what to do with them is extremely important.

Courts can take into account most pension rights whilst dividing assets during a divorce or dissolutions of civil partnerships. This guide explains the options for reaching a settlement.

Divorce law for pensions differs between Scotland and the rest of the UK. These differences are noted where relevant.

PLEASE NOTE ALL SUBSEQUENT REFERENCES TO SPOUSES DIVORCING ALSO COVER DISSOLUTION OF CIVIL PARTNERSHIPS UNLESS SPECIFIED OTHERWISE.

Legislation that impacts on pensions and divorces

Matrimonial Causes Act 1973

This Act gave courts in England and Wales the power to take the value of individual and occupational pensions into account when settling the matrimonial estate.

Matrimonial Causes (Northern Ireland) Order 1978

This Order gave similar provisions to courts in Northern Ireland.

Family Law (Scotland) Act 1985

In Scotland, historically the value of pension benefits could be offset as part of the financial settlement, though the ex-spouse had no direct access to the pension. This Act set out the principles to be applied for sharing the value of the matrimonial estate.

In England, Wales and Northern Ireland all pension assets belonging to the couple are taken into account on divorce. But in Scotland, only pension assets built up during the period of marriage/civil partnership are taken into account.

Pensions Act 1995

Prior to this Act, the only method for taking into account the value of pension benefits was by 'offsetting'. This Act introduced 'earmarking orders', now referred to as 'attachment orders' in England, Wales and Northern Ireland. This Act also applies in cases of civil partnership dissolution and nullity proceedings.

Welfare Reform & Pensions Act 1999

This Act introduced 'pension sharing' where the divorce petition was filed with the court on or after 1 December 2000. Offsetting and attachment/earmarking orders remain as alternatives.



1 Options for Pensions when Divorcing

There are three options to take into account the value of pension assets and reach a settlement:

- Offsetting
- Attachment/earmarking order
- Pension sharing

Offsetting

The court takes into account the value of a pension by offsetting it against other assets. Effectively the ex-spouse gets another asset or share of another asset, up to the appropriate value of the share of the pension, instead of the share of the pension. This option is often used when both parties are financially successful and both parties have substantial pensions. Offsetting orders are unaffected by remarriage or death.

Example

John and Mary are divorcing. John has a SIPP worth £250,000 and the family home is worth £600,000 (no mortgage). There are no other assets (or liabilities).

The total assets are worth £850,000. If the court awarded each party a settlement of 50% this results in a value of £425,000 for each party.

Mary gets £425,000 of the equity in the home and John keeps his pension valued at £250,000 and gets £175,000 of the equity in the home, bringing his share up to £425,000.

If John is under age 55 and assuming no ill health or protected retirement age, he will not be able to access his share of the assets until he's eligible to take pension benefits.

Attachment/earmarking orders

In England, Wales and Northern Ireland, a specified percentage of the pension benefits are paid to the ex-spouse. However, this can only happen from the date the member starts to draw benefits. It is in effect deferred maintenance.

In Scotland, the court can't earmark the pension income of the member, only the tax-free cash sum and lump sum death benefits.

This applies to all the main types of UK occupational and personal pension schemes but can't apply to state pensions.

Attachment/earmarking orders are available for divorces that started on or after:

- 1 July 1996 (England and Wales)
- 10 August 1996 (Northern Ireland)
- 19 August 1996 (Scotland)
- 5 December 2005 (dissolution of civil partnerships)

These orders normally apply to benefits earned up to the divorce date. However, if the order doesn't specify this, it covers all the member's benefits up to their retirement date.

The total benefits (pension and/or tax-free cash) are assessed against the member's lifetime allowance (LTA) and the member's income tax liability. This is despite a portion of the benefits being paid to the ex-spouse. The pension received by the ex-spouse is therefore tax-free in their hands.

This option has not been popular because of the disadvantages which include the following:

- attachment/earmarking orders don't provide a 'clean break' divorce.
- the attachment/earmarking order expires if the ex-spouse or ex-partner remarries.
- the attachment/earmarking order expires if the ex-spouse or ex-partner dies.
- the member can choose to take benefits whenever they decide (subject to normal HMRC rules). This could result in delaying taking benefits as long as possible in the hope that the ex-spouse will remarry or die first.
- the ex-spouse has no control over the investment of the pension fund. The member could deliberately invest in poorly performing funds to diminish the value of the fund.
- state pensions and contracted out rights cannot be attached/earmarked (but can be used in the value for offsetting purposes).

If the member transfers the pension rights, the attachment/earmarking order will follow the member's rights to the new arrangement.



Pension sharing

Pension sharing orders can apply to any divorce where proceedings commenced on or after 1 December 2000 or for dissolutions of civil partnerships from 5 December 2005.

Pension sharing orders provide a clean break between parties as the pension assets are split at the point of divorce allowing each party to decide what to do with their share independently.

The court issues a pension sharing order which states how much of the pension the ex-spouse is entitled to receive. The amount is expressed as a percentage of the pension transfer value being split, except in Scotland where it can be also expressed as a monetary amount.

After the sharing order comes into effect, the receiving spouse owns the pension in their own right and can manage it as they wish. The ex-spouse's share of the pension is called a 'pension credit' and the reduction in the member's pension is called a 'pension debit'. The ex-spouse can normally transfer their pension credit into their own pension arrangement

then deal with their pension credit benefits as they wish. Some public sector schemes will, however, only provide the member's ex-spouse with an internal pension credit, so the ex-spouse becomes a pension credit member with their own separate rights, but still subject to the scheme rules.

Pension sharing is also an option for crystallised pension benefits. If the crystallised benefits have been used to provide an annuity, the ex-spouse can either use their share of the fund to continue to receive an annuity from the existing provider or take an external cash transfer to make their own choice of pension arrangement. The member's annuity is then reduced to take account of the pension debit.

The basic state pension cannot be split in a pension sharing order.

Pension schemes have four months to implement a pension sharing order, starting from the date the order takes effect or the date the administrator/trustee receive all the required documents and information, whichever is later.

2 The Pension Sharing Process

The court instructs the member to get a valuation of their pension benefits (a cash equivalent transfer value, or CETV) as at the date of petition or, if earlier, when the divorcing couple officially separated, along with certain other information about their benefits.

The pension scheme administrator/trustee must supply the valuation within three months or no later than six weeks before the divorce hearing if the administrator/trustee had prior notice of the impending hearing.

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. In Scotland the pension sharing order may instruct a monetary amount or a percentage of the pension benefit to be subject to a debit. Outside Scotland, the debit amount must be expressed as a percentage. 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 is actioned.

The existing pension scheme can choose to allow the ex-spouse to join the scheme in their own right or to take the transfer value to another registered pension scheme. There are two exceptions:

- where the member's pension is being paid through a guaranteed pension annuity with a pension provider, the pension provider may insist on an annuity with that provider; or
- where assets cannot be readily cashed in, the scheme may decide that the ex-spouse must become a member of the scheme, in their own name. This would apply for unfunded schemes, public sector schemes or where the assets are in property such as in a SIPP.

Once the pension administrator/trustee gets a pension sharing order they have four months to implement it. They can delay start of the implementation period until their charges are paid or whilst relevant information is outstanding. Should they wish to appeal against the pension sharing order they have three weeks from receipt to appeal against it.



3 How Pensions are Valued

In England, Wales and Northern Ireland, the financial settlement is generally based on the value of all the pension rights each spouse had when they split up. But in Scotland, only the increase in the value of each spouse's pensions between the date they married and the date of separation is taken into account.

Before pension sharing can be set up, it is necessary to establish how much any pensions held are worth. This includes:

- occupational pensions established through an employer
- personal pension schemes
- additional state pensions i.e. any pension from the state in addition to basic state pension

Valuing work place pensions

Workplace pensions can be a 'defined contribution' meaning that a set amount is paid into a pension fund. In this case, the annual statement details the 'transfer value' for the pension.

For a final salary pension scheme, its value is determined by how much the member earns, their length of service with the employer and the scheme's accrual rate. The calculation is complicated and it will be necessary to request the value from the scheme actuary.

For public sector pensions it will be necessary to contact the scheme administrator to obtain a CETV and a statement of benefits.

Valuing personal pensions

The value of a personal pension is shown on the latest annual statement along with a 'transfer value' which is the figure the court will use to assess pension sharing.

How is the value of the pension credit calculated?

The pension credit share is based on a CETV of the member's policy or scheme benefits. Once the pension share is agreed by the court, this is applied to an updated CETV to obtain the value of the pension credit. The eventual CETV may be more or less than the original CETV valuation.

The legislation allows the pension administrator/trustee to decide the valuation day for actual implementation of the pension sharing within the four months' implementation period. Any benefits earned or contributions paid after the date of the court order should be excluded from the valuation.

4 Pension Sharing Effects on the Member

When a pension sharing order comes into effect, the CETV creates a pension debit against the member's benefits. This directly reduces the value of the benefits in money purchase schemes and leads to an actuarial adjustment in defined benefit schemes.

If the debit comes out of uncrystallised funds, this reduces the value of benefits tested against the member's LTA when there is a subsequent benefit crystallisation event (BCE).

A pension debit has no effect on a member's scheme level protected tax-free cash, even though it involves a partial transfer out of the member's benefits.

The pension debit member can normally rebuild their pension benefits. However, there can be barriers to this, such as losing enhanced or fixed protection. (See section 6). There is also the possibility of higher earners being caught by the tapered annual allowance, or those who have accessed benefits flexibly being caught by the money purchase annual allowance.



5 Pension Sharing Effects on the Ex-spouse

When a pension sharing order comes into effect, the CETV creates a pension credit for the member's ex-spouse. The credit will not be treated as a contribution when checking against the annual allowance. It becomes part of the ex-spouse's own pension fund and is tested against their own LTA at any of the usual BCEs.

If the pension credit is paid out of funds the original member crystallised from 6 April 2006 onwards, it is termed a 'disqualifying' pension credit. The ex-spouse can't take any tax-free cash from this source. However, they can still choose when to use the credit to provide pension benefits for themselves, subject

to normal HMRC rules. They can benefit from an LTA enhancement via a pension credit factor as this will already have counted against the original member's LTA. This registration must be completed within five years after the 31 January following the tax year when the pension sharing order was made.

Some pension credit members who made a claim by 5 April 2009 will have an LTA enhancement via a pre-commencement pension credit factor. This takes account of the pre-6 April 2006 treatment of pension debits and credits. Pension credits can adversely affect people with enhanced or fixed protection. (See section 6).

6 Interaction with the Lifetime Allowance (LTA) Protections

When a pension sharing order comes into force it may affect LTA protection. The effect pension debits and credits can have on different forms of protection include:

Primary protection

Debits

If a member's pension is subject to a pension debit after 5 April 2006 they will need to reassess their primary protection. The value of their pension rights as at 5 April 2006 is reduced by the amount of the pension debit. If this results in the value of the pension rights being below £1.5m, primary protection will be lost along with any associated lump sum protection.

If the value of the pension rights is still above £1.5m, the primary protection factor will be recalculated. Any associated lump sum protection would remain the same. The new primary protection factor will apply to new BCEs from the effective date of the pension sharing order.

Credits

Receiving a pension credit will not invalidate primary protection. However, it also will not cause the protection to be reassessed, so the credit may result in the ex-spouse exceeding their protected allowance.

If the pension credit is from crystallised funds, the ex-spouse may be able to apply for an LTA enhancement factor. A pension credit received before 6 April 2006 would already be included in the ex-spouse or ex-partner's primary protection factor.

Enhanced protection

Debits

A pension debit will not directly affect enhanced protection. However, because enhanced protection is lost if a contribution is made, those in money purchase schemes e.g. SIPP will not be able to replace the deducted funds.



Credits

For those holding enhanced protection, there are strict rules about transferring pension benefits, particularly into new arrangements. Ex-spouses receiving a pension credit must be careful to ensure the transfer does not cause them to lose enhanced protection. In most cases, the funds will need to be transferred into an existing pension arrangement (note that a transfer to a new arrangement, in an existing scheme would not meet the requirements).

Fixed protection 2012, 2014 and 2016

Debits

Members will not lose fixed protection if they are subject to a pension debit. However, they will lose the protection if they make further contributions so once again will not be able to replace the lost funds.

Credits

Ex-spouses receiving a pension credit will also need to take care that the transfer does not invalidate their fixed protection. They will normally need to transfer the funds into an existing pension arrangement. Ex-spouses may be able to apply for an LTA enhancement factor to protect against LTA charges.

Individual protection 2014 and 2016

Debits

When a member is subject to a pension debit, their protected LTA must be reassessed. The member must inform HMRC of the pension debit within 60 days.

For both types of protection, the value of the pension debit is first valued. For individual protection 2014 (IP2014), the value reduces by 5% for every complete tax year since 2013/14. For individual protection 2016 (IP2016), it is 5% for every complete tax year since 2015/16.

The revalued pension debit is then deducted from the value of the member's pension rights on 5 April 2014 (IP2014) and 5 April 2016 (IP2016).

IP2014 is lost if the value of pension rights on 5 April 2014 is now below £1.25m. Otherwise the member's personal allowance is reset according to the new value.

IP2016 is lost if the value of pension rights on 5 April 2016 is now below £1m. Otherwise, their personal allowance is reset accordingly.

Example

Bob's pension rights on 5 April 2014 are valued at £1.45m. He applies for IP2014 and his protected LTA is £1.45m.

On 6 June 2018, Bob gets divorced and has a pension debit of £200,000. As 6 June 2018 is within the 2018/19 tax year, therefore only 4 complete tax years have passed since 2013/14 i.e. 2014/15; 2015/16, 2016/17 and 2017/18. The value of the pension debit is reduced by 20% (4 x 5%), giving a revalued amount of £160,000.

Bob's pension rights on 5 April 2014 are revalued to £1.29m (£1.45m - £160,000). He gets to keep his individual protection, but his protected allowance is now £1.29m. This will apply for any future BCEs.

If the revalued pension debit has been worth more than £200,000 i.e. leaving his revalued pension rights below £1.25m, Bob would have lost IP2014.

Pam has IP2014. She had £1.7m of pension savings on 5 April 2014 making her protected LTA £1.5m.

Pam crystallised £600,000 via flexi-access drawdown in December 2015 taking tax free cash but no income. That left 60% of her protected £1.5m LTA available - or £900,000 on monetary terms.

Pam gets divorced and a £450,000 pension credit came into effect on 15 June 2016. As 2 complete tax years have passed since 2013/14 there was a 10% reduction in the pension debit deducted from the value of her pension savings for IP2014 purposes (from £450,00 to £405,000). That reduced the value of her IP2014 to £1.295m. In monetary terms her remaining available LTA became 60% of £1.295m or £777,000.

Depending on fund growth assumptions, Pam could consider rebuilding her pension fund via further contributions as she is not caught by the money purchase annual allowance.



Credits

Receiving a pension credit will not affect individual protection. Ex-spouses concerned about the LTA charges in respect of the pension credit may be able to apply for an LTA enhancement factor.

LTA enhancement factors

Ex-spouses who receive a pension credit may be able to apply for a 'pension credit factor' if both of the following conditions apply:

- The pension credit was obtained on or after 6 April 2006
- The pension credit is from funds that were crystallised by the original member on or after 6 April 2006

The pension credit factor effectively adds the value of the pension credit to the ex-spouse or ex-partner's existing LTA, preventing an LTA excess charge from applying in respect of the credit.

7 Key Points

- Divorce law for pensions differ between Scotland and the rest of the UK.
- **Offsetting** gives the ex-spouse a share of an asset equivalent to the appropriate value of the agreed share of the member's pension – usually this involves the ex-spouse receiving a larger share of the matrimonial home.
- **Attachment/earmarking orders** are effectively deferred maintenance, giving the ex-spouse a portion of the member's pension built up during their marriage. This approach brings various disadvantages though.
- **Pension sharing** separates the ex-spouse's pension entitlement from the member's pension, providing a clean break.
- Following the introduction and subsequent reduction of the LTA, transitional protections such as primary, enhanced, fixed and individual protections are available. These can have an impact on the decisions made during divorce.

8 Advice

The rules surrounding offsetting, attachment/earmarking orders and pension sharing are complex. We recommend that you seek independent advice from a suitably qualified individual/firm to steer you through the options and rules covering pensions and divorce. PSG SIPP Ltd is not authorised to provide advice.



9 Frequently Asked Questions

Can pension sharing be achieved without going to court?

It is not possible to divide the pension arrangements without going to court. This is because the pension administrator/trustee cannot act to divide a pension arrangement without a direction from the court.

Which pension arrangements are covered by pension sharing?

Pension sharing can apply to all types of private pension arrangements, occupational and personal, registered and non-registered as well as pensions already in payment. State pensions can be shared in certain circumstances depending on when divorce proceedings started and on the State pension entitlement accrued.

Are state pensions included in pension sharing?

Pension sharing orders can cover additional state pensions for those who reached state pension age (SPA) by 5th April 2016, or the protected payment element of the new state pension for those who reach SPA from 6th April 2016. Additional state pension is based on SERPS and the state second pension. Divorcees reaching SPA by 5th April 2016 who haven't remarried are sometimes able to use their ex-spouse's national insurance record to increase their basic state pension without affecting the ex-spouse's entitlement. The option doesn't apply to anyone reaching the SPA from 6th April 2016.

How are pension assets valued?

For pension sharing, the prescribed valuation method is the CETV. However, in certain circumstances one of the parties may argue for a different value to be used.

There are two types of valuations for pension sharing:

- an information valuation is used by the court and the divorcing parties to help decide on how to share assets; and
- an implementation valuation is used when a pension sharing order has been made and all the requirements to make the transfer from one pension arrangement to another has been received.

In Scotland, only the value of the pension which has built up during the period of marriage up to the date of separation (or the date the court summons is served) should be taken into account. The solicitors acting for the parties will calculate this as part of the divorce settlement.

What court documents are required for pension sharing?

A pension sharing order should be accompanied by a pension sharing annex (form P1), for each pension arrangement that is to be shared. An annex should include the pension provider name and reference number of the pension arrangement the share is to be taken from and the percentage to be shared.

In Scotland, pension sharing can be achieved either through a pension sharing order made by the court or a corresponding provision in a qualifying agreement. A qualifying agreement (which is the more common method) is a written financial agreement between the two parties that is registered in the Books of Council and Session. An order or agreement should quote the provider name and reference number of the pension arrangement the share is to be taken from and can quote the percentage or amount to be shared.

What are the ex-spouse's pension credit options?

All private sector occupational schemes and personal pension plans must offer the option of transferring the pension credit externally to an arrangement chosen by the ex-spouse. This may give the ex-spouse the choice of transferring their share into a new arrangement such as a personal pension or transferring the pension credit into an arrangement or scheme that they are already a member of. Depending on the age of the ex-spouse, a pension credit can be transferred into an uncrystallised arrangement such as a personal pension or into one where pension benefits are going to be taken immediately such as a drawdown arrangement.

The only schemes that have to offer an ex-spouse partnership membership in the member's scheme are unfunded public sector schemes or final salary schemes which are not fully funded. In this case, if the ex-spouse chooses an external transfer instead, they will be quoted a reduced CETV.

At their discretion the scheme administrator/trustee may offer an ex-spouse their own benefits within the member's scheme as an alternative although this is unlikely to be the preferred option. From the ex-spouse's point of view, it may not feel like a 'clean break' if they become a member of their ex-partner's pension scheme.



To ensure a clean break the ex-spouse can:

- transfer their pension credit to a personal pension or stakeholder pension in their own name; or
- transfer their pension credit to a pension scheme of which the ex-spouse is already a member, but only if the scheme rules allow; or
- transfer their pension credit to a buyout policy (from occupational schemes only).

Can a tax-free lump sum be paid from a pension credit that originated from a pension in payment?

No. A pension credit made from a pension in payment is often referred to as a 'disqualifying' pension credit.

What happens if a pension share is made from a capped drawdown fund?

Individuals in capped drawdown should be aware that any pension debit could have a significant impact on the maximum income they can take.

If someone is under age 75 and their fund reduces following a pension debit, then there should be a review of the maximum income limit for the remaining years of the review period. The income limit should be recalculated on the day the pension sharing order takes effect using the remaining capped drawdown fund and the individual's age at that time. However, the reduced maximum income limit does not take effect until the start of the next pension year in the review period.

It follows that a review of the income limit would not be carried out if the pension debit is made in the final pension year of the review period. In this scenario, the income limit would be reviewed as normal once the review period has expired. Similarly, if a pension debit is made from a fund belonging to someone aged 75 or over, then the income limit would need to be reviewed as normal on the next annual review date.

Do pension credits or debits count against the annual 'contribution' allowance?

No.

Do pension credits count towards the member's or ex-spouse's LTA?

Pension sharing orders effective on or after 6 April 2006 count towards the ex-spouse's LTA only. If the pension sharing order affected pension benefits that were already in payment, the ex-spouse can apply for an increase to their own LTA. They can do this as the pension benefits will have been tested against the LTA of the member when the benefits were taken.

What happens if the ex-spouse doesn't cooperate?

The scheme administrator/trustee can choose a default option where the ex-spouse is unable or unwilling to make a decision on where to transfer her pension share. However, the scheme administrator/trustee cannot transfer to a personal pension without the member's consent because contract is made between the member and the pension provider. The only real option is to buy out the scheme's liability by transferring pension rights to a section 32 'buy-out' policy which is a deferred annuity.

Can pension sharing occur after divorce is final?

An application for divorce proceedings and ancillary relief proceedings are separate processes and therefore pension sharing can and often will occur after the divorce is final. However, a pension sharing order cannot be made until the granting of the decree nisi. At this time there is a short window or opportunity where the pension sharing order can be varied. Applying for a variation of settlement order would mean the pension sharing order could not be implemented. Once the decree absolute was granted and the pension sharing order implemented no further variation is possible.

What happens if a member or their ex-spouse dies before a pension share is implemented?**The two scenarios that could occur are:**

- The member dies after the court order has been finalised but before the pension share is implemented - generally the pension credit is deemed to exist and the transfer to the ex-spouse should continue to be processed.
- The ex-spouse dies after the court order has been finalised but before the pension share is implemented - generally the ex-spouse will be treated as having benefits within the member's scheme. Death benefits would then be quoted and settled based on the rules of the scheme.

Can pension sharing take place for an overseas divorce?

A foreign court has no jurisdiction to make a pension sharing order against a UK pension arrangement. If a couple are getting divorced overseas and they wish to share the benefits held under a UK pension arrangement they need to obtain a pension sharing order from a UK court.



10 Disclaimer

All references to taxation are based on our understanding of current taxation law and practice and may be affected by future changes in legislation and the individual circumstances of the investor.

In addition, the information provided is based on our current understanding of the relevant legislation and regulations and may be subject to alternation as a result of changes in legislation or practice.

