Factsheet 09

Pensions on Divorce or Dissolution

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Pensions are assets owned by an individual that are subject to various tax regulations. For example, money cannot be drawn down from most pensions until the pension holder is at least 55. When the pension can be drawn down a tax-free lump sum can usually also be taken. This is usually up to 25% of the pension value. Any additional money withdrawn is subject to tax.

Pensions are an asset that should be considered on divorce or dissolution, but due to the tax regulations, there are specific ways that they are dealt with on divorce.

What is a pension's value?

The value that is used is the Cash Equivalent Value (CEV), which can be obtained from your pension provider. This is the value that your pension would be given if you were able to transfer it to a new pension scheme. You can obtain a CEV for a pension which is already in payment. The CEV should be obtained for all the pensions owned by you and your spouse. Values can also be obtained for any additional state second pension entitlement that you and your spouse have.

It should be noted that the CEV for final salary pension schemes can sometimes be considered undervalued and you may therefore need to instruct a solicitor who regularly deals with pensions on divorce. There are different pension schemes with different benefits. You will not be comparing like with like when you compare CEVS of a Final Salary and Money Purchase schemes and therefore care is required.

How are pensions factored into a financial settlement?

All the assets, including pensions, should be considered when considering what a fair divorce financial settlement is. Often the pension assets are dealt with separately to the non- pension assets due, rather than adding all the assets together before deciding a suitable division of the assets, due to the nature of pensions and implications for tax and income. A pension is different from dividing cash. Whilst regulations concerning pensions have been relaxed, there can be significant tax consequences of taking money out of pensions. Advice should always be obtained from a pension expert before entering into a divorce settlement if there are pensions involved.

Pension Sharing Orders

If pension assets are significant, a Pension Sharing Order is often the fairest way to deal with pensions as part of a divorce settlement. This is where a specific percentage of a spouse's pension, known as a pension credit, is transferred into a pension fund in the other spouse's name.

Many pensions will allow a pension credit to be transferred out of their pension scheme into a different pension scheme. In such a scenario, the person receiving the pension credit will need to take advice from a financial advisor regarding the best pension scheme to pay their pension credit into. Some schemes, particularly government pension schemes, such as the NHS Pensions scheme and the Police Pension scheme, will not allow the pension credit to be transferred out of the fund and the person receiving the benefit of the pension credit, has their own pension created in that scheme.

Once a pension sharing order has been made, the two spouses have separate pensions and they can then each pay additional contributions into their respective pensions without the other benefitting and they can draw down their pensions at a date of their choosing, subject to the scheme rules, without any agreement being needed from the other spouse.

Pension sharing orders can enable a couple to achieve a clean break settlement, particularly if they are close to retirement or are already retired.

Pension attachment orders

Pension attachment orders are rarely made since the legislation changed in 2000 to allow pension sharing orders. Pension sharing orders can only be made in divorce proceedings, so pension attachment orders can be used. if you have judicial separation (legal separation as opposed to divorce) proceedings.

Pension attachment orders allow one spouse to receive the benefit of part of the other's pension, be it income or lump sum, but only when this benefit is received by the pension holder. If you receive the benefit of a pension attachment order you must wait for the pension holder to decide to retire before you receive any benefit from the pension. Also, any income received by way of a pension attachment order is considered spousal maintenance and will end if the recipient remarries or dies.

Offsetting

If one spouse wishes to retain more of their pension, or one party retain more cash (usually equity in a property) they can offset any claim against capital in lieu of making a pension sharing order. There is no specific formula which allows you to calculate how much should be paid in cash to offset a pension share and different pension experts have different views, however the capital required is unlikely to be the same as the equivalent CEV figure since there will be reductions to take account of tax payable when the pension is in payment, and a figure for the "utility" which relates to the additional benefit of having cash in the hands of the recipient which will be different from case to case. These matters will need to be considered within the context of an expert's pension report, following which it is a matter for negotiation, taking into account all the circumstances of the case.

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