5 key reasons you should speak to a financial planner about pensions when getting divorced

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Making the decision to end a marriage can be a life-changing one with serious financial consequences.

One of the most important implications will be the division of your assets. If this isn't handled correctly, it can cause further trouble down the line.

Many couples tend to do their financial and retirement planning together, which is why it can sometimes be difficult to separate the assets – particularly when it comes to pensions.

According to research, just 12% of people divorcing consider pensions when dividing assets with their partners.

Almost a quarter (24%) actively waive their rights to the value of pensions.

If you're getting divorced, there can be a lot to think about and it's important not to neglect your pension arrangements. Here is why you should speak to a financial planner when you divorce.

1. A financial planner can help you to organise a fair pension sharing arrangement

If you divorce, "pension sharing" is one potential option as it offers both parties the chance for a clean break.

Pension sharing was introduced in 2000 and can be a useful way of dividing up pensions after a divorce.

If you decide to go for this option, the partner with the pension of a lower value may be given a portion of their ex's pension on divorce. This is called a "pension credit".

Pension sharing explained

The court can issue a pension sharing order (PSO) which states how much of a member's pension will be shared with their ex-spouse.

The amount is expressed as a percentage of the transfer value(s) of the pension(s) that are to be split.

For example, if the value of the pension was £200,000, a 50% share would result in a £100,000 pension credit for the non-member.

Things can be a bit more complicated if you or your partner have a defined benefit pension scheme. These schemes typically provide a pension based on the number of years of service, as well as the salary of the scheme member.

This can be problematic for calculations, as there is no ongoing fund value to work with. Valuing such an asset very often requires an actuary, and different actuaries can yield different valuations!

As you can imagine, dividing the pensions in an equitable way can be difficult and time-consuming. Working with a financial planner can help you to understand the relevance of the different valuations and options to your own circumstances. It can also provide peace of mind that both you and your ex-partner are getting a fair deal.

A planner can also help you to set up a pension scheme to receive your pension credit.

2. A planner can help to assess equality of income vs equality of assets when dividing assets

If you opt for pension sharing, one major thing you'll need to consider is how it will affect both your long-term financial plans.

It's important to determine whether capital equality or income equality is the more appropriate way to divide your pension assets. This is where professional advice can help you.

"Capital equality" versus "income equality"

Capital equality, whereby the values of your pension schemes are totalled up and divided in half, is the simpler of the two options. It can be useful in several scenarios, such as:

- If the value of your pension is small in comparison to your overall assets
- If you and your partner are relatively young, so income projections may be unreliable.

Alternatively, it may be fairer to divide your pension assets on the basis of income equality, by equalising the actual income that the pensions are expected to produce when you retire. This can be more useful when:

- You have significant pension assets
- Your pensions make up a high proportion of the total value of your assets.

It can sometimes be difficult to know when each method may be fairer for both you and your ex-partner. This is where seeking advice can help, as an adviser can assess the situation more clearly to ensure that the split is as fair as possible.

3. A financial planner can help you to avoid potential tax issues

If you opt for pension sharing, you may need to consider how it would affect your Lifetime Allowance (LTA) as this could have a significant impact on your pension wealth.

Working with a financial professional can help you to avoid any potential tax pitfalls.

If you have a pension debit, you can sometimes pay contributions to make up for the value of your lost assets, subject to normal restrictions.

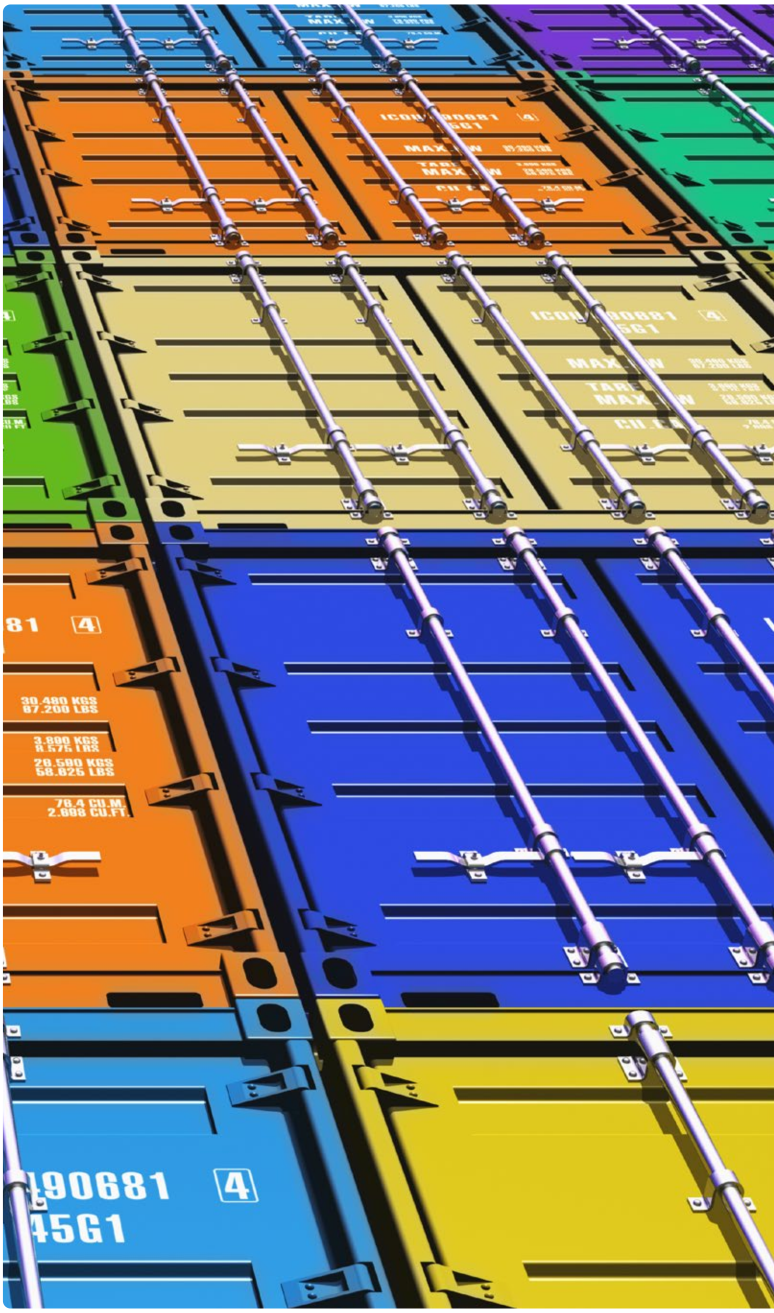
However, this isn't always the case and so it's important to be able to make an informed decision.

The Lifetime Allowance explained

The Lifetime Allowance is the maximum amount of tax-efficient pension savings you're allowed to accrue in your lifetime.

In the 2021/22 tax year, this stands at £1,073,100 and covers the total value of your pensions. This includes your contributions, your employer's contributions from your workplace pension, tax relief, and investment returns.

When you take benefits from your pension, the Lifetime Allowance will be applied. If the value of your combined pensions is greater than the limit, you may have to pay a charge on the value above the threshold. You may be liable for a tax charge of 55% of any excess taken as a lump sum or 25% of the excess if taken as regular income.



Conversely, if you're receiving a pension credit then, in many cases, it will count towards your LTA. If this is the case, you need to understand the implications of exceeding the threshold.

Tax laws can be a potential minefield, which is why it's important to work with someone who has a good understanding. Working with a financial planner can help to prevent you running into any unforeseen problems, allowing you to move on and build your pension wealth effectively.

4. A planner can help to divide your wealth if you opt for pension offsetting

Pension offsetting explained

When divorcing, all your assets and those of your ex-partner are taken into account.

If you decide to opt for pension offsetting, each party keeps their pension assets.

These are then offset against the other assets – for example, if one person has a large pension pot, the other might get the house (assuming it has a similar value).

One notable alternative to pension sharing is "pension offsetting".

While the former splits up the pension assets between you and your ex-partner, offsetting effectively treats your pension wealth as a single asset.

This can be problematic where there are different types of pension scheme for each spouse, but the approach does have its place in the right set of circumstances.

Broadly, this approach means that one partner retains lower pension wealth but is compensated with non-pension assets of the same value. The value of the pension is "offset" against your other assets.

There can be many good reasons for pension offsetting, such as:

- Keeping things simple, potentially meaning the process is faster
- One party may need to use other assets (such as the marital home)
- If the pension is small, it may not be cost-effective to undergo a costly pension sharing order
- It can be a useful option if you have overseas pensions which need to be split, as they cannot be shared through a UK court order.

But there can also be drawbacks to the arrangement, such as:

- One partner may be left with no provision for retirement
- It can sometimes be hard to accurately value assets, as their values may increase at different rates
- It can be difficult to accurately divide assets fairly, as the value of pension schemes may be more valuable in the long term.

As you can imagine, when dividing out such large assets it can be very costly to make a mistake. If this happens, either you or your ex-partner may suffer financially, which is why it's important to work with a professional during this process.

5. A planner can help you to understand the "utility discount"

Pension offsetting can sometimes be the simplest and fairest way to divide wealth on divorce, however, there can be complications which require a more nuanced approach.

One of the most common issues affecting offsetting stems from the fact that comparing the capital value of a pension with a property, or cash, for example, is a little like comparing apples with pears.

Unlike cash deposits, pensions wealth is not readily accessible. There are minimum age requirements, tax rules on withdrawals, and death benefit rules applicable to pensions. The overall effect is that cash is generally considered to have more utility value than a pension.

This concept applies also to one spouse retaining the family home in lieu of pensions. While property is less liquid than cash, it is still highly unlikely that the homeowner will have any direct tax issues as a result of owning the asset, whereas the pension owner will at least have to consider tax when accessing pension wealth.

A spouse who receives cash instead of pension may be assumed to have financial advantages through having more flexibility. Consequently, the partner who retains the pension may be entitled to a discount (the "utility discount") as regards the amount of cash needed to offset the pensions value they retain.

This is typically in the range of 10% to 30% but there are no hard and fast rules, and great care should be taken on a case-by-case basis.

When you work with a financial planner, they can ensure that both parties are fairly compensated for the assets, allowing you to have a clean break and minimise any potential animosity.

Get in touch

Dividing assets after a divorce can seem like a financial minefield, which is why it's important to seek professional advice.

We have wide experience in working with divorcing clients and can thoroughly assess your financial situation to find the fairest way to divide your assets. This allows you and your ex-partner to move on with your lives.

If you feel you would benefit from professional advice, we can help.

Get in touch at hello@longhurst.co.uk or call us at 01327 223243.

Please note:

A pension is a long-term investment not normally accessible until 55 (57 from April 2028). The fund value may fluctuate and can go down, which would have an impact on the level of pension benefits available. Past performance is not a reliable indicator of future results.

The tax implications of pension withdrawals will be based on your individual circumstances. Thresholds, percentage rates and tax legislation may change in subsequent Finance Acts.