

Divorce and your finances

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Two in five marriages in the UK now end in divorce. A split can have devastating ramifications for both partners' financial wealth, and with most couples sharing their finances, it is important to make the right financial planning decisions if the worst should happen.

Managing the investments

It makes sense to try to retain any savings in an individual savings account (Isa) or similar tax-free wrapper. But it is important that any adjustments to an investment portfolio are made in the same tax year of separation. It is possible to transfer assets between husband and wife without there being a capital gains tax liability, but this has to be done in the appropriate tax year. Leave it too late and a tax charge will likely be incurred.

Where endowments are to be disposed of, it can be better to go to the open market rather than surrender them back to the insurance company, as a higher price can often be obtained this way.

A couple will also need to rewrite their wills. A will only becomes null and void on marriage, not upon divorce, so to ensure that disposal of assets on death fit the changed circumstances, it is important the couple update their wills as soon as possible after the divorce.

Finally, after an investment portfolio has been divided, it is important that a financial planning review is undertaken, to ensure each individual's investment holdings are properly aligned to their attitude to risk.

"A portfolio may have been constructed with certain short term goals in mind and as such has an aggressive strategy. If some of these assets are then passed to the wife or husband who has a cautious approach to investment, this element of the portfolio will need reassessing in line with their personal attitude to risk," comments Fiona Sharp, a financial planner with independent financial adviser (IFA) Almary Green.

Divorce is a very stressful business, so engaging a trusted professional - if you can stomach paying another one - could help you through the maze of taxation and legal issues. A number of independent financial advisers specialise in divorce and financial advice and you can find one near you using the IC website (www.iconline.co.uk/FundsAndFinance/FindAnIFA) or by phoning 0800 085 6250. The Personal Finance Society (www.findanadviser.org, telephone: 020 8530 0852) can help you search for a chartered financial planner. A good indication of whether an adviser is divorce literate will be an accreditation from Resolution, the association of family lawyers.

Splitting the pension

With equity in residential property being squeezed since the peak of the market in summer 2007, pensions have become a more important element when negotiating a divorce settlement. "It is important to realise that where property is offset against pension, £1 of property does not necessarily equal £1 of pension," says Ms Sharp. "Property as an asset is available now but the pension may not be available for some years, so there is a disparity in the value."

One of the main calculations around pensions is to equalise income in retirement. This will not always mean a 50:50 split since the cost of providing income for women in retirement can be more expensive, taking into account longevity. This may mean they need a larger proportion of the pension pot in order to generate equal income in retirement, particularly after a long marriage.

The first step is to obtain the cash equivalent transfer value (CETV) from the pension trustees. Depending on the type of pension and the way in which it is proposed to be addressed in the context of the divorce, further expert valuation from an actuary and/or input from a financial adviser may be required.

The parties then need to consider how the asset should be dealt with. This can be done in one of three ways:

- Pension Offsetting

This arrangement requires an evaluation of the total assets, including pension schemes, and then splitting those assets between the divorcing couple - usually one party gets the property, and the other the pension. The problem with this arrangement is that pensions and property are two completely different asset classes, making a realistic valuation difficult.

- Pension attachment or earmarking

When the pension starts paying out, the ex-partner has a portion of it reserved for them. "These are not popular as these deferred payments to the other spouse fly in the face of the court's goal to achieve a clean break," comments solicitor and divorce law expert, Caroline Wright at Boodle Hatfield.

- Pension sharing

Most couples will opt for this solution, which essentially sees the pension scheme split, so the other partner can lay immediate claim to their portion.