Standard Life

Pension Post

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For financial advisers only

A Pension Adjustment Order (PAO) is a court order which can be made following a divorce, judicial separation, dissolution of a registered civil partnership and the ending of certain cohabitations. In this issue of Pension Post, Tony Gilhawley, Technical Guidance Ltd, looks at how PAOs work and the options open to the beneficiary of the PAO.

Pension Adjustment Orders

As most current PAOs relate to divorce of a husband and wife where a wife gets a PAO over her ex-husband's pension, for simplicity sake we will refer to this scenario (using Joe and Mary) throughout this update. But as pointed out above, PAOs can also apply to civil partners, married couples of the same gender, and in certain circumstances, to co-habitants, and can equally apply to a husband obtaining a PAO over his ex-wife's retirement benefits.

Scope of PAOs

A PAO can be made by the Courts over all 'pension schemes' including:

- Defined Benefit (DB) and Defined Contribution (DC) employer schemes, including insured one member schemes and SSASs
- Additional Voluntary Contributions (AVCs)
- Retirement annuity contracts (RACs)
- Trust RACs
- Personal Retirement Savings Accounts (PRSAs)
- Buy Out Bonds (BOBs) also known as Personal Retirement Bonds

Where Joe has a number of different pension arrangements, Mary will need to get a separate PAO over each one. Mary can't get a 'jumbo' PAO covering a range of different benefits.

What a PAO does - earmarking

A PAO over Joe's retirement benefits directs the trustees/insurer of the relevant arrangement to split the retirement benefits at retirement and pay part (could be all in some cases) of the benefits to Mary.

Contrary to popular belief, it doesn't say 'give Mary 50% of Joe's fund/benefits'. The PAO specifies two items:

- a relevant period, say 1 January 2003 to 1 July 2013, and
- a specified percentage, for example 50% (but could be any figure up to 100%).

Mary will therefore get, in this example, 50% of the retirement benefits accrued or built up by Joe in the particular arrangement during the period 1 January 2003 to 1 July 2013 (the 'goal post' dates set by the PAO). In this example, the PAO does not extend to any contributions paid before 1 January 2003 or after 1 July 2013.

Example - PRSA	Example – Defined Benefit
Mary gets a PAO over Joe's PRSA fund of €300,000; the relevant period in the PAO is 1 July 2004 to 31 August 2012, and the specified percentage is 50%. Joe's PRSA was funded by single contributions paid as follows: • 1 April 2002: €50,000 • **15 November 2004: €75,000** • **15 November 2012: €25,000** • 1 July 2013: €50,000 You can see that Mary is entitled to 50% of the PRSA fund built up by the bolded contributions paid between the two 'goal post' dates of 1 July 2004 and 31 August 2012 specified in the PAO. When Joe draws on his PRSA fund, the PRSA provider will work out what part of the fund at that time was funded by the two bolded contributions above, and provide 50% to Mary as a retirement fund, and use the balance to provide retirement benefits for Joe. We, therefore, can't tell in advance, what Mary's share of Joe's fund will be wroth, until Joe takes his benefits.	Mary gets a PAO over Joe's DB scheme benefits; the relevant period in the PAO is 1 July 2004 to 30 June 2012, so 8 years, and the specified percentage is 50%. The scheme provides a pension of 1/60th of pensionable salary for each year of service. Joe joined the scheme on 1 July 1995 and his NRA is 1 July 2025, so 30 years potential service to NRA. Under the PAO, Mary will be entitled to a pension of: 50% x 8/60ths x Joe's pensionable salary that is 4/60ths x pensionable salary, which equates to 50% of the pension accrued by Joe between the goal post dates of 1 July 2004 and 30 June 2012. Joe's pension entitlement at retirement, which is 30/60ths x pensionable salary in this example, will be reduced by the pension payable to Mary, (4/60ths), so that his residual pension will be 26/60ths.

If the €75,000 contribution paid into Joe's PRSA above on 15 November 2004 was a transfer value from another arrangement, it is **not** taken into account for Mary's PAO if it relates fully to contributions paid to the transferring arrangement prior to 1 July 2004, the starting goal post date of the relevant period specified in the PAO.

So, you need to look behind transfer values received within the goal post dates to see what part, if any, was itself built up by contributions paid to the previous arrangement between the dates specified in the PAO; only that part is taken into account for calculating the PAO beneficiary's share of the retirement benefits.

The PAO is called 'earmarking' as it places a mark or debt against Joe's future retirement benefits, in favour of Mary. But the debt isn't paid to Mary until Joe actually takes his retirement benefits. It's at that time the benefits are divided between the two of them.

Variation

A PAO can be made subject to future variation or not, as the case may be. If the PAO is subject to future variation, it is open to either of the parties to go back to Court at a later date seeking to have the PAO changed or abolished entirely. However, most PAOs are made as being not subject to future variation, i.e. they are fixed. But you should check in each case.

Nil PAO

You may occasionally come across a so called 'nil' PAO. This is a PAO that has no commercial value to the PAO beneficiary, for example, it may specify a relevant period of a few days and the specified % might be 0.001%.

The purpose of the nil PAO (which is made to be not subject to future variation) is to ensure that the PAO beneficiary cannot come back in the future looking for a share of the retirement benefit in question.

For example, take the Joe PRSA example above. If Joe had a separate retirement annuity (RAC), the deal might be that he is prepared to give her the share of his PRSA but not of the RAC. A nil PAO may therefore be made over the RAC in addition to the normal PAO made over the PRSA; Mary then can't come back later on looking for a larger share of his RAC.

The transfer value option

However, Mary doesn't have to wait until Joe retires. She has an option now, or later but before Joe draws on his benefits, to take the transfer value from his pension arrangement to a PRSA or BOB in her own name, or to an occupational pension scheme she is a member of. She simply applies to the PRSA provider, insurer, or trustees as the case may be and directs them to pay the transfer value to her nominated vehicle.

Note that in relation to a transfer from Joe's occupational pension scheme to Mary's PRSA:

- the 15 year rule does **not** apply to Mary's transfer, so that even if Joe has been in the scheme for more than 15 years, Mary can still elect to transfer her share of his fund to a PRSA
- a Certificate of Benefit Comparison is not required, as Mary was not a member of Joe's scheme

Sit and wait OR take a transfer value?

If Joe's retirement benefits are DC, there are a number of potential disadvantages for Mary in 'waiting' for Joe to take his benefits for her to get her share of his benefits:

- She has no control over Joe's investment decisions. The value of her share of his fund will rise and fall in line with his investment choices. His attitude to investment risk could be totally unsuitable to her
- The timing of the taking of her benefits is dictated by when Joe decides to take his benefits

If Joe's retirement benefits are **DB**, there are potential advantages and disadvantages for Mary in taking a transfer value now, similar to the advantages and disadvantages of a deferred member taking a transfer value from a DB scheme (see the separate Pensions Post on DB schemes). For example:

- the invested transfer value is unlikely to replace the value of her share of Joe's DB benefits given up
- By taking a transfer value, Mary can get access to her benefits before Joe's NRA, which might not be possible under a DB scheme which is underfunded and does not allow early retirement

If Mary takes a transfer value to a PRSA or BOB, she can draw on these benefits at the earliest age Joe could have taken his benefits from his arrangement:

Joe's pension arrangements	Mary can take her benefits in the PRSA or BOB
An occupational pension scheme	From Joe's 50th birthday
A buy out bond	From Joe's 50th birthday
A Retirement Annuity Contract	From Joe's 60th birthday

So if Joe is older than Mary, she may be able to access her PAO benefits in the new arrangement even if she is under age 50 herself.

Revenue maximum benefits

Mary's benefits (even if she takes a transfer value) are deemed to be a retained benefit of Joe's for his Revenue maximum funding purposes under occupational pension schemes. But her PAO transfer value benefits are not deemed to be her benefits for her Revenue maximum funding purposes! Strange but true.

A similar approach is taken in relation to the Threshold limits. Mary's benefits (even if she takes a transfer value) are always deemed to be Joe's for the purposes of the Threshold limit. However, any resulting chargeable excess tax which arises for Joe (by treating her benefits as his) is split between Joe and Mary. See the separate Pension Post on PAOs and the threshold limit, for more details.

Lump sum tax

Joe and Mary are each entitled to their own €200,000 tax free lump sum limit and €300,000 standard chargeable amount limits, when they take their respective lump sum retirement benefits.

But bizarrely as pointed out above, Mary's lump sum and ARF benefit are still treated for the Threshold limit and Joe's Revenue maximum benefits as Joe's!

ARFs and AMRFs

Technically, a PAO can not be obtained over an AMRF or ARF; instead the AMRF or ARF can be split by a Property Adjustment Order. But having said that, you may occasionally come across an AMRF or ARF made subject to a PAO. Revenue has confirmed that a transfer value from an ARF, AMRF or vested PRSA on foot of a PAO or Property Adjustment Order can be made gross, that is without deduction of PAYE.

However, there is some confusion whether Mary, who gets a share of Joe's ARF under a PAO has to establish an AMRF first in her own name, if she does not meet the €12,700 income test at that point, before transferring the balance to an ARF. Some say yes, some say no. Take your pick, it would seem.

Advice

What each side in a PAO needs (Joe and Mary in our example) is good advice.

That's where you come in.