

## **PRINCIPLE OR PRAGMATISM?**

### **THE CURRENT STATE OF FINANCIAL PROVISION ON DIVORCE**

*“It seems to us that any solicitor in any part of Scotland, even if not a divorce specialist, should be able to turn to a statute on financial provision on divorce and find some clear statement of the underlying principles on the basis of which he could advise his client and seek to negotiate a settlement.”*

*Scottish Law Commission, Report No 67 on Aliment and Financial Provision,  
4 November 1981, para 3.37*

There are very few recent reported cases on financial provision. This may be because the Scottish Law Commission’s ambition for what became the Family Law (Scotland) Act 1985 has been achieved. Or it may be because we are back to what the Commission describes as a system which “encourages a process of haggling in which one side makes an inflated claim and the other tries to beat it down.” The report continues, “A battle of nerves ensues, sometimes right up to the morning of the proof. By that time it is known which judge is dealing with the case, and this may become a factor affecting last-minute and hurried negotiations.” This process is deprecated as “calculated to increase animosity and bitterness.” Part of the bitterness could be attributed to the legal expenses incurred in such a process.

#### **Principle versus discretion**

Family lawyers are now more than familiar with the structure of the Family Law (Scotland) Act 1985. We advise clients repeatedly that if a court has to consider the question of financial provision, there are five principles to apply. The first and usually the most important principle is that the net value of the matrimonial property requires to be shared fairly in terms of section 9(1)(a) of the Family Law (Scotland) Act 1985. The principle in section 9(1)(b) requires the court to take fair account of any economic advantage derived by either party from the contributions of the other, and any economic disadvantage suffered by either party in the interests of the other party. The third principle, provides that the court should take fair account of the economic burden of caring for children under the age of 16 (section 9(1)(c)). If one party has been dependent to a substantial degree upon the financial support of the other, then there should be provision to enable that party to adjust over a period of not more than three years (section 9(1)(d)). The court should seek to relieve serious financial hardship that may be suffered as a result of divorce (section 9(1)(e)). Any award of

financial provision should be reasonable having regard to the resources of the parties (section 8(2)).

While the statutory approach is based on principle, in reality the court has a substantial measure of discretion. “Fair sharing” and “fair account” involve an exercise of discretion. The way in which the court balances the application of the various principles may require some subtlety (*Coyle v Coyle* 2004 Fam LR 2). The choice of orders to satisfy the requirements is also a matter for the court’s discretion (*McCaskill v McCaskill* 2004 FamLR 123), albeit subject to the statutory emphasis on a clean break. The court can only order a periodical allowance if the capital awarded is inappropriate or insufficient to satisfy the requirements of the principles, having regard to the resources of the parties (section 13(2)).

There is an uneasy tension in financial provision between the application of principle and the necessity for flexibility. This is best exemplified in the decision of the House of Lords in *Jacques v Jacques* 1997 SC (HL) 20, where their Lordships endorsed the presumption of equal sharing in the net value of matrimonial property, and left it to the court of first instance to determine whether in any given case there were special circumstances justifying departure from equality and the extent of any such departure. Family lawyers may deplore the lack of guidance, but must applaud the adherence to the combined effect of general principle and individual flexibility. Lord Hope referred to this issue in *Little v Little* 1990 SLT 785, the first appeal under the 1985 Act. He spoke of the complicated checklist of provisions set out in the Act, but despite the detail the scheme leaves much to the discretion of the court in “achieving a fair and practicable result in accordance with common sense.”

Trying to detecting consistent application of the principles can be frustrating. In *Coyle v Coyle* Lady Smith expressed the view that Parliament did not, in the 1985 Act, provide that whenever a couple divorce after a marriage in which one has been the breadwinner and one has been the homemaker, the latter must receive extra and compensatory financial provision on divorce. She was however referring to the wife’s argument that her husband had derived an economic advantage from her domestic contributions. Lady Smith did go on to reflect in her orders the wife’s economic disadvantage arising from the sacrifice of her career on marriage. In *Burnside v*

*Burnside* (unreported, Edinburgh Sheriff Court, May 2007) Sheriff Nigel Morrison was faced with academic opinion (Clive, *Edinburgh Law Review* vol 10, p 413; Norrie, *Journal of the Law Society*, July 2006, p 16) to the effect that a woman who chose motherhood over career could be “compensated”. He rejected the concept of “compensation” but not the notion that giving up a career should be taken into account either as a special circumstance under section 9(1)(a) or an economic disadvantage in terms of section 9(1)(b). He decided that the wife should have 60% of the net value of the matrimonial property, plus a periodical allowance for three years to enable her to adjust to loss of support in terms of section 9(1)(d). The outcome could be characterised as generous and demonstrates the breadth of discretion allowed to the court in its application of principle.

*Sweeney v Sweeney* 2004 SC 372 provided a re-examination at Inner House level of both principle and discretion. In *Sweeney* the husband had shares and certain businesses. He argued that the value of these assets was calculated by reference to the sum he would receive on sale, but that if he sold, he would be liable to pay capital gains tax. Accordingly the value of the assets to him was the value net of tax. The Lord Ordinary agreed. The wife appealed. The Inner House rejected the husband’s argument. They said “As a matter of ordinary language ‘the value’ of [any] property which is realisable for money is the price which a hypothetical willing purchaser would pay, and the hypothetically willing seller receive from him, for that property on a hypothetical sale at the date in question. It is not constituted by that price less any costs (including any liability to tax) which the hypothetical seller would incur in the event of such a sale.” They went on to point out that the net value of the matrimonial property required to be shared fairly, which could involve consideration of tax. Furthermore the application of the principle in section 9(1)(a) could not be seen in isolation. The ultimate purpose of the legislation was that any order for payment of a capital sum should meet two criteria, one being that it is justified by the section 9 principles and the other that it is reasonable having regard to the parties resources, at the time the payment is finally made.

In *Sweeney v Sweeney (No 2)* 2006 SC 82 the court made a small allowance for capital gains tax that would arise in respect of assets the husband would be required to sell in order to satisfy the order for payment of a capital sum. That sum had not been

expressly quantified and the allowance was relatively meagre. The moral is that the practicalities of payment must be addressed. If payment means that assets will be realised and tax paid, the calculation should be put before the court.

### **Incidence of taxation**

In the first appeal in *Sweeney*, the court did comment *obiter* that tax will not always be irrelevant to issues of valuation. The example they gave was where shares in a company were valued on a break-up basis. It is inherent in such a valuation that the hypothetical purchaser would offer a price based on the assumption that assets would be realised and costs, including corporation tax would require to be met. The last few years have seen a controversy over the value of shares in companies, where the fixed assets included heritable property that has increased in value. Surveyors have provided a valuation. Accountants have taken account of that valuation in the net asset value. One set of accountants have then deducted from the value of the company tax that would be payable were the asset sold and the other set have resisted any deduction at all. Those resistant to deduction have made the point that the tax has not actually been incurred and unless there is a sale may never be incurred. FRS 19 has been prayed in aid to say that it is inappropriate to make an allowance for tax in audited accounts. That is not however the point. The issue is how much would a willing buyer pay to a willing seller for shares. The buyer of a particular house may be willing to pay (say) £100,000 for the house. If the same buyer is purchasing all the shares in a company that owns the same house and the house has increased in value since its purchase by the company, the buyer will be acquiring a potential future tax debt. If there is limited prospect of the company selling the house the buyer may not be concerned about the potential tax. If it is likely that the company may sell the house then the buyer is likely to want a discount on the value of the shares. How much discount may depend on how soon it is anticipated the company will sell the house. The solution seems fairly obvious, but accountants are still treating the issue as one of principle, rather than adopting a pragmatic approach.

Tax looms large in many cases involving significant assets. It is worth bearing in mind that a transfer of assets from husband to wife may involve the transferor in paying capital gains tax. This is after all a 'disposal'. There are three circumstances where there is no immediate charge to tax:

- a) Where the transfer takes place within the tax year when separation occurs. If spouses separate on 7 April, this gives a year to sort matters out. It can be useful if they have a portfolio of buy-to-let properties in joint names and want to separate out titles so each retains part of the portfolio in his or her sole name. If parties separate on 30 March there is limited opportunity for arranging transfers within the tax year.
- b) Where the item transferred is the matrimonial home. Care is still required. There may require to be an election where the transfer is more than three years after separation, and the transferor has acquired another home. If the house has extensive grounds, the whole value may not be included.
- c) Where business interests are transferred by virtue of a transfer of property order, then gift hold-over relief may apply. In these circumstances it may be inadvisable to resolve matters by Minute of Agreement, rather than court order.

Avoidance of an immediate charge to tax is a mixed blessing. It avoids expense at the time of the transfer, but the transferee takes the property at the base value at which it was held by the transferor, and so may be liable for tax on the whole increase in value if and when the property is finally sold.

### **Partnership**

Partnership presents a problem for the application of principle. The reported cases indicate some confusion. If one of the spouses is a partner, the asset he or she has is the interest in the partnership. That asset cannot generally be 'sold'. The value of the interest will depend on how it could be realised. The partnership agreement, which failing the Partnership Act 1890, will apply. The value of the asset may be the amount that the partner would receive were the business to be sold as a going concern and the partnership wound up. The starting point for valuation is the partner's capital account, to which may be added any additional sums arising from re-valuation of assets or inclusion of assets such as goodwill. The capital account is moveable property. Even if there is heritable property held by or on behalf of the partnership, and this is represented in the accounts, the partner's capital account is generally moveable (see Partnership Act 1890, section 22). In *Marshall v Marshall* 2007 FamLR 48 Lord Hardie had to decide whether farms vested in the husband and his

brother were matrimonial property or partnership property. He applied sections 20 and 21 of the Partnership Act 1890. The land had been purchased using partnership funds and was therefore partnership property. Thus far the case involved the application of principle.

The Lord Ordinary in *Marshall v Marshall* accepted that he required to identify the matrimonial property, calculate its net value and then decide how that value should be shared. However the case seems to have been argued on the basis that the increase in value of the husband's capital account during the marriage was matrimonial property. This is a puzzling approach. A partnership capital account can be compared to a bank account. Money is paid in, money is drawn out. The funds in a bank account at the end of a marriage usually bear no relation to the funds there at the beginning. By the end of a marriage the whole balance is generally matrimonial property. The same analysis could apply to a partnership capital account.

The comparison with a bank account breaks down where the partnership owns heritable property. It could be argued that the value of heritable property held by the partnership at the beginning the marriage should be excluded from the calculation of the net value of matrimonial property, but if the partnership acquires property during the marriage then the whole value of that property in so far as represented in the capital account should be included in the calculation. Again it does not appear in *Marshall* that the matter was presented in this way. It is perhaps unsurprising that the Lord Ordinary finally resorted to pragmatism and awarded £130,000 to the wife as "a capital sum (that) will enable the defender to purchase a suitable house and to live in reasonable comfort."

Confusion over the difference between personal and partnership property caused significant difficulties in the case of *Clark v Clark* 2006 FamLR 90; 2007 FamLR 34. The parties in that case farmed together. The wife sought an incidental order for sale of the farm. The husband did not oppose the sale, which was granted while the divorce was still pending. He then regretted allowing the order for sale to be granted and sought recall on the basis that the farm was partnership property and an order for sale was incompetent. The sheriff held that he was too late to raise the issue of competency after the order had been granted. The sheriff principal refused the

husband's appeal on the basis that it was open to the partners to agree that a partnership asset be sold and the proceeds divided and the husband must be taken to have agreed when he did not challenge or oppose the crave for sale. Partnership remains a difficult area in which practitioners struggle to apply the principles of the 1985 Act.

### **Transfer of property**

In *Wallis v Wallis* 1993 SC (HL) 49 the House of Lords held that where property transferred from one spouse to another by virtue of a transfer of property order, any change in the value of that property since the relevant date should be ignored. The result was that if property increased in value a spouse received a 'windfall' with a transfer of property order. On the other hand courts became reluctant to order transfer as such a 'windfall' was seen to be unfair (see *McCaskill v McCaskill* 2004 FamLR 123). The Scottish Parliament endeavoured to remedy the problem in section 16 of the Family Law (Scotland) Act 2006. In its application to "property transferred" value at the "appropriate valuation date" is substituted for value at "relevant date". The appropriate date is generally the date of the making of an order. The 2006 Act has introduced a new set of problems:

- If an asset is held in joint names, is the whole asset treated as having its current value, or is it only the interest transferred that has current value?
- If the parties each hold shares in a company, and one is ordered to transfer shares to the other, are all the parties' shares treated as having current value, or only the shares transferred?
- What happens if the property transferred is an interest in a partnership?
- What if the property transferred has been in the sole control of one of the parties and he or she has taken deliberate steps to diminish the value. This could occur where parties have shares in a company managed by one of them, and the spouse in charge ceases to channel business through that company, and sets up another.
- In some cases there is a delay between proof and the making of an order. Could a party come back to court and lead evidence of a change in value?
- The Act does allow the court to choose a different "appropriate valuation date" where there are exceptional circumstances, but this should be "as near as may be"

to current value. What are exceptional circumstances? What does it mean to chose a date “as near as may be” to current value?

Thus far there is no reported decision to assist in identifying the principle. Again, parties are left to haggle on a pragmatic basis.

### **Pensions**

The 1985 Act was innovative in its approach to pensions. In section 10(5) it provides that the proportion of any rights or interests of either party in any benefits under a pension arrangement which is referable to the period of the marriage shall be taken to form part of the matrimonial property. In *Burnside v Burnside* (unreported, Sheriff Nigel Morrison, Edinburgh Sheriff Court, May 2007) an attempt was made to apply section 16 of the 2006 Act to the value of the pension, on the basis that a pension-sharing order was to be sought. The pension had increased in value between separation and divorce. The sheriff rejected the argument and took as the value of the pension its cash equivalent transfer value at separation.

There has in the past been much litigation over the value of a pension referable to the period of a marriage. Section 10(8), first introduced in 1996, provides for regulations to prescribe how to calculate the value of a pension for the purposes of the 1985 Act. The current regulations are the Divorce etc. (Pensions) (Scotland) Regulations 2000 (SSI 2000/112). The effect of the regulations is to prescribe valuation by reference to the cash equivalent transfer value of the pension. Where a spouse had a pension before marriage, the value should be apportioned by reference to a formula -

$$A \times \frac{B}{C}$$

Where A is the value of the value of the spouse’s rights or interests in the pension arrangement, C is the period of the membership of that party in the pension arrangement before the relevant date and B is the period of C which falls within the period of the marriage of the parties before the relevant date “and, if there is no such period, the amount shall be a zero” (regulation 4).

What does regulation 4 mean by “membership”? An employee who leaves his or her employment will probably cease to be an ‘active member’ of the scheme but will become a ‘deferred member’. A person who starts to draw a pension will remain a member. If deferred or pensionable membership is included in calculating ‘B’ then this means that part of the value of a pension arising from employment that terminated prior to marriage is matrimonial property. The longer the marriage, the greater the proportion of the value falls to be included. On the other hand if this interpretation is correct, then it is difficult to see when ‘B’ could ever be zero. A pension may taken into account in a first marriage, and then a proportion of the same pension will feature in the second marriage. We have been promised an interpretation any number of times, but there is as yet no reported decision. In the meantime the process of haggling continues.

It could be worse. Suppose, before the marriage a spouse has benefits in a pension arrangement with a particular employer. During the marriage that spouse starts a SIPP and transfers the value of his pension into the SIPP, where, due to prudent investment the value increases. More money is invested in the SIPP during the marriage. How much of the value of the SIPP is matrimonial property? Are there ‘special circumstances’ arguments for unequal sharing of such of the value as is matrimonial property? The questions remain unanswered.

### **Avoidance**

The court can become pragmatic in determining what is matrimonial property. There is a recent example in *AB v CD* 2007 FamLR 53. In that case the matrimonial home and most of the assets acquired by the defender during the marriage were held in an offshore discretionary trust. On the face of matters none of these assets were matrimonial property. On the other hand funds were made available to the defender from the trust at his request. He made decisions about the transactions to be undertaken by the trustees. They did what he asked them to do. They withheld information from the wife until ordered to produce it by the court in Jersey. Even then they delayed in producing accounts. By the time the pursuer received information, the property and funds held in the trust had been distributed. The matrimonial home had been passed to a British Virgin Islands company, which had sold it. The court was satisfied on the evidence that the defender was able to treat the

trust as a “piggy bank” and accordingly that the value of the trust at the relevant date should be treated as matrimonial property.

The court can also be pragmatic about the purpose of an order in terms of the Family Law (Scotland) Act 1985. Enforcement of an order elsewhere in Europe is much easier if the order can be characterised as ‘maintenance’. It can then be enforced under Council Regulation (EC) No 44/2001 (‘Brussels I’, superseding the 1968 Brussels Convention). In *Van den Boogaard v Laumen* [1997] 1 QB 759 the European Court of Justice decided that a lump sum may be “maintenance” if it is fixed to ensure a predetermined level of income, or compensate for the disparity which the breakdown of a marriage creates in the respective living standard of the parties. This contrasts with enforcement of rights in property arising out of a matrimonial relationship, which cannot be enforced under Brussels I. Whether a particular award is maintenance or enforcement of rights in property should be apparent from the judgment of the court. In *AB v CD* Lord Brodie expressly characterised £500,000 of his £1,000,000 award as “maintenance”. Notwithstanding that this was an award calculated by reference to the principle in section 9(1)(a) of the 1985 Act, it was an award to allow the pursuer a means of providing for herself to the extent of some £27,500 for the rest of her life. If an award may require to be enforced in Europe, it is worth inviting the court to consider how much may be treated as “maintenance” for the purposes of Brussels I.

### **Sequestration**

There is another reason for looking at how much of an order for financial provision represents an award of an alimentary nature. This relates to sequestration. There are few cases examining the relationship between the bankruptcy and financial provision, so Sheriff Principal Taylor’s decision in *Lessani v Lessani* 2007 FamLR 81 could make interesting reading. In this case the defender was sequestrated after proceedings commenced. The sheriff nevertheless made an award of financial provision and the defender appealed.


The difficulty of principle in the case was to decide how much of the award fell to rank as a debt in the defender’s sequestration and how much remained for the defender to pay. In *Crichton v Crichton’s Trustee* 1999 SLT (Sh Ct) 113 Sheriff

Principal Hay decided that capital sum awarded in the action of divorce was a contingent debt due by the debtor as from the date of raising of the action, and the former husband in that case was entitled to be ranked as an ordinary creditor in his wife's sequestration respect of the capital sum. In so far as a capital sum is a contingent debt the sum requires to be determined and claimed from the trustee. If it is not determined and claimed it will be lost. Section 55 of the Bankruptcy (Scotland) Act 1985 provides for discharge of the bankrupt from the debts for which he was liable at sequestration. There is however an exception for aliment and "any sum of an alimentary nature" (other than aliment due on the date of the sequestration, which must be claimed from the trustee). In *Lessani* the sheriff had made an award under section 9(1)(c) in respect of the burden of child care borne by the wife. He had however capitalised the award, and included it in the capital sum payable on divorce. The sheriff principal was satisfied that the capital awarded by reference to section 9(1)(c) was a sum of an alimentary nature, and fell to be paid by the defender notwithstanding his sequestration and subsequent discharge.

### **Conclusions**

The absence of recent reported cases may be because the 1985 Act sets out such a clear statement of the principles to be applied that there is no need to have recourse to the courts. The Act is straightforward to apply in simple cases, but how many cases are simple? Are parties reluctant to litigate in cases where there are real problems in applying the principles? Do we have last-minute and hurried negotiations, leading to animosity and bitterness? Are parties opting for pragmatism of their own, rather than resorting to the uncertain discretion of the court?

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