FINANCIAL PROVISION ON DIVORCE:
BEYOND EQUAL SHARING

Janys M Scott QC
28 October 2013

Introduction

[1] The Family Law (Scotland) Act 1985 has been with us for 27 years. The Act has provided a clear framework for financial provision on divorce. It is not overburdened with intricacies. The application of the Act remains the search for "a fair and practicable result in accordance with common sense", as Lord President Hope explained in the first appeal (*Little v Little* 1990 SLT 785). However the flexibility of the legislation means that there is scope for disagreement. The developing complexity of the law in other areas has its impact on the application of the 1985 Act.

How far to push percentages

[2] The first principle for an award of financial provision is that the net value of the matrimonial or partnership property should be shared "fairly" in terms of section 9(1)(a). It is inevitable that views on what is "fair" will differ. The net value is taken to be shared fairly when shared equally or in such other proportions as are justified by special circumstances (section 10(1)). "The presumption is thus for equality" as Lord Jauncey put it in *Jacques v Jacques* 1997 SC (HL) 20. But if the presumption can be displaced, how should the legislation work? We tend to spend much time on when equality may be displaced, but less on the issue of how. And the law on "how" is not particularly coherent. I would like to propose that we should start with the circumstances, not with the proportions.

[3] We all know that the question of whether or not particular circumstances are "special" and if so what, if any, effect they should have on the outcome of the case, is a matter for the sheriff or Lord Ordinary hearing the case. The House of Lords was clear about this in *Jacques v Jacques.* Section 10(6) provides an illustrative list of possible "special circumstances", but just because there are circumstances that feature in that list will not necessarily justify departure from equal sharing. The sheriff or judge must be satisfied that equal sharing would not be fair in the circumstances of the case. This makes it difficult for a practitioner to advise on whether a "special circumstances" argument will be successful, but equally it makes it difficult for the sheriff or judge to decide a case where it is said that equal sharing is not fair. Advancing broad propositions about percentages is not necessarily going to assist the court.

[4] There are three oft-cited cases in relation to unequal sharing. Revisiting them sheds some light on why percentage arguments are not always the right approach. In *Davidson v Davidson* 1994 SLT 506 the net value of the matrimonial property was agreed at £177,000, invested in a farm acquired by the wife from the proceeds of inherited shares. The husband was awarded a capital payment of £60,000, but the case is not authority for the proposition that an appropriate percentage in a case "like this" is one third. Although the Lord Ordinary referred to "special circumstances", he also referred to the serious financial hardship that would be suffered by the husband when he no longer had the matrimonial home to live in. He mentioned section 9(1)(e), which requires the court to apply the principle that a person who seems likely to suffer serious financial hardship as a result of divorce should be awarded such financial provision as is reasonable to relieve him of hardship over a reasonable period. More than one principle was being applied. The sum of £60,000 was awarded to allow the husband to acquire a home. The reasoning was practical and linked to his needs, not to any abstract percentage calculation.

[5] *R v R* 2000 Fam LR 43 was a similar case where the husband had realised inherited and donated assets and used the proceeds to buy farmland. The matrimonial property worth some £1,200,000 could all be traced back to inheritance and donation. The wife was awarded a capital sum of £380,000. While this was about 30% of the net value of the matrimonial property, Lord Eassie does not mention any percentage. He pronounces himself satisfied that the circumstances justify a departure from equal sharing, but then balances this consideration against the economic advantage derived by the husband from the wife's contributions and the economic disadvantage she suffered as she could not "follow up on independent economic activity because of her maternal and marital responsibilities" (in terms of section 9(1)(b)). He also referred to the burden of child care

(section 9(1)(c)), and mentioned the issue of adjustment to loss of support (sections 9(1)(d)), which was in the circumstances dealt with in the award of a capital sum. In other words the £380,000 was a pragmatic award of a sum that the judge considered satisfied all the principles in play in the case.

[6] There are cases where judges do turn to percentages, but only after doing the practical exercise of making decisions on individual assets. For example in *MacLean v Maclean* 2001 Fam LR 118 Lord Rodger examined a much more complex farming situation. He made decisions about the different elements of the case, taking out certain property altogether, and then deciding how the balance should be shared. He came to the view that a 75%:25% division was appropriate. This was however on a reasoned basis, after examining each item of property. It is one of the best cases for a percentage approach under section 9(1)(a), but it is not the easiest case to follow on its facts and Lord Rodger proceeds immediately from the mention of percentages to pointing out that the defender would be entitled to the specific sum of £235,000.

[7] There is a better illustration of the point in Lord Tyre's decision in *B v B* 2012 Fam LR 65. He uses the language of "allocation". He allocated to the pursuer the value of property that represented his pre-matrimonial assets, the value of which "effectively remained outside the pool of common wealth of the family" and divided the balance equally. He then expressed the division in the form of percentages of the total matrimonial pot, which had the effect of some "rounding". He went on to deal with some reallocation of the actual property and consequent adjustments of the amount awarded, but the net effect was an award that left the pursuer with 60% of the net value of the matrimonial property. This percentage was reached after careful calculation and consideration of the arguments relating to the individual items of property. It was not an arbitrary choice of a particular proportion.

[8] "Pure" percentages have been used in cases where the foundation for a business has pre-dated the marriage, but by the relevant date the whole business is matrimonial property. The Lord Ordinary shaved a token 2% off the value to be shared in *Sweeney v Sweeney* (see Inner House decision at 2004 SC 372, para [7]). The same approach was taken in *Watt v Watt* 2009 Fam LR 62, albeit the Lord Ordinary then awarded the wife 48% of the whole value of the matrimonial property, not just the value of the business.

[9] Detecting principles in "special circumstances" cases is notoriously difficult, but there may be a theme. Unless the court is recognising an argument for a *de minimis* connection with pre-marital property by a nominal reduction, then percentages have to be justified. An argument that a particular percentage reduction or increase should be made should be

backed by more precise calculations of why there should be a particular award. This is at variance with some of the earlier cases, such as *Loudon v Loudon* 1994 SLT 381 (of which more below), but there is an argument that we have become more sophisticated in our application of the principles of section 9.

Fair sharing and resources

[10] That brings me to the link between "special circumstances" and "resources". These two theoretically fall to be considered at quite different stages of the financial provision exercise. The former affect how the net value of the matrimonial property should be shared and the latter may temper the extent of an award, if there are difficulties over payment. This is the effect of section 8(2) which requires any award of financial provision to be (a) justified by the principles in section 9 and (b) reasonable having regard to the parties' resources.

[11] Around ten years ago we had a dispute about how the court should treat cases where an asset in a party's hands would, if sold, be subject to capital gains tax. In *Sweeney v Sweeney* the Lord Ordinary had deducted potential capital gains tax from the net value of the matrimonial property when he carried out the valuation exercise. The Inner House held that this was an error (*Sweeney v Sweeney* 2004 SC 372). Hypothetical tax cannot be taken into account when assessing the value of property. The court did however recognise that the incidence of tax could be taken into account in the exercise of fair sharing, or when having regard to the resources of the parties. Following their decision in principle, the Inner House returned to this case in *Sweeney v Sweeney (No 2)* 2006 SC 82 and made a small allowance for the possibility of capital gains tax arising on the anticipated disposal of certain assets.

[12] We waited until this year for the first major case to follow *Sweeney* and recognise the effect of tax on an award of financial provision. This was *W v W* [2013] CSOH 136. The case was unusual in so far as the husband had established a company with a colleague prior to marriage. The two of them were equal shareholders and co-directors. During the marriage the husband gave nearly half his shares to the wife. She was keen to transfer them back to him in return for a capital payment. He and his colleague were actively looking for a buyer for the business. If the wife was ordered to transfer her shares back to the husband, then holdover relief would apply. She would not be liable to pay capital gains tax. The husband would however bear the tax due on the increase in value of her shares as and when the shares were sold. The argument ran that it would be unfair for the husband to "pay" full value for the shares, when he would then be liable for capital gains tax on sale. The Lord Ordinary proceeded on the basis that there would be a sale, and that being so, it was appropriate to regard the current value of the pursuer's shares as including "an element of locked-in tax liability whose burden she will not bear if her shares are transferred to the

defender with the benefit of hold over relief". He deducted 10% of the value of the shares which he ordered to be transferred. It is important to recognise that this figure was not plucked from the air. The defender would, on sale of the shares, pay capital gains tax, presumably at the entrepreneurs' relief rate of 10%.

[13] There is a more extreme example in *M v M and W Estate Trustees* 2011 Fam LR 24. In that case the husband's business had been worth about £200,000,000, but it had collapsed. By the relevant date it was worth only £4.6 million and by the time of proof there was nothing left. The wife's financial provision was to come out of a trust that the husband had established for the benefit of his children by other women. If the value of the company at the relevant date were included in the sharing exercise, the wife's award could have exceeded the value of the trust. Lady Clark left out the value of the company altogether. She also left out the value of a loan of £2.2 million by the husband to the company, which she held was irrecoverable. Leaving out these sums was part of her decision on special circumstances, but explicitly made with reference to the issue of resources.

Fair sharing and other principles

[14] As already seen, there is an interesting relationship between the requirement to share fairly the net value of the matrimonial property and the application of the other section 9 principles. The starting point in relation to an award of financial provision is usually the sharing of the net value of the matrimonial property (*Cunniff v Cunniff* 1999 SC 537 and *Coyle v Coyle* 2004 Fam LR 2 at para [50]). The court then moves on to consider any other relevant principles. These principles do not however necessarily relate to the sharing of the net value of the matrimonial property. There may be no matrimonial property to speak of, in which case the point is clear. The court may have to consider other principles alone, as in for example *De Winton v De Winton* where there was no matrimonial property and the wife relied on the principle in section 9(1)(b) relating to economic advantage and disadvantage. Or *Haugan v Haugan* where the only point related to avoiding serious financial hardship to the wife (section 9(1)(e)).

[15] Matters are more difficult when the court is required to share fairly and at the same time to apply another principle or principles. This may result in one of the parties receiving a fair share of the net value of the matrimonial property (which may or may not be an equal share), plus something else on top. The law requires the overall result to satisfy all the relevant principles (see *Sweeney v Sweeney (No 2)* 2006 SC 82 para [14]). The principles in section 9 are interrelated. Section 11(2)(b) requires the court to consider whether an imbalance in economic advantage and disadvantage between the parties has been corrected by a sharing of the value of the matrimonial property or otherwise…" So, for example, if a

spouse has suffered the economic disadvantage of giving up work to look after children for the purposes of section 9(1)(b), this may be corrected by sharing in the value of a business meantime built up by the other spouse under section 9(1)(a). A capital sum or transfer of property awarded under section 9(1)(a) may provide for adjustment to loss of support or alleviate what would otherwise be serious financial hardship within section 9(1)(d) or (e) (section 13(2); *McConnell v McConnell (No 2)* 1997 Fam LR 108; *W v W* [2013] CSOH 136 at para [63]).

[16] Lord Macfadyen in *Jackson v Jackson* 2005 Fam LR 108 (at 95-38 to 42) possibly went further. He held that if a party fails to displace the presumption of equal sharing, that party cannot traverse the same ground again under the guise of applying section 9(1)(b). He was clearly unhappy with *Loudon v Loudon* 1994 SLT 381, where Lord Milligan had increased the wife's percentage of the net value of the matrimonial property under reference to the principle in section 9(1)(b). Lord Madfayden's comment was to the effect that the proper relationship between section 9(1)(a) and section 9(1)(b) did not seem to him to have been properly worked out. He was inclined to explain *Loudon* by saying that the section 9(1)(a) principle dictated equal sharing of the value of the matrimonial property, but the section 9(1)(b) principle then came into play as a separate justification for a different order of financial provision from the one which would have been justified if regard had been had to only section 9(1)(a). The same might be said for *Davidson v Davidson* and *R v R.*

Redistribution of assets

[17] There is increasing recognition that the court has a role in 'redistributing' assets on divorce. This is not in itself a question of "special circumstances" as was pointed out long ago by Sheriff Principal Macphail in *McCaskill v McCaskill* 2004 Fam LR 123. Whether to order transfer of property is " a discretionary decision to be based on a careful examination of the circumstances". The Inner House carried matters a stage further in *Murdoch v Murdoch* 2012 SC 271. They held that it is competent to order transfer of property on the basis that the recipient would make a counter-balancing payment, even if the payee had not craved the payment. In other words a party cannot prevent transfer by refusing to ask for a capital sum in return. If a redistribution of assets is a "fair and practicable result in accordance with common sense", the court can proceed, and order any necessary balancing payment. It may not even be necessary for the intending payee to seek an order in these terms, although the Inner House in *Murdoch* did allow amendment to insert a crave relating to the proffered balancing payment.

[18] We now seem to have settled down to a pragmatic interpretation of section 10(3A) of the Family Law (Scotland) Act 1985 that requires matrimonial property to be valued at the

relevant date, with a view to sharing that value, but then in the course of 'redistribution' property is exchanged at its current value. This was the intention of the 2006 amendment (Family Law (Scotland) Act 2006, section 16) addressing the adverse effects of *Wallis v Wallis* 1993 SC (HL) 49. Thus in *W v W* [2013] CSOH 136, the wife was due to pay about £950,000 to the husband on the basis of equal sharing of values at the relevant date, but she wanted the house and wanted to transfer to him her shares. The overall effect, if these transfers were made, was that he was going to have to pay a balancing capital sum to her. The valuation exercise for the court related to current, not relevant date, values of the house and shares.

Recovering assets from third parties

[19] This summer we were treated to a Supreme Court decision in an English case, finding that heritable properties held by limited companies were available for distribution to the wife on divorce. This was the case of *Prest v Petrodel Resources Limited* [2013] UKSC 34. The High Court in England had ordered the transfer of the properties from the companies to the wife, on the basis that the wife was not otherwise likely to receive any part of the ancillary relief due to her. The Supreme Court agreed that in the circumstances of that case the order was appropriate and competent. This was not because the court was entitled to disregard the separate legal persona of the companies. The "corporate veil" remained firmly in place. It was not because the power to make such a transfer could be inferred in the English Matrimonial Causes Act 1973. It was rather because the companies could be regarded as holding the properties in trust for the husband. The "beneficial ownership" had never passed to the companies. The properties had been notionally vested in the companies for a nominal consideration or the purchases had been funded by the husband. In these circumstances there was a "resulting trust" in his favour. It is highly unlikely that a Scottish court would reach a similar result. Scots law does not recognise "resulting trusts" of this nature. A trust over heritable property generally requires to be constituted in writing (Requirements of Writing (Scotland) Act 1995, section 1(2)).

[20] The closest Scotland has come to the decision in *Prest v Petrodel* was in *AB v CD* 2007 Fam LR 53 where Lord Brodie accepted that an offshore discretionary trust was run for the husband's sole benefit, and treated the value of the trust assets as part of the matrimonial property. This was part of the valuation exercise. Lord Brodie did not order transfer of trust assets to the pursuer. The assets were not in any event still held by the trust. If a party seeks payment out of property transferred to a third party, he or she will have to make a case for setting aside the transfer under section 18 of the Family Law (Scotland) Act 1985, as occurred in *M v M and W Estate Trustees* 2011 Fam LR 24. There the husband had transferred

considerable wealth to a trust set up for his children (born to women other than his wife). By the date of divorce he had no resources and the trust was the only source of funds to satisfy the wife's claim. Section 18 is however only a partial answer. The third party may dispose of the property, although there can be interdict to prevent this (*M v M and Wards Estate Trustees* 2009 SLT 750). The court cannot set aside or vary a transaction if this would prejudice the rights of third parties acquired in good faith, for value. The power only applies to transactions effected by the other person not more than five years before the making of the claim.

[21] Even where there has not been a transfer to a third party, their involvement in matrimonial property or current assets may cause difficulties. The Family Law (Scotland) Act 1985 deals with third parties in section 15. An order for transfer may require the consent of a third party. In the ordinary situation of a secured loan, then the standard security will usually impose a requirement of consent before there can be a transfer of property (see eg. *McNaught v McNaught* 1997 SLT (Sh Ct) 60). No incidental order can be made so as to prejudice the rights of a third party who has been exercising those rights immediately before the order under consideration. In *W v W* the transfer of shares by the wife to the husband required the consent of the husband's co-shareholder and co-director. Equally, were she to retain her shares she was concerned about her position as a minority shareholder and demanded the protection of an agreement that the third party would not give.

Sequestration

[22] Matters are particularly frustrating if a spouse or civil partner has been sequestrated. A sequestration introduces a third party with an interest in the litigation, this is the debtor's trustee. It is no good trying to divert property away if sequestration looks likely, as the trustee may apply for recall of an order for payment of a capital sum or a transfer of property order, or for that matter a pension-sharing order (Bankruptcy (Scotland) Act 1985, section 35). If a spouse or civil partner is sequestrated he or she will have a personal interest in divorce, and in relation to pension-sharing and aliment, but the trustee will have an interest in other financial aspects of the divorce. The first point to make is that there must be intimation to the trustee and the trustee has an interest in entering the process as a defender to the action.

[23] The second point is that if a sequestration takes place while proceedings are pending, it may be dangerous to stop. If on the date of sequestration a claim has already been made then it will probably be treated as a contingent debt, which requires to be evaluated and then to rank for payment (see *Crighton's Trustee v Crighton* 1999 SLT (Sh Ct) 113). If the claim

is not pursued, it may be lost. It is not clear what will happen if separation occurs before the sequestration, but divorce proceedings are commenced after the debtor's discharge.

[24] If the sequestration occurs while the proceedings are pending it may well be worth pressing on with a claim for a capital sum, just so long as there is likely to be some estate for the trustee to distribute. An obligation to pay a capital sum due on the date of sequestration, will rank for a dividend from the trustee. A claim pending in divorce proceedings is a "contingent debt". The trustee is strictly responsible for evaluation of the claim (Bankruptcy (Scotland) Act 1985, sch 1 para 3), with the possibility of appeal to the sheriff, but if the claim is evaluated as a result of an order for payment of a capital sum in the course of divorce proceedings, the trustee will generally accept this as determining the value of the claim. The larger the capital sum with reference to the other debts, the greater the proportion of the estate will be paid to the spouse as creditor. This is not a case where the court should reduce a claim having regard to the payer's resources.

[25] On the other hand there is unlikely to be much point in pressing on with a claim for a transfer of property. The estate of a sequestrated debtor vests in his trustee (Bankruptcy (Scotland) Act 1985, section 31(1)). The trustee cannot be ordered to transfer the property. A statutory transfer to the trustee cannot be set aside under section 18 of the 1985 Act. Discharge of the debtor will not generally result in property being restored to him or her. Administration of the sequestration may go on after the discharge. That is the trustee may continue to realise assets and deal with payment of debts.

[26] The most productive claim may well be for a pension sharing order. Unlike an order for payment of a capital sum, a pension sharing order may be satisfied in full. This is because a pension does not vest in the trustee. The assets of an occupational pension scheme will not vest in the trustee. Tax-approved pensions and potentially some unapproved pensions are excluded from the property to vest in the trustee by sections 11 and 12 of the Welfare Reform and Pensions Act 1999 (subject to recovery of excessive contributions under section 36Aff). Private pensions are now essentially in the same position as occupational pensions. This sets up a tension between the debtor spouse and his trustee. The spouse has an interest in the pension. He or she will want to protect the pension and may urge the court to make an order for a capital sum. The trustee will require to protect the estate and can do so if a pension sharing order is made to satisfy as much as possible of the claim for financial provision. The claiming spouse or civil partner is likely to have a common interest with the trustee on this aspect of the case.

[27] Matters are more complex in relation to aliment and periodical payment. Aliment due on the date of sequestration is a debt and should be claimed from the trustee. Aliment or periodical allowance due after the date of sequestration cannot be claimed from the trustee (Bankruptcy (Scotland) Act 1985, section 22(9) and sch 1 para 2) but remains payable by the debtor. The debtor's income is available to make alimentary payments (section 32(3)). When the debtor is discharged, this does not discharge an obligation to pay aliment, or any sum of an alimentary nature that could not be claimed from the trustee (section 55(1)(d)). This can give rise to an interesting possibility. If an award of financial provision is characterised as being of an alimentary nature, it will be due from the spouse, not the trustee. In *Lessani v Lessani* 2007 Fam LR 81 the wife was awarded a capital sum under section 9(1)(a) and an additional payment under section 9(1)(c), calculated on the basis of the income she required to care for her son until he attained the age of 16. The first part of the award was enforceable against her former husband's trustee, but the sheriff principal characterised the second part as alimentary. That second part was then enforceable against the husband.

[28] The relationship between financial provision and sequestration is interesting and may well be an area where the law will develop. A trustee served with intimation of proceedings should recognise that he has an interest. A trustee who fails to sist himself or herself as a party may still be found liable in expenses of vindicating a claim against the debtor's estate (*Miller v McIntosh* (1884) 11 R 729).

Foreign property

[29] Property beyond the realm is not beyond sharing in the course of financial provision. There has been a vogue among wealthy spouses to buy a property in Spain, or some other part of Europe, or the world. Property overseas will form part of the assets of a spouse and may therefore be matrimonial property. The court may make orders ancillary to an action for divorce, notwithstanding that property is located outwith the jurisdiction. This is the effect of the Domicile and Matrimonial Proceedings Act 1973, section 10. The section has an unfortunate history. It was drafted to refer to a list of orders in schedule 2, which came to include orders for financial provision under the Family Law (Scotland) Act 1985 (para 12B). However section 10 was amended by the Children (Scotland) Act 1995 to refer to ancillary orders generally, without specific mention of the schedule, which in consequence has been left stranded. This has not assisted practitioners concerned to establish the competency of seeking orders relating to overseas property.

[30] There is however some comfort. In *Connolly v Connolly* 2005 Fam LR 106 the Inner House made orders for transfer and sale of heritable property in the Republic of Ireland. Competency was not debated. The orders operated against the parties themselves. Failure

to obtemper such an order would be contempt of court. There could be no question of the order operating directly against the property. The Division made this order because the parties were unlikely to co-operate in sale of the Irish property. It was therefore transferred to the wife, so she could sell and the proceeds be divided between the parties in accordance with the court's determination of financial provision, and allowing for payment of arrears of aliment.

Conclusions

[31] We may be seeing a more sophisticated and analytic approach to the Family Law (Scotland) Act 1985 as it meets the challenges of a changing legal, financial and social context. The basic structure of the Act does however stand the test of time. It continues to be capable of delivering a fair and practicable result, in accordance with common sense.

Lecture delivered at the CLT Scotland Family Law Conference, Murrayfield Stadium
28 October 2013