THE CHARTERED INSURANCE INSTITUTE

AF2

Advanced Diploma in Financial Planning

Unit AF2 – Business financial planning

April 2013 Examination Guide

SPECIAL NOTICES

Candidates entered for the October 2013 examination should study this examination guide carefully in order to prepare themselves for the examination.

Practice in answering the questions is highly desirable and should be considered a critical part of a properly planned programme of examination preparation.

AF2 – Business Financial Planning

Contents

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Telephone: 020 8989 8464
Fax: 020 8530 3052
Email: customer.serv@cii.co.uk

IMPORTANT GUIDANCE FOR CANDIDATES

Introduction

The purpose of this Examination Guide is to help you understand how examiners assess candidates' knowledge and their ability to apply this to a case study scenario. You can then use this understanding to help you in your preparation for the examination.

Before the examination

Study the syllabus carefully

This is available online at www.cii.co.uk or from Customer Service. All the questions in the examination are based directly on the syllabus. *You will be tested on the syllabus alone,* so it is vital that you are familiar with it.

There are books specifically produced to support your studies that provide coverage of all the syllabus areas, however you should be prepared to read around the subject. This is important particularly if you feel that further information is required to fully understand a topic or an alternative viewpoint is sought. The reading list which can be found with the syllabus provides valuable suggestions.

Note the assumed knowledge

For the Advanced Diploma in Financial Planning, candidates are assumed to have studied the relevant units of the Diploma in Financial Planning or the equivalent. This knowledge is set out on the relevant syllabus.

Read widely

If you do not have experience in advising clients whose financial needs are relatively sophisticated, *it is quite unrealistic to expect that the study of a single textbook will be sufficient to meet all your requirements.* While books specifically produced to support your studies will provide coverage of all the syllabus areas, you should be prepared to read around the subject. This is important, particularly if you feel that further information is required to fully understand a topic or an alternative viewpoint is sought. It is vital that your knowledge is widened beyond the scope of one book. The reading list which can be found with the syllabus provides valuable suggestions.

Make full use of the Examination Guide

This Examination Guide contains a full examination paper and model answers. The model answers show the types of responses the examiners are looking for and which would achieve maximum marks, *However, you should note that there are alternative answers to some question parts which would also gain high marks.* For the sake of clarity and brevity not all of these alternative answers are shown.

This guide and previous Examination Guides can be treated as 'mock' examination papers. Attempting them under examination conditions as far as possible, and then comparing your answers to the model ones, should be seen as an essential part of your exam preparation. The examiner's comments on candidates' actual performance in each question provide further valuable guidance. You can purchase copies of the most recent Examination Guides online at www.cii.co.uk. CII members can download free copies of older Examination Guides online at www.cii.co.uk/knowledge.

Know the layout of the tax tables

Familiarise yourself with the information contained within the tax tables printed at the back of each Examination Guide. These tax tables will be provided to candidates as part of the examination paper. The tax tables enable you to concentrate on answering the questions without having to worry about remembering all the information. *Please note that you are not allowed to take your own tax tables into the examination.*

Know the structure of the examination

Assessment is by means of a three-hour written paper in two sections. All questions are compulsory:

Section A consists of one case study, worth 80 marks. You will be expected to carry out a variety of tasks, after analysing the information provided.

Section B consists of two shorter case studies worth a total of 80 marks. Again you will be expected to carry out a variety of tasks based upon the information provided.

Each question part will clearly show the maximum marks which can be earned.

Appreciate the standard of the examination

Candidates must demonstrate that they are capable of advising clients *whose overall levels of income and capital require a more sophisticated scheme of investment* than is normally prepared by a Certificate level adviser. These clients require a critical appraisal of the various financial planning options available to them.

Read the Advanced Diploma in Financial Planning information for candidates and important notes for candidates

Details of administrative arrangements and the regulations which form the basis of your examination entry are to be found in the current Advanced Diploma in Financial Planning Information for Candidates and important notes for candidates, which is *essential reading* for all candidates. It is available online at www.cii.co.uk or from Customer Service.

In the examination

The following will help:

Spend your time in accordance with the allocation of marks:

- The marks allocated to each question part are shown on the paper;
- If a question has just two marks allocated, there are likely to be only one or two points for which the examiner is looking for, so a long answer is wasting valuable time.
- Conversely, if a question has 12 marks allocated, a couple of lines will not be an adequate answer. Always remember that if the paper is not completed, your chances of passing will be reduced considerably.
- Do not spend excessive time on any one question; if the time allocation for that question has been used up, leave some space, go on to the next question and return to the incomplete question after you have completed the rest of the paper, if you have time.

Take great care to answer the question that has been set.

- Many candidates leave the examination room confident that they have written a 'good' paper, only to be surprised when they receive a disappointing result. Often, the explanation for this lies in a failure to think carefully about what the examiner requires before putting pen to paper.
- Highlighting key words and phrases is a technique many candidates find useful.
- The model answers provided in this Examination Guide would gain full marks. Alternative answers that cover the same points and therefore answer the question that has been asked would also gain full marks.

Tackling questions

Tackle the three questions in whatever order feels most comfortable. Generally, it is better to leave any questions which you find challenging until you have attempted the questions you are confident about. Candidates' should avoid mixing question parts, (for example, 1(a)(i) and (ii) followed by 2(b)(ii) followed by 1(e)(i)) as this often leads to candidates unintentionally failing to fully complete the examination paper. This can make the difference between achieving a pass or a narrow fail.

It is vital to label all parts of your answer correctly as many question have multiple parts to them (for example, question 1(a) may have parts (i), (ii) and (iii)). Failure to fully distinguish between the separate question parts may mean that full credit cannot be awarded. It is also important to note that a full answer must be given to each question part and candidates should not include notes such as 'refer to answer given in 1(b)(i)'.

Answer format

Unless the question requires you to produce an answer in a particular format, such as a letter or a report, you should use 'bullet points' or short paragraphs. The model answers indicate what is acceptable for the different types of question.

Where you are asked to perform a calculation it is important to show **all** the steps in your answer. The majority of the marks will be allocated for demonstrating the correct method of calculation.

Provided handwriting is legible, candidates will **not** lose marks if it is 'untidy'. Similarly, marks are not lost due to poor spelling or grammar.

Calculators

If you bring a calculator into the examination room, it must be a silent, battery or solar-powered, **non-programmable** calculator. The use of electronic equipment capable of being programmed to hold alphabetical or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements. The majority of the marks will be allocated for demonstrating the correct method of calculation.

EXAMINERS' COMMENTS

Candidates overall performance

The majority of candidates performed well in questions one and three of the paper. However, some candidates demonstrated a general lack of knowledge concerning the structure, potential liabilities and taxation of Limited Liability Partnerships.

Question 1

Part (a)(i) was well answered by the majority of candidates.

Part (a)(ii) was generally well answered, but some candidates did not seem to have read the question carefully and answered this question as if the Self Invested Personal Pension (SIPP) was buying the boat directly.

In part (a)(iii) not all candidates were able to demonstrate that they understood the implications of a pension scheme holding tangible moveable property.

In part (a)(iv) some candidates were confused on the different rules applying to a Small Self Administered Scheme (SSAS) or a SIPP. A SASS can lend the value of up to 50% of its net assets directly to a sponsoring employer, subject to certain HM Revenue & Customs (HMRC) rules. A SIPP cannot lend directly to a sponsoring employer, but can borrow by way of a mortgage on a property held within the SIPP up to 50% of its net assets.

In parts (a)(iv) and (v) some candidates were confused on the detail of the rules. If a loan is provided to the sponsoring company it must be secured by a first charge, in this case on the dockside land and buildings as the office premises do not have sufficient value to cover the loan and interest.

Part (b)(i) was answered well by the majority of candidates.

In part (b)(ii) some candidates did not identify all of the key issues, such as checking the Articles of Association to ensure the directors had authority to issue shares and that there were no pre-emption rights.

Part (c)(i) was answered well by the majority of candidates.

In part (c)(ii) a few candidates did not make the point that if the deceased shareholder was a non-controlling director, the share value should not be discounted and that intangible assets not on the balance sheet should also form part of the valuation.

Parts (d)(i) and (ii) were both answered well by the majority of candidates.

In part (e)(i) a large number of candidates did not recommend that the Critical Illness policy should be written in trust. Apart from this the question was well answered.

In part (e)(ii) some candidates appreciated that a cross option arrangement could force an ill shareholder to sell against his wishes and that a single option would be more appropriate. However, very few candidates mentioned that if the sale was forced it could create a Capital Gains Tax (CGT) liability and that if assets were replaced by cash, Business Property Relief (BPR) would not apply and a potential Inheritance Tax (IHT) liability could be triggered.

Question 2

Many candidates did not provide the in depth answers the examiners were seeking in this part of the examination, and as a result, this question was not well answered. Candidates are reminded that they should ensure that they are familiar with the Limited Liability Partnership (LLP) and that they are able to compare and contrast its benefits and shortcomings, with those of a sole trader or limited liability company.
In part (a), the main point missed by some candidates, was that as there were only two members, both, have to be designated.

In part (b)(i) a few candidates were able to provide answers to the liabilities of ordinary partnerships. However, some candidates mistakenly stated that each partner was only liable for 50% of the partnership debts. In this scenario this was incorrect, their liability was not only unlimited but also not in proportion to their share of the partnership.

In part (b)(ii) there was some confusion amongst candidates as to what the member's liabilities are in an LLP.

In part (c) the majority of candidates understood that pre conversion each partner was personally liable, but again on conversion to an LLP there was some confusion between what the LLP liabilities were and what the members' liabilities were.

Parts (d)(i) and (ii) were not answered in the depth the examiners required. In part (d)(i) most candidates stated that Graham was mistaken but failed to provide an in depth technical account of why. The treatment of the £20,000 of capital introduced was not well answered.

In part (d)(ii) despite the instruction to the contrary, some candidates went in to great detail about tax submissions and payments. This illustrates the need for candidates to read the question carefully before answering. Many candidates omitted to mention Capital Gains Tax. As far as income tax is concerned they may be subject to the opening and closing year rules, when either joining or leaving the LLP and would be taxed on partnership profits whether drawn or not. In an LLP one of them has to be the 'nominated member' and submit the Partnership tax return to HMRC.

Question 3

In parts (a)(i) to (iv), the question asked candidates to state the purpose of the ratios provided and comment on the results. A number of candidates did not answer in full and lost valuable marks. The ratios were provided, but some candidates changed them and in doing so did not gain marks. The majority of candidates were able to correctly calculate the ratios and make meaningful comments on the trend. To receive full marks candidates should make technical deductions such as 'the quick ratio' has fallen below 1, which means the company cannot meet its current liabilities from its current assets" and not make generalised statements such as the 'quick ratio has fallen and this could have serious consequences'.

The finished goods stock ratio caused some candidates a problem and there were some speculative descriptions of what it portrayed. It is a measure of how long goods are held in stock before being sold.

Part (b) was reasonably well answered but to gain maximum marks candidates needed to have provided an action to improve the ratio and a reason for that action. Marks were not achieved for stating that the action improved the ratio. An example of what was required would be Debtor days - Greater effort required to collect outstanding payments because this improves cash flow.

Part (c) was concerned with Carlotta's maternity and whether she would or would not be eligible for SMP. Candidates provided good answers with the majority being well versed in the finer technicalities of the qualifying criteria.

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AF2

Advanced Diploma in Financial Planning

Unit AF2 – Business financial planning

April 2013 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2012/2013, unless stated otherwise in the question, and should be answered accordingly.

Assume all individuals are domiciled, resident and ordinarily resident in the UK unless stated otherwise.

Candidates should answer based on the legislative position immediately BEFORE the 2013 budget.

Instructions

- Three hours are allowed for this paper.
- **Do not begin writing until the invigilator instructs you to.**
- **Read the instructions on page 3 carefully before answering any questions.**
- Provide the information requested on the answer book and form B.
- You are allowed to write on the inside pages of this question paper, but you must **NOT** write your name, candidate number, PIN or any other identification anywhere on this question paper.
- The answer book and this question paper must **both be handed in personally by you** to the invigilator before you leave the examination room. **Failure to comply with this regulation will result in your paper not being marked and you may be prevented from entering this examination in the future**

Unit AF2 – Business financial planning

Instructions to candidates

Read the instructions below before answering any questions

- **Three hours** are allowed for this paper which carries a total of 160 marks as follows:
  - Section A: 80 marks
  - Section B: 80 marks
- You are advised to spend approximately 90 minutes on Section A and 90 minutes on Section B.
- You are strongly advised to attempt **all** questions to gain maximum possible marks. The number of marks allocated to each question part is given next to the question and you should spend your time in accordance with that allocation.
- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.
- You may find it helpful in some places to make rough notes in the answer booklet. If you do this, you should cross through these notes before you hand in the booklet.
- It is important to show all steps in a calculation, even if you have used a calculator.
- If you bring a calculator into the examination room, it must be a silent battery or solar-powered non-programmable calculator. The use of electronic equipment capable of being programmed to hold alphabetic or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements.
- Tax tables are provided at the back of this question paper.
- Answer each question on a new page and leave six lines blank after each question part.

Subject to providing sufficient detail you are advised to be as brief and concise as possible, using note format and short sentences on separate lines wherever possible.

SECTION A

This question is compulsory and carries 80 marks

Question 1

Aaron, age 52 and Walter, age 57, are the two equal shareholding directors in Seatek Services Ltd, a company that maintains offshore wind farms. The value of the business is £1,200,000. They each own 500 £1.00 nominal ordinary shares, which is the entire issued share capital of the company. They are about to admit another shareholding director, Pieter, next week and he will invest £250,800 in the company by subscribing for £1.00 nominal ordinary shares. All parties have agreed Pieter's share entitlement will be based on the value of the current 1,000 shares.

There is an existing shareholder agreement which states that 'on the death of a shareholder the ownership of his shares shall pass entirely to the surviving shareholder'. There is no provision for compensating the deceased's family in the agreement and so, at the same time that the agreement was drawn up, Aaron and Walter each took out a £300,000 level term assurance policy written to their 65th birthday. Each policy was written in trust for the benefit of their respective spouses. These two policies are still in force and there are no other policies or agreements. Aaron, Walter and Pieter are all in good health and wish to discuss updating the shareholder agreement to ensure there is adequate compensation for their families and also that the arrangement is structured to take advantage of any Inheritance Tax reliefs that are available. They are also concerned that if any of them suffer from future ill health that their co-shareholders would be in a position to buy them out should they wish it.

They have seen a supply boat for sale, which will cost £500,000. In spite of having good accounts and a strong balance sheet, their bank will not provide them with a marine mortgage which is their usual method of financing this type of purchase. They are consequently seeking alternative options and recently asked you if they could use their pension funds to buy the supply boat.

In preparation for your next meeting with them, you have requested details of their current pension values and, in addition, a list of the land and buildings the company owns and their current values. You have been advised that there are no spare funds to make further pension contributions at this time. Your discussions indicated that £200,000 of the cash to be invested in the company by Pieter and £30,000 of the cash currently held by the company could be used towards the purchase of the supply boat. All three directors have advised you that they are prepared to use their personal pension funds to help with the funding shortfall, but whatever method is recommended to raise the capital, the balance sheet must be left in a strong position.

Schedule of cash, land and buildings:

Office Premises	£250,000 owned outright
Adjoining dockside land and buildings	£300,000 owned outright
Cash held by the company	£197,000

Schedule of personal pension funds (PP):

Aaron		**Walter**		**Pieter**	
Company	**Value**	**Company**	**Value**	**Company**	**Value**
Tartan Life PP	£223,000	Leeds Life PP	£240,000	Dover Life PP	£152,000

Questions

*To gain maximum marks for calculations you **must** show **all** your workings and express your answers to **two** decimal places.*

(a) **(i)** List **four** alternative funding options to purchase the boat. **(4)**

(ii) Explain, providing figures to support your explanation, if a self-invested personal pension scheme (SIPP) purchase of the office premises would provide sufficient funds for the company to purchase the boat. **(4)**

(iii) Explain why it would be inadvisable for their combined pension funds to purchase the boat directly, if HM Revenue & Customs consider it to be tangible moveable property. **(5)**

(iv) Explain, providing figures to support your explanation, how the establishment of a small self administered scheme (SSAS) and the use of a SSAS loanback could facilitate the purchase of a boat. **(6)**

(v) Explain, providing figures to support your explanation, any HM Revenue & Customs criteria that have to be met for the SSAS loanback to be approved. **(9)**

(b) **(i)** Calculate, **showing all your workings**, how many £1.00 nominal shares Pieter will receive for his £250,800 subscription. **(5)**

(ii) Explain the formalities that should be observed in issuing Pieter with his shares. **(6)**

(c) **(i)** Explain the inadequacies of the existing share agreement and compensation arrangements that need to be addressed prior to Pieter joining. **(10)**

(ii) Explain, giving your reasons to Pieter as a minority shareholder, the safeguards that can be put in place in a shareholder agreement to ensure his family receive fair value for the loss of his shares on his death. **(10)**

(d) **(i)** Explain to the clients the criteria required to obtain Inheritance Tax business property relief and the benefits of qualifying for it in relation to their circumstances. **(6)**

(ii) Recommend and justify a share protection arrangement which would best fulfil the needs of the **three** shareholders. **(5)**

(e) As directors, they have indicated that they require critical illness cover as part of their agreements.

(i) Explain to them how this arrangement would work in practise. **(5)**

(ii) Explain the potential problems of using a double option agreement and recommend an alternative that could be used. **(5)**

Total marks available for this question: 80

SECTION B

Both questions in this section are compulsory and carry an overall total of 80 marks

Question 2

Graham and Peter have been running a successful electrical contracting business for a number of years. The business is an ordinary partnership with Graham and Peter each owning a 50% share.

Over the last couple of years they have experienced a general downturn in business and an increasing number of late paying customers has caused them to have difficulties with their cash flow.

They are concerned about what would happen to them personally as a result of either a claim for negligence or if the business deteriorates further and needs to be wound up.

Their accountant recommends that they convert from an ordinary partnership to a limited liability partnership (LLP); secondly that having converted to an LLP they should both introduce additional capital of £20,000 from their existing personal assets to help keep the business afloat; and finally that their business relationship be formally documented in an LLP agreement.

Graham and Peter have indicated that they are agreeable to the accountant's recommendations, provided they can receive interest from the LLP on their capital introduced. Graham believes the proposed arrangement will allow them to be paid tax efficiently by taking a low salary with the balance of their income as dividends.

Questions

(a) Explain to Graham and Peter how their administrative responsibilities in the business would increase if the partnership is converted to an LLP. **(6)**

(b) Explain to Graham and Peter their financial obligations to their creditors and each other should the business become insolvent, trading as an:

(i) ordinary partnership; **(6)**

(ii) LLP. **(6)**

(c) Explain how the conversion to an LLP would change the way the partnership might be sued for **any** negligence acts committed, before and after the conversion. **(6)**

(d) **(i)** Comment on the accuracy of Graham's understanding of how remuneration might be taken and any other factors that will influence the style of partners' remuneration if the accountant's recommendations are implemented. **(7)**

(ii) Describe the basis of assessment to tax that will apply to Graham and Peter once the business is converted to an LLP. *In your answer, do not make any reference to either allowable deductions or specific dates of submission/payment.* **(9)**

Total marks available for this question: 40

Question 3

Patricia Baker-Williams is the Managing Director and 85% shareholder of BW Collection Ltd, a small company which manufactures exclusive home furnishings. The other company directors, her husband and two mature children, each own 5% of the company shares. BW Collection Ltd makes branded goods for their main customer, a national department store. However, they also supply furnishings under their own brand to a number of high end furniture stores.

The company has seen its sales decline, which has begun to worry Patricia and she has provided you with the following information from the company's accounts:

Profit and Loss:

	2012 **£**	**2011** **£**
Turnover	3,100,000	3,500,000
Cost of sales	1,700,000	1,800,000
Other operating expenses	1,300,000	1,500,000
Interest	55,000	45,000

Balance Sheet:

	2012 **£**	**2011** **£**
Fixed Assets	500,000	550,000
Stocks	600,000	750,000
Debtors	650,000	700,000
Cash at bank	25,000	75,000
Creditors: amounts falling due within one year	725,000	600,000
Creditors: amounts falling due after more than one year	200,000	100,000

In order to improve the company's sales, Patricia employed Carlotta Delato, a young designer, six months ago. Carlotta has just informed Patricia that she is three months pregnant and has not yet decided whether she would like to continue working or stay at home once the baby is born. Patricia would like Carlotta to continue to be involved in the company in the future.

Questions

*To gain maximum marks for calculations you **must** show **all** your workings and express your answers to **two** decimal places.*

(a) Calculate, **showing all your workings,** each of the following ratios, for the performance of the company in 2011 and 2012, state the purpose of the ratio and comment on the significance of your results.

(i) Operating profit (turnover less cost of sales and operating expenses). **(5)**

(ii) Quick ratio (current assets – stock / current liabilities). **(5)**

(iii) Debtor days ((debtors/sales) x 365). **(5)**

(iv) Finished goods stock ratio ((stocks/costs of sales) x 365). **(5)**

(b) For each of the **four** ratios identified in (**a**) above, recommend **one** action that the company could take to improve the result, giving **one** reason for each recommendation. **(8)**

(c) **(i)** State, giving your reasons, whether or not Carlotta will qualify for statutory maternity pay. **(3)**

(ii) Explain to Patricia the statutory maternity benefits available to Carlotta in respect of leave and pay. **(7)**

(iii) Provide examples of two incentives Patricia could provide to Carlotta to encourage her to return to work. **(2)**

Total marks available for this question: 40

NOTE ON MODEL ANSWERS
The model answers given are those which would achieve maximum marks. However, there are alternative answers to some question parts which would also gain high marks. For the sake of clarity and brevity not all of these alternative answers are shown. An oblique (/) indicates an equally acceptable alternative answer.

Model Answer for Question 1

Candidates would have gained full marks for any four of the following:

(a) (i)
- Find an alternative bank/Private loan/Director loan.
- Find further shareholders/Alternative Investment Market (AIM) listing/share capital.
- Remortgage of Land & Buildings/capital secured against a 1st charge.
- A Self Invested Personal Pension (SIPP) or Small Self Administrated Scheme (SASS) purchase of office/land/buildings.
- SSAS loan back to the company secured on office/land /buildings.

(ii)
- Boat Capital shortfall £270,000/£230,000 cash available.
- There would be a shortfall of £20,000 because the building is only valued at £250,000.
- Purchase of the offices by a SIPP will not give them the funds required.

(iii)
- Because it is tangible moveable property it should not be held in a pension scheme.
- HM Revenue & Customs (HMRC) will view the boat as taxable property and trigger a tax charge.
- And an unauthorised payment charge.

(iv)
- By transferring the directors' personal pension funds into the SSAS.
- With Seatek Offshore Services limited as the sponsoring company.
- It provides a fund of £615,000 in total.
- Up to 50% of the net fund/£307,500 is available to loan back to the company.
- So the shortfall of £270,000 can be provided.
- As the boat purchase is a legitimate commercial expense.

(v)
- The loan of upto 50% is secured as a first charge; on the dockside land and buildings, as they are valued at £300,000.
- The initial valuation must be at least £270,000, plus the loan interest over the life of the loan.
- The interest rate must be 1% above the average base rate of the six main clearing banks.
- The loan must be for a legitimate business/commercial purpose.
- The term of the loan must be less than five years but may be rolled over for a further term of less than five years.
- But only once.
- The loan must be repaid in equal instalments of interest and capital.

(b) (i) Company is worth £1,200,000 and there are 1,000 nominal £1.00 shares issued.
Value per share is £1,200,000 ÷ 1000 = £1,200.
So Pieter will receive £250,800 ÷ £1,200.
= 209 shares.

(ii)
- The Articles of Association should be checked to ensure the directors have the authority to issue shares and there are no pre-emption rights.
- The shares are then issued following an ordinary resolution.
- Companies house must be informed and details of the new owner must be recorded in the Company's register of members/issue new member with a share certificate.

(c) **(i)**

- The value of the company is £1,200,000, so a 50% shareholding will be worth £600,000.
- But the cover is only £300,000 so there is a £300,000 shortfall.
- There is no compunction for the directors to be insured and so their families may not be adequately compensated for their loss of the shares.
- The cover does not increase as the value of the business increases.
- It only provides a sum assured on death and not serious ill health.
- It ceases at age 65, so after that time there is no provision for the family of a deceased director.
- Current agreement does not allow for a new shareholder.

Candidates would have gained full marks for any ten of the following:

(ii)

- The method of valuation should be set out in the agreement.
- It should be conducted by an independent third party and not the company's existing accountants as they will have a potential conflict of interest.
- Between continuing and retiring shareholders.
- It should state that the share valuation should not be discounted.
- If the deceased shareholder is a non-controlling director.
- The valuation would be based on the deceased shareholders stake in the company/not discounted.
- Taking into account intangible assets as well as tangible assets.
- Whether they appear on the balance sheet or not.
- Cross option agreement, to ensure family have option to sell their shares, and can enforce the sale; within a given time period.
- Business property relief is preserved.
- Life cover to have an appropriate sum assured.

(d) **(i)**

- Following a qualifying trade.
- Holdings over 5%.
- Providing the property has been held for two years and there is no binding contract for sale at the time of death.
- Business property relief is a relief reducing IHT.
- By reducing the tax due on the property transferred.
- In the case of your unlisted business by 100%.

(ii)

- Cross option agreement.
- Not a binding contract for sale.
- So preserves business property relief.
- On the share holdings.
- After two years of ownership.

(e) **(i)**

- A policy covering critical illness is written under trust and in the event of a claim the proceeds are paid to the trustees.
- they hold the funds ready to buy out the ill shareholder.
- If the healthy shareholders indicate that they wish to buy the shares.

(ii)

- The ill shareholder has no choice under the terms of a double option agreement than to sell.
- A sale could result in a CGT liability falling on the ill shareholder and in addition, a potential IHT liability.
- As an asset attracting IHT BPR would be replaced by cash.
- Single option.
- So that only the ill shareholder could trigger the sale of his shares.

Model Answer for Question 2

Candidates would have gained full marks for any six of the following:

(a)
- In the case of an Limited Liability Partnership (LLP) with two members both must be designated members/min of two.
- This means they have extra responsibilities such as:
- Appointing an auditor if required.
- Preparing accounts.
- Delivering the accounts to the registrar of companies.
- Advising the registrar of any changes e.g. registered office or name.
- Submitting the completed annual return to the registrar.
- They are accountable in law for failing to carry out these duties.

(b) (i)
- In an ordinary partnership, Graham and Peter are 'jointly and severally' liable for the debts of the business.
- If the business assets are not sufficient to meet the debt, their personal assets are at risk, without limit/bankrupt.
- And not in proportion to their share of the partnership.
- Each partner's private assets are available for the other partner's unpaid debt.
- The partner can then claim a contribution from the other partner that a court would regard as being 'just and equitable'.
- The right to this contribution is lost two years after it accrues.

Candidates would have gained full marks for any six of the following:

(ii)
- As members of an LLP, Graham and Peter will have protection from business creditors.
- Only the assets of the LLP that are at risk.
- Not their individual assets.
- But no individual ('several') responsibility for each other's actions.
- As members of an LLP they may be required to contribute to its assets if there is an asset deficiency on a winding-up, but only to the extent that they had agreed to do so in the LLP agreement.
- Furthermore any withdrawals of capital/high remuneration taken within two years of winding up.
- Could be subject to claw back, if they knew or had reasonable grounds to know that such a withdrawal would result in the insolvency of the LLP.

(c) Acts done pre-conversion:
- As an ordinary partnership, it does not have a legal existence separate from its partners/personal liability of partner.
- So if a partner was negligent prior to conversion then the customer can sue the partners to recover the loss.

Acts done post conversion:
- The LLP is a separate legal entity/is distinct from its members.
- So the LLP will be liable for any act of negligence post conversion.
- The negligent partner (member) will only be liable as well as the firm
- Where he has not made it clear on all documentation that he was acting on behalf of the LLP.

(d) (i)
- Both Graham and Peter can only share in the profits of the business.
- Interest payable by the business to Graham and Peter on the £20,000 capital introduced is not a deductible business expense; but merely an appropriation of profits.
- Payment of a salary to the partners is also an appropriation of profits
- Prior to distribution of the remaining profits in accordance with the LLP agreement.
- Graham's understanding of how remuneration might be paid is incorrect.
- It is not possible for the LLP to pay dividends; as it is a type of partnership, not a limited company with share capital.

(ii)

- The basis of assessment for them will be the same as if they were still partners in an ordinary partnership.
- The tax liability does not fall on the LLP itself.
- Graham and Peter will be subject to taxation individually on their share of the LLP's profits; whether drawn from the business or not; and CGT on the disposal of any partnership assets.
- They may be subject to the opening and closing year rules; applied to Graham and Peter when either joins/leaves the LLP.
- One of them will have to be the 'nominated member' who will have to complete a Partnership Tax Return and submit this to HMRC.
- The partners have to pay their tax and National Insurance Contributions (NIC) under self-assessment.

Model Answer for Question 3

(a) **(i)** 2011

£3,500,000 - £1,800,000 – £1,500,000 = £200,000

2012

= £3,100,000 - £1,700,000 - £1,300,000 = £100,000

- Operating profit is a measure of the profitability of the business.
- It has halved/reduced dramatically.
- Suggesting they have operational issues to investigate and address.

(ii) 2011

(£700,000 + £75,000) / £600,000 = 1.29

2012

(£650,000 + £25,000) / £725,000 = 0.93

- Quick ratio measures company's ability to meet current liabilities from readily realisable assets.
- It has fallen sharply to below 1.
- Meaning the company doesn't have sufficient assets to pay its creditors/meet its liabilities.

(iii) 2011

(£700,000 / £3,500,000) x 365 = 73

2012

(£650,000 / £3,100,000) x 365 = 76.53

- Debtors' ratio shows the average time it takes to collect money owed.
- 73 days is a long time and could be improved.
- It is deteriorating.

(iv) 2011

(£750,000 / £1,800,000) x 365 = 152.09

2012

(£600,000 / £1,700,000) x 365 = 128.82

- How long goods are held in stock before being sold; producing more than they can sell in a reasonable length of time/overproduction.
- The measure is improving but still has a long way to go but they are selling stock more quickly.

(b) **Operating profit**

- Improve operating profit by reducing costs.
- There should be capacity because costs have not fallen in proportion to the reduced sales.

Quick ratio

- Reduce the value of stock in hand.
- In order to turn that value into cash to restore the quick ratio to greater than 1.

Debtor days

- Greater effort into debt collection/offer discounts for quick settlements/invoice factoring.
- Improves cash flow. Improves quick ratio.

Finished goods

- Cut back on production.
- Free up cash tied up in stock.(Improves cash flow and quick ratio.)

(c) **(i)**

- Yes. Carlotta will qualify for Statutory Maternity Pay (SMP) because she will have worked for BW Collection Ltd for more than 26 weeks; before the 15th week before the baby's due date.

(ii)

- Carlotta will be entitled to paid leave whilst pregnant to attend appointments made on the advice of a registered medical practitioner, midwife or health visitor.
- She will be entitled to at least 52 weeks' maternity leave.
- BW Collection Ltd must allow Carlotta to return to her old job and must also 'seriously consider' any request by Carlotta to return to work on a part-time basis.
- It is illegal for new mothers to return to work where within two weeks of giving birth.
- Under SMP Carlotta will be paid at 90% of her average weekly pay for the first six weeks.
- Followed by 33 weeks at the lower of the above level or; a flat weekly rate set for each tax year (£135.45 for 20012/13).

Candidates would have gained full marks for any two of the following:

(iii)

- Could offer a share option scheme.
- Patricia could offer Carlotta a back to work bonus.
- Carlotta could be given the option to work from home.
- Childcare vouchers.

All questions in the October 2013 paper will be based on English law and practice applicable in the tax year 2013/14, unless stated otherwise and should be answered accordingly.

The Tax Tables which follow are those that were used in the April 2013 examination. The October 2013 examination will use the published 2013/14 Tax Tables which can be found online on the CII website: www.cii.co.uk

INCOME TAX

RATES OF TAX	2011/2012	2012/2013
Starting rate for savings*	10%	10%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	50%	50%
Starting-rate limit	£2,560*	£2,710*
Threshold of taxable income above which higher rate applies	£35,000	£34,370
Threshold of taxable income above which additional rate applies	£150,000	£150,000
Child benefit charge from 7 January 2013: 1% of benefit for every £100 of income over	N/A	£50,000

**restricted to savings income only and not available if taxable non-savings income exceeds starting rate band.*

MAIN PERSONAL ALLOWANCES AND RELIEFS

Income limit for Personal Allowance §	£100,000	£100,000
Personal Allowance (basic) §	£7,475	£8,105
Personal Allowance (age 65-74) §	£9,940	£10,500
Personal Allowance (aged 75 and over) §	£10,090	£10,660
Married/civil partners (minimum) at 10% †	£2,800	£2,960
Married/civil partners (age 75 and over) at 10%	£7,295	£7,705
Income limit for age-related allowances	£24,000	£25,400
Blind Person's Allowance	£1,980	£2,100
Enterprise Investment Scheme relief limit on £1,000,000 max (£500,000 in 2011/2012)	30%	30%
Seed Enterprise Investment relief limit on £100,000	N/A	50%
Venture Capital Trust relief limit on £200,000 max	30%	30%

§ *the Personal Allowance reduces by £1 for every £2 of income above the income limit irrespective of age.*
† *where at least one spouse/civil partner was born before 6 April 1935.*

Child Tax Credit (CTC)		
- Child element per child (maximum)	N/A	£2,690
- family element	£545	£545
Threshold for tapered withdrawal of CTC	N/A	£15,860

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	Weekly	Monthly	Yearly
Lower Earnings Limit (LEL)	£107	£464	£5,564
Primary threshold	£146	£634	£7,605
Upper Accrual Point	£770	£3,337	£40,040
Upper Earnings Limit (UEL)	£817	£3,540	£42,475

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS	
	Contracted-in rate/contracted-out (money purchase)	Contracted-out rate (final salary)
Up to 146.00*	Nil	Nil
146.01 – 770.00	12%	10.6%
770.01 – 817.00	12%	12%
Above 817.00	2%	2%

**This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £107 per week. This £107 to £146 band is a zero rate band introduced in order to protect lower earners' rights to contributory State benefits e.g. Basic State Pension.*

Total earnings £ per week	CLASS 1 EMPLOYER CONTRIBUTIONS		
	Contracted-in rate	Contracted-out rate	
		Final salary	*Money purchase*
Below 144.00**	Nil	Nil	Nil
144.01 – 770.00	13.8%	10.4%	13.8%
770.01 – 817.00	13.8%	13.8%	13.8%
Excess over 817.00	13.8%	13.8%	13.8%

*** Secondary earnings threshold.*

Class 2 (self-employed)	Flat rate per week £2.65 where earnings exceed £5,595 per annum.
Class 3 (voluntary)	Flat rate per week £13.25.
Class 4 (self-employed)	9% on profits between £7,605 - £42,475 2% on profits above £42,475.

PENSIONS

TAX YEAR	LIFETIME ALLOWANCE	ANNUAL ALLOWANCE
2006/2007	£1,500,000	£215,000
2007/2008	£1,600,000	£225,000
2008/2009	£1,650,000	£235,000
2009/2010	£1,750,000	£245,000
2010/2011	£1,800,000	£255,000
2011/2012	£1,800,000	£50,000
2012/2013	£1,500,000	£50,000

ANNUAL ALLOWANCE CHARGE
20% - 50% member's tax charge on the amount of total pension input in excess of the annual allowance.

LIFETIME ALLOWANCE CHARGE
55% of excess over lifetime allowance if taken as a lump sum.
25% of excess over lifetime allowance if taken in the form of income, which is subsequently taxed under PAYE.

INHERITANCE TAX

RATES OF TAX ON DEATH TRANSFERS	2011/2012	2012/2013
Transfers made after 5 April 2012		
- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
- Lifetime transfers to and from certain trusts	20%	20%

**For deaths after 5 April 2012, a lower rate of 36% applies where at least 10% of deceased's net estate is left to charity.*

MAIN EXEMPTIONS		
Transfers to		
- UK-domiciled spouse/civil partner	No limit	No limit
- non-UK-domiciled spouse/civil partner (from UK-domiciled spouse)	£55,000	£55,000
- UK-registered charities	No limit	No limit
Lifetime transfers		
- Annual exemption per donor	£3,000	£3,000
- Small gifts exemption	£250	£250
Wedding/civil partnership gifts by		
- parent	£5,000	£5,000
- grandparent	£2,500	£2,500
- other person	£1,000	£1,000

100% relief: businesses, unlisted/AIM companies, certain farmland/building
50% relief: certain other business assets

Reduced tax charge on gifts within 7 years of death:

- Years before death	0-3	3-4	4-5	5-6	6-7
- Inheritance Tax payable	100%	80%	60%	40%	20%

CAR BENEFIT FOR EMPLOYEES

The charge for company car benefits is based on the carbon dioxide (CO_2) emissions. There is no reduction for high business mileage users.

For 2012/2013:

- Cars that cannot emit CO_2 have a 0% charge.
- The percentage charge is 5% of the car's list price for CO2 emissions of 75g/km or less.
- For cars with CO_2 emissions of 76g/km to 99g/km the percentage is 10%.
- Cars with CO_2 emissions of 100g/km have a percentage charge of 11% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 35% (emissions of 220g/km and above).

There is an additional 3% supplement for diesel cars not meeting Euro IV emission standards. However, the maximum charge remains 35% of the car's list price.

Car fuel The benefit is calculated as the CO_2 emissions % relevant to the car and that % applied to a set figure (£20,200 for 2012/2013) e.g. car emission 100g/km = 11% on car benefit scale. 11% of £20,200 = £2,222.

1. **Accessories** are, in most cases, included in the list price on which the benefit is calculated.
2. **List price** is reduced for capital contributions made by the employee up to £5,000.
3. **Car benefit** is reduced by the amount of employee's contributions towards running costs.
4. **Fuel scale** is reduced only if the employee makes good **all** the fuel used for private journeys.
5. **All car and fuel benefits** are subject to employers National Insurance Contributions (Class 1A) of 13.8%.

PRIVATE VEHICLES USED FOR WORK

	2011/2012 Rates	2012/2013 Rates
Cars		
On the first 10,000 business miles in tax year	45p per mile	45p per mile
Each business mile above 10,000 business miles	25p per mile	25p per mile
Motor Cycles	24p per mile	24p per mile
Bicycles	20p per mile	20p per mile

MAIN CAPITAL AND OTHER ALLOWANCES

	2011/2012	2012/2013
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£100,000	£25,000
Plant & machinery (reducing balance) per annum	20%	18%
Patent rights & know-how (reducing balance) per annum	25%	25%
Certain long-life assets, integral features of buildings (reducing balance) per annum	10%	8%
Energy & water-efficient equipment	100%	100%
Zero emission goods vehicles (new)	100%	100%
Qualifying flat conversions, business premises & renovations	100%	100%

Motor cars: Expenditure on or after 01/04/09 (Corporation Tax) or 06/04/09 (Income Tax)

CO_2 emissions of g/km:	110 or less*	111-160	161 or more
Capital allowance:	100% first year	18% reducing balance	8% reducing balance

*If new

Research & Development:	Capital expenditure	100%

MAIN SOCIAL SECURITY BENEFITS

		2011/2012	2012/2013
		£	£
Child Benefit	First child	20.30	20.30
	Subsequent children	13.40	13.40
	Guardian's allowance		15.55
Employment and Support Allowance	Assessment Phase		
	Age 16 – 24	Up to 53.45	Up to 56.25
	Aged 25 or over	Up to 67.50	Up to 71.00
	Main Phase		
	Work Related Activity Group	Up to 94.25	Up to 99.15
	Support Group	Up to 99.85	Up to 105.05
Attendance Allowance	Lower rate	49.30	51.85
	Higher rate	73.60	77.45
Retirement Pension	Single	102.15	107.45
	Married	163.35	171.85
Pension Credit	Single person standard minimum guarantee	137.35	142.70
	Married couple standard minimum guarantee	209.70	217.90
	Maximum savings ignored in calculating income	10,000.00	10,000.00
Bereavement Payment (lump sum)		2,000.00	2,000.00
Widowed Parent's allowance		100.70	105.95
Jobseekers Allowance	Age 16 - 24	53.45	56.25
	Age 25 or over	67.50	71.00
Statutory Maternity, Paternity and Adoption Pay		128.73	135.45

CAPITAL GAINS TAX

EXEMPTIONS	2011/2012	2012/2013
Individuals, estates etc	£10,600	£10,600
Trusts generally	£5,300	£5,300
Chattels proceeds (restricted to five thirds of proceeds exceeding limit)	£6,000	£6,000

TAX RATES		
Individuals:		
Up to basic rate limit	18%	18%
Above basic rate limit	28%	28%
Trustees and Personal Representatives	28%	28%
Entrepreneurs' Relief* – Gains taxed at:	10%	10%
Lifetime limit	£10,000,000	£10,000,000

*For trading businesses and companies (minimum 5% employee or director shareholding) held for at least one year.

CORPORATION TAX

	2011/2012	2012/2013
Full rate	26%	24%
Small companies rate	20%	20%
Small companies limit	£300,000	£300,000
Effective marginal rate	27.5%	25.0%
Upper marginal limit	£1,500,000	£1,500,000

VALUE ADDED TAX

	2011/2012	2012/2013
Standard rate	20%	20%
Annual Registration limit	£73,000	£77,000