THE CHARTERED INSURANCE INSTITUTE

AF3

Advanced Diploma in Financial Planning

Unit AF3 – Pension planning

October 2014 examination

> **SPECIAL NOTICES**
>
> **All questions in this paper are based on English law and practice applicable in the tax year 2014/2015, unless stated otherwise in the question, and should be answered accordingly.**
>
> **It should be assumed that all individuals are domiciled and resident in the UK unless otherwise stated.**

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 AF3 – Pension 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

Read the following carefully, then carry out **ALL** of the tasks **(a)**, **(b)**, **(c)**, **(d)**, **(e)**, **(f)** and **(g)** which follow.

Tim and Ed are twins who own TEA 4-2, a successful catering business. In the 2014/2015 tax year, both brothers will have relevant earnings of £200,000. Tim and Ed will reach their 65th birthday at the end of October 2014 and both intend to retire at the end of December 2014 when Ed's son will take over the running of the business. After this time, their only income will be pension and investment income.

Tim, who is a widower with no dependants, had pension funds as at 5 April 2006 valued at £1,950,000, 25% of which were in respect of tax-free cash. As a result he registered for primary protection in May 2007. In May 2008 he crystallised a personal pension valued at £170,000. He took the maximum permitted pension commencement lump sum and the balance of the funds are currently held in a capped drawdown pension.

Tim intends to crystallise all of his remaining pension funds at the end of October 2014. The uncrystallised funds, all held in a self-invested personal pension (SIPP), are valued at £2,350,000. Tim is planning to leave his entire estate to charity when he dies.

Ed is married to Emma, aged 55. He has pension funds in a SIPP valued at £830,000. He is keen to contribute as much as possible into his pension whilst he is still able to receive tax relief on the contribution. His total pension input in recent years has been:

	2008/2009	2009/2010	2010/2011	2011/2012	2012/2013	2013/2014
Total pension input	£35,000	£25,000	£40,000	£20,000	£60,000	£65,000

Ed's SIPP has a pension input period of 1 January – 31 December each year. Ed has not made any payments to his pension in the current pension input period.

Emma will continue to work for at least another five years. Ed, who has a moderate attitude to risk, would like some advice about how best to generate an income from his pension funds that will ensure he and Emma can maintain their standard of living in both the short and longer term. Ed intends to defer receipt of his State Pension.

Emma is the Managing Director and 50% shareholder of her family's printing business, DFR Ltd, which has share capital currently valued at £1,200,000. Emma and her brother and sister are members of the company's small self-administered scheme (SSAS). The scheme is currently valued at £2,780,000 and Emma has a statement showing that her share of the fund was valued at £1,350,000 on 5 April 2014.

Emma, who has no form of transitional protection, is interested in the investment opportunities available to the SSAS.

Tim, Ed and Emma will all be entitled to receive a full State Pension.

QUESTIONS CONTINUE OVER THE PAGE

Questions

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

(a) Tim intends taking the maximum permitted pension commencement lump sum (PCLS) from his self-invested personal pension (SIPP) and to invest the balance of his fund into a drawdown pension.

(i) Calculate, **showing all your workings**, Tim's maximum PCLS. **(6)**

(ii) Calculate, **showing all your workings**, the amount Tim will have available to invest into a drawdown pension after the PCLS and lifetime allowance tax charge have been deducted. **(10)**

(b) Tim would like his pension funds to be paid to a charity upon his death, but has yet to complete a nomination form.

(i) Outline the conditions that must be met in order that Tim's pension fund can be paid as a charitable lump sum death benefit. **(3)**

(ii) Explain the impact if Tim fails to complete a nomination form prior to his death. *Assume there are no changes to his personal circumstances.* **(6)**

(c) Ed wishes to pay the maximum tax relievable contribution to his pension.

(i) Calculate, **showing all your workings**, the maximum gross contribution Ed can make into his pension before the end of the 2014/2015 tax year without incurring an annual allowance tax charge. **(8)**

(ii) Explain how the contribution, calculated in part **(c)(i)** above, should be paid, in order for Ed to receive the maximum possible tax relief, without incurring an annual allowance tax charge. **(8)**

(d) Outline the additional information you would need from Ed in order to advise him on how best to use his pension fund to meet his and Emma's short and longer term income needs. **(9)**

(e) Outline the benefits Emma may be entitled to receive if Ed were to die whilst deferring his State pension, and state any conditions she would have to satisfy. **(8)**

(f) Emma would like to apply for Individual Protection 2014.

(i) Outline why Emma is able to apply for Individual Protection 2014 and state the latest date her application must be received by HM Revenue & Customs. **(4)**

(ii) Assuming Emma's application is successful, state the level of protection she will receive. **(3)**

(iii) Outline to Emma the potential benefits and any limitations of Individual Protection 2014. **(3)**

(g) There are a number of investment options being considered by the trustees of the small self-administered scheme (SSAS).

(i) The trustees of the SSAS are considering buying some of Emma's DFR Ltd shares. State the limits that will apply for this to be an authorised transaction. **(2)**

(ii) Outline **three** potential disadvantages to Emma if she sells some of her shares in DFR Ltd to the SSAS. **(3)**

(iii) The trustees of the SSAS are considering lending money to DFR Ltd. Outline the conditions that must apply for the loan to qualify as an authorised employer loan. **(7)**

Total marks available for this question: 80

QUESTIONS CONTINUE OVER THE PAGE

SECTION B

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

Question 2

Read the following carefully, then carry out **ALL** of the tasks **(a)**, **(b)** and **(c)** which follow.

Raj, aged 60, is married to Meera, aged 58. The couple have two financially independent children and four grandchildren. Raj and two partners run a very successful engineering firm and Raj plans to continue working full-time in the business for a further eight years until Meera reaches State Pension age. The couple, who have an income well in excess of their day-to-day needs, then plan to retire. Raj has an agreement with his partners that they will purchase his share of the business.

Raj was previously a director of Flying Sparks Ltd but left in February 2011, after 22 years service. Since that time the company profits have been in decline and Raj is concerned about the company's ongoing viability.

During his employment, Raj was a member of Flying Sparks Ltd's contracted-out defined benefit pension scheme and his latest benefit statement shows he has a preserved pension entitlement of £33,450 per annum at the scheme's normal retirement age of 65. The scheme provides a spouse's pension of 2/3rds of the member's entitlement and re-values pensions in deferment and escalates pensions in payment in line with statutory minimum rates.

Raj has been investigating his options with regard to this pension and has recently received an illustration showing a cash equivalent transfer value (CETV) of £292,500. The note from the trustees accompanying the illustration stated that the figure has been reduced to take account of the scheme's current underfunding. Raj has obtained a transfer value analysis report (TVAS) which shows a critical yield of 9.8%, when compared to the scheme benefits, and 3.6%, when compared to the benefits payable if the scheme enters the Pension Protection Fund (PPF).

Raj is now considering the following **three** options:

- Taking his benefits under the scheme now – if he does the trustees have informed him that after the early retirement penalty is applied he will receive a pension of £23,415 per annum.
- Accept the CETV and transfer his benefits from the Flying Sparks pension scheme to a personal pension plan.
- Leaving his benefits in the Flying Sparks pension scheme and drawing his pension when he stops working in eight years time.

Questions

(a) In the event that Raj opts to take his benefits from the scheme immediately:

(i) explain how his benefits within the scheme will increase in payment; **(8)**

(ii) outline the changes that may occur to his benefits if the scheme subsequently enters the Pension Protection Fund (PPF). **(6)**

(b) Raj is concerned that the Flying Sparks pension scheme may enter the PPF in the near future.

(i) Outline the actions that must be taken, and any timescales that apply, to ensure that Raj is able to transfer his current cash equivalent transfer value of £292,500 to a personal pension plan. **(4)**

(ii) Explain why the PPF critical yield is lower than the scheme critical yield. **(6)**

(iii) Explain why the benefits Raj receives from a personal pension plan may be less than the benefits payable under the Flying Sparks pension scheme, even if the critical yield is achieved. **(6)**

(c) Outline the factors that you would take into consideration when advising Raj on which of the **three** options he is considering would best meet his needs. **(13)**

Total marks available for this question: 43

QUESTIONS CONTINUE OVER THE PAGE

Question 3

Read the following carefully, then carry out **ALL** of the tasks **(a)**, **(b)**, **(c)** and **(d)** which follow.

Lucy, aged 37, works part-time for HJY Ltd. She receives a basic salary of £26,000 and has P11D benefits of £2,500 per annum. Lucy intends to start working full-time when her youngest child starts secondary school in 2018. At this time she expects her basic salary to increase to around £42,000 per annum.

HJY Ltd reached their staging date on 1 October 2014. Lucy has been told the company intends to automatically enrol all eligible jobholders into the National Employment Savings Trust (NEST) scheme but that they are postponing their auto-enrolment date until 1 January 2015. Having made further enquiries, Lucy has discovered that the company intend to pay the minimum allowable employer contribution based on the qualifying earnings definition.

Lucy has an existing stakeholder pension plan (SHP) into which she is currently paying £200 per month. She has an adventurous attitude to risk and feels that the fund range of her SHP is not meeting her needs. Lucy is interested in transferring her SHP into a pension that would give her access to more suitable investment opportunities.

Lucy is a beneficiary under her uncle's Will and has been told she will receive a lump sum of £10,000 as soon as probate is obtained. She wishes to invest this for her retirement but is unsure whether she should invest these funds in a New Individual Savings Account (NISA) or into her pension.

Questions

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

(a) Lucy has not yet received a postponement notice. Outline how HJY Ltd will determine the latest date for issuing this notice to their workforce. **(3)**

(b) Lucy is unsure whether she wishes to be a member of her employer's pension scheme.

(i) Calculate, **showing all your workings**, the monthly contribution Lucy's employer will make into NEST on her behalf during the 2014/2015 tax year. *Assume there is no change in salary and benefits.* **(4)**

(ii) Outline the process Lucy must follow if she wishes to opt out of HJY Ltd's pension scheme. **(3)**

(iii) Explain why Lucy should consider remaining in the HJY Ltd pension scheme. **(7)**

(c) Outline the additional information you would require in order to advise Lucy on her wish to transfer her stakeholder pension funds to a new pension contract. **(8)**

(d) Explain the factors Lucy should take into account in deciding whether to invest her inheritance into a NISA or into her pension. **(12)**

Total marks available for this question: 37

The tax tables can be found on pages 13 – 19

INCOME TAX

RATES OF TAX	2013/2014	2014/2015
Starting rate for savings*	10%	10%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	45%	45%
Starting-rate limit	£2,790*	£2,880*
Threshold of taxable income above which higher rate applies	£32,010	£31,865
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	£50,000	£50,000

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

MAIN PERSONAL ALLOWANCES AND RELIEFS

	2013/2014	2014/2015
Income limit for Personal Allowance §	£100,000	£100,000
Personal Allowance (basic if born after 5 April 1948) §	£9,440	£10,000
Personal Allowance (if born between 6 April 1938 and 5 April 1948) §	£10,500	£10,500
Personal Allowance (if born before 6 April 1938) §	£10,660	£10,660
Married/civil partners (minimum) (if born before 6 April 1935) at 10% †	£3,040	£3,140
Married/civil partners (if born before 6 April 1935) at 10% †	£7,915	£8,165
Income limit for age-related allowances	£26,100	£27,000
Blind Person's Allowance	£2,160	£2,230
Enterprise Investment Scheme relief limit on £1,000,000 max	30%	30%
Seed Enterprise Investment relief limit on £100,000	50%	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 (under the income threshold).*
† *where at least one spouse/civil partner was born before 6 April 1935.*

	2013/2014	2014/2015
Child Tax Credit (CTC)		
- Child element per child (maximum)	£2,720	£2,750
- family element	£545	£545
Threshold for tapered withdrawal of CTC	£15,910	£16,010

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	**Weekly**	**Monthly**	**Yearly**
Lower Earnings Limit (LEL)	£111	£481	£5,772
Primary threshold	£153	£663	£7,956
Upper Accrual Point	£770	£3,337	£40,040
Upper Earnings Limit (UEL)	£805	£3,489	£41,865

Total earnings £ per week	**CLASS 1 EMPLOYEE CONTRIBUTIONS**	
	Contracted-in rate	**Contracted-out rate (final salary)**
Up to 153.00*	Nil	Nil
153.01 – 770.00	12%	10.6%
770.01 – 805.00	12%	12%
Above 805.00	2%	2%

**This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £111 per week. This £111 to £153 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 153.00**	Nil	Nil	Nil
153.01 – 770.00	13.8%	10.4%	13.8%
770.01 – 805.00	13.8%	13.8%	13.8%
Excess over 805.00	13.8%	13.8%	13.8%

*** Secondary earnings threshold.*

Class 2 (self-employed)	Flat rate per week £2.75 where earnings exceed £5,885 per annum.
Class 3 (voluntary)	Flat rate per week £13.90.
Class 4 (self-employed)	9% on profits between £7,956 - £41,865 2% on profits above £41,865.

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
2013/2014	£1,500,000	£50,000
2014/2015	£1,250,000	£40,000

ANNUAL ALLOWANCE CHARGE

20% - 45% 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.

CAPITAL GAINS TAX

EXEMPTIONS	2013/2014	2014/2015
Individuals, estates etc	£10,900	£11,000
Trusts generally	£5,450	£5,500
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.*

INHERITANCE TAX

RATES OF TAX ON DEATH TRANSFERS	2013/2014	2014/2015
Transfers made after 5 April 2014		
- 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 2014, 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)	£325,000	£325,000
- 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 2014/2015:

- Cars that cannot emit CO_2 have a 0% charge.
- The percentage charge is 5% of the car's list price for CO_2 emissions of 75g/km or less.
- For cars with CO_2 emissions of 76g/km to 94g/km the percentage is 11%.
- For cars with CO_2 emissions of 95g/km to 99g/km the percentage is 12%.
- Cars with CO_2 emissions of 100g/km have a percentage charge of 13% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 35% (emissions of 210g/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 (£21,700 for 2014/2015) e.g. car emission 100g/km = 13% on car benefit scale. 13% of £21,700 = £2,821.

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

	2013/2014 Rates	2014/2015 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

	2013/2014	2014/2015
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£250,000	£500,000
Plant & machinery (reducing balance) per annum	18%	18%
Patent rights & know-how (reducing balance) per annum	25%	25%
Certain long-life assets, integral features of buildings (reducing balance) per annum	8%	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 April 2014 (Corporation Tax) or 06 April 2014 (Income Tax)

CO_2 emissions of g/km:	95 or less*	96-130	131 or more
Capital allowance:	100% first year	18% reducing balance	8% reducing balance

*If new

CORPORATION TAX

	2013/2014	2014/2015
Full rate	23%	21%
Small companies rate	20%	20%
Small companies limit	£300,000	£300,000
Effective marginal rate	23.75%	21.25%
Upper marginal limit	£1,500,000	£1,500,000

VALUE ADDED TAX

	2013/2014	2014/2015
Standard rate	20%	20%
Annual registration threshold	£79,000	£81,000
Deregistration threshold	£77,000	£79,000

MAIN SOCIAL SECURITY BENEFITS

		2013/2014	2014/2015
		£	£
Child Benefit	First child	20.30	20.50
	Subsequent children	13.40	13.55
	Guardian's allowance	15.90	16.35
Employment and Support Allowance	Assessment Phase		
	Age 16 – 24	Up to 56.80	Up to 57.35
	Aged 25 or over	Up to 71.70	Up to 72.40
	Main Phase		
	Work Related Activity Group	Up to 100.15	Up to 101.15
	Support Group	Up to 106.50	Up to 108.15
Attendance Allowance	Lower rate	53.00	54.45
	Higher rate	79.15	81.30
Retirement Pension	Single	110.15	113.10
	Married	176.15	180.90
Pension Credit	Single person standard minimum guarantee	145.40	148.35
	Married couple standard minimum guarantee	222.05	226.50
	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		108.30	111.20
Jobseekers Allowance	Age 16 - 24	56.80	57.35
	Age 25 or over	71.70	72.40
Statutory Maternity, Paternity and Adoption Pay		136.78	138.18

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