

AF1

Advanced Diploma in Financial Planning

Unit AF1 – Personal tax and trust planning

April 2011 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2010/2011, 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 2011 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 AF1 – Personal tax and trust 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 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

Barry Welch, aged 57, is a widower. When his wife died in January 2010, she left an amount in her Will equal to the full Nil Rate Band to their two adult children, Ian and Gillian. The remainder of her estate passed to Barry. Ian has a son, aged four, and Gillian has a daughter, aged five. Barry and all the members of his family are in good health.

Barry is managing director of an engineering company, which he set up as a private limited company in April 2004 with his wife and two brothers. As Barry inherited his wife's shares in the business, he now owns a 60% shareholding. The business trades from workshops, which were initially rented. In 2006, Barry purchased in his own name the freehold of the workshops from the landlord and now personally receives the rent from the company. On 1 April 2011, the business was valued at £780,000 and the workshops were valued at £560,000.

Barry has two pension funds, a personal pension valued at £150,000 and a retirement annuity valued at £40,000. Both plans provide for a return of the full fund on death. The personal pension is subject to a master trust but the retirement annuity is not in trust. He now feels he should consider placing the retirement annuity fund in a new bare trust for the benefit of his grandchildren in the event of his death before retirement.

The value of Barry's other assets as at 1 April 2011 were as follows:

	£
Main residence	365,000
Chattels	60,000
Bank & Building Society accounts	42,500
Apartment in Spain	130,000
ISAs	33,250
Onshore single premium with profits bond	37,100

In addition, Barry has a 25% life interest in an interest in possession trust set up 10 years ago under his mother's Will on her death. He is entitled to income but not capital. As at 1 April 2011 the trust fund was valued at £530,000.

In July 2006, Barry and his wife were the joint settlors of a bare trust for the benefit of both their grandchildren, which was set up with an investment of £100,000. The trustees were Barry and his wife and there have been no further appointments of trustees. The trust was intended to assist the grandchildren with future education needs. The trust fund was initially invested in a portfolio of gilts, unit trusts and investment trusts, and there have been no changes to the portfolio. Barry's oldest grandchild is now about to start school and he feels a review might be useful.

The only other lifetime gift that Barry has made was a cash gift of £12,000 to his son, when he married in May 2006. This gift was made by Barry alone.

Barry is aware that, if he dies, his estate will have an Inheritance Tax liability and that the liability will increase as he has substantial surplus income. Therefore, Barry would like to establish tax efficient regular savings to assist his grandchildren with any future house purchase. As he has used ISAs in the past for personal savings, he was considering cash ISAs. However, a friend suggested he consider regular premium Friendly Society Savings Plans.

Barry made a new Will in 2010 leaving everything to his son and daughter. The Will named a close family friend as executor, who has recently died. While Barry has no wish to change the provisions of his Will, he is concerned as to the position now that the only executor has died.

Questions

- (a) (i) Calculate, **showing all your workings**, the total Inheritance Tax (IHT) payable if Barry died on 1 April 2011. (20)
- (ii) State who is liable for the IHT payable on the estate and calculate, **showing all your workings**, the amount for which they would be accountable. (8)
- (b) Explain to Barry the relevant conditions for claiming Business Property Relief against IHT for his shareholding in the engineering company and the extent of Barry's eligibility. (7)
- (c) With regard to Barry's concerns about his Will:
- (i) list the main duties of an executor; (7)
- (ii) explain the impact on Barry's estate now the sole executor has died; (5)
- (iii) identify the two main methods by which Barry can appoint a new executor. (2)
- (d) With regard to the bare trust established by Barry and his wife, explain the main considerations that should be included in a review of the trust. (9)
- (e) With regard to Barry's intention to place the retirement annuity fund in a bare trust, explain in detail how this course of action would be treated for IHT at outset by HM Revenue & Customs (HMRC). (10)
- (f) Explain the main Income Tax and IHT considerations if Barry decides to set up the regular savings for his grandchildren using the following products (*ignore contribution limits*):
- (i) Friendly Society Savings Plan; (8)
- (ii) cash ISA. (4)

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

Mike and Cathy are married and both aged 55. They have one child, Fiona, aged 30. Fiona has a son, Edward, aged three.

Cathy became self-employed on 6 April 2010 and her accounting year ends on 5 April 2011. Cathy has made a larger than expected profit for the tax year 2010/2011 and is unsure of the process for settling her Income Tax liabilities.

Mike is employed as a sales manager and earns a basic salary of £50,000 per annum. Mike also received £15,000 in bonuses in the tax year 2010/2011. Mike has a company car which is available for his private use, but his employer does not pay for fuel for private use. The car was registered in March 2010, has a list price of £25,000, CO₂ emissions of 138g/km and uses diesel fuel. Mike has a personal pension into which he pays £200 per month by direct debit. He also makes gift aid payments of £1,000 per annum to a registered charity.

Mike holds the following investments:

Asset type	Current value £	Interest/Income received 2010/2011 £
NS&I Investment Account	7,000	14
Monthly Income Unit Trust ISA	60,000	3,240
XYZ plc ordinary shares	25,000	990
Building Society Online Account	50,000	1,200
Current Account	40,000	Nil

Both Mike and Cathy are interested in gifting £25,000 of their assets to their daughter, Fiona, in order that she might establish an absolute trust for Edward's benefit.

Questions

- (a) (i) Calculate, **showing all of your workings**, the Income Tax payable by Mike for the tax year 2010/2011. (18)
- (ii) Using the tax liability calculated in (a)(i) above, calculate, **showing all your workings**, the change in the Income Tax payable by Mike for 2010/2011 if he had invested £30,000 from his current account into an Enterprise Investment Scheme in the tax year 2010/2011. (4)
- (b) Explain briefly to Cathy the process by which she will meet her Income Tax liability for her 2010/2011 trading year. *Your answer should include relevant dates but should not explain how business profits are calculated.* (6)
- (c) Explain briefly the tax treatment if Mike and Cathy make a cash gift of £25,000 to their daughter, Fiona, for her to immediately establish an absolute trust for Edward. (7)

Total marks available for this question: 35

Question 3

Karl, aged 51, is married. He bought his first house on 30 April 1980 for £17,000 and during that year spent a further £2,000 on improvements. The value of the house at 31 March 1982 was £23,000. Karl lived there until his marriage on 30 June 1995 when he moved into his wife's house and rented his own house out which at that time was valued at £260,000. Karl sold his house on 31 March 2011 for £340,000 (after all costs). Karl understands he may have a Capital Gains Tax (CGT) liability in respect of this sale. He has no other CGT gains or losses for the tax year 2010/2011 and no CGT losses from previous years.

Karl is self-employed and runs his own manufacturing business, which has been very successful in the past. However, the business has been struggling financially for the last three years.

Karl's gross taxable income before allowances for the tax year 2010/2011 is £20,000. His only personal assets are a personal pension with a current fund value of £150,000 and a small portfolio of investment trusts inherited from his father. In addition, Karl established a discretionary trust as settlor in 2007 for the benefit of his three children. The discretionary trust is invested in deposits, unit trusts and corporate bonds.

Questions

- (a) Explain how the HM Revenue & Customs (HMRC) rules with regard to principal private residence relief will apply to Karl's CGT liability on the sale of his house. **(10)**
- (b) Calculate, **showing all your workings**, Karl's CGT liability for the tax year 2010/2011 on the sale of his house on 31 March 2011. **(13)**
- (c) Explain what would happen to each of the following assets if Karl becomes bankrupt:
- (i) his personal pension; **(4)**
 - (ii) his portfolio of investment trusts; **(2)**
 - (iii) the discretionary trust. **(5)**
- (d) (i) Explain the Income Tax treatment if income is accumulated within the trust set up by Karl. **(7)**
- (ii) Explain how this differs if trust income were distributed to beneficiaries. **(4)**

Total marks available for this question: 45

The tax tables can be found on pages 9 – 13

INCOME TAX

RATES OF TAX	2009/2010	2010/2011
Starting rate for savings*	10%	10%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	N/A	50%
Starting-rate limit	£2,440*	£2,440*
Threshold of taxable income above which higher rate applies	£37,400	£37,400
Threshold of taxable income above which additional rate applies	N/A	£150,000

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

MAIN PERSONAL RELIEFS

Income limit for Personal Allowance §	N/A	£100,000
Personal Allowance (basic) §	£6,475	£6,475
Personal Allowance (age 65-74) §	£9,490	£9,490
Personal Allowance (aged 75 and over) §	£9,640	£9,640
Married/civil partners (minimum) at 10% †	£2,670	£2,670
Married/civil partners (age 75 and over) at 10%	£6,965	£6,965
Income limit for age-related allowances	£22,900	£22,900
Blind person's allowance	£1,890	£1,890
Enterprise Investment Scheme relief limit at 20%	£500,000	£500,000
Venture Capital Trust relief limit at 30%	£200,000	£200,000

§ the Personal Allowance reduces by £1 for every £2 of income above the income limit irrespective of age from 2010/2011.

† where at least one spouse/civil partner was born before 6 April 1935.

Child Tax Credit (CTC)		
- family element	£545	£545
- family element baby addition	£545	£545
CTC usually reduced by 6.67% of joint income over	£50,000	£50,000

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	Weekly	Monthly	Yearly
Lower Earnings Limit (LEL)	£97	£421	£5,044
Primary threshold	£110	£477	£5,715
Upper Earnings Limit (UEL)	£844	£3,656	£43,875
Upper Accruals Point	£770	£3,337	£40,040

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS	
	Contracted-in rate	Contracted-out rate
Up to 110.00*	Nil	Nil
110.01 – 770.00	11%	9.4%
770.01 – 844.00	11%	11%
Above 844.00	1%	1%

Total earnings £ per week	CLASS 1 EMPLOYER CONTRIBUTIONS		
	Contracted-in rate	Contracted-out rate	
		<i>Final salary</i>	<i>Money purchase</i>
Below 110.00**	Nil	Nil	Nil
110.01 – 770.00	12.8%	9.1%	11.4%
770.01 – 844.00	12.8%	12.8%	12.8%
Excess over 844.00	12.8%	12.8%	12.8%

* This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £97 per week. This £97 to £110 band is a zero rate band introduced in order to protect lower earners' rights to contributory State benefits e.g. Basic State Pension.

** Secondary earnings threshold.

Class 2 (self-employed)	Flat rate per week £2.40 where earnings exceed £5,075 per annum.
Class 3 (voluntary)	Flat rate per week £12.05
Class 4 (self-employed)	8% on profits between £5,715 - £43,875 plus 1% on profits above £43,875

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

NOTIONAL EARNINGS CAP

£123,600 – (For schemes that require post-1989 benefits to be still subject to a cap).

ANNUAL ALLOWANCE CHARGE

40% 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

2009/2010 2010/2011

Transfers made after 5 April 2010

- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
- Lifetime transfers to and from certain trusts	20%	20%

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 to same person	£250	£250

Wedding/civil partnership gifts by

- parent	£5,000	£5,000
- grandparent/party to marriage/civil partnership	£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 (CO₂) emissions. There is no reduction for high business mileage users.

For 2010/2011:

The percentage charge is 15% of the car's list price for CO₂ emissions at or below the qualifying level of 130g/km.

The base percentage charge of 15% increases in 1% steps for every additional full 5g/km over the 130g/km threshold, up to a maximum of 35% of the car's list price.

A lower percentage charge of 10% of the car's list price applies for emissions at or below 120g/km and 5% for emissions at or below 75g/km.

If price of car exceeds £80,000 then its price for tax purposes will be fixed at £80,000.

There is an additional 3% supplement for diesel cars not meeting Euro IV emission standards or registered after 31 December 2005. However, the maximum charge remains 35% of the car's list price.

Car fuel The benefit is calculated as the CO₂ emissions % relevant to the car and that % applied to a set figure (£18,000 for 2010/2011) e.g. car emission 160g/km = 21% on car benefit scale.
21% of £18,000 = £3,780.

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 12.8%.

PRIVATE VEHICLES USED FOR WORK

2010/2011 Rates

Cars

On the first 10,000 business miles in tax year 40p per mile
 Each business mile above 10,000 business miles 25p per mile

Motor Cycles

24p per mile

Bicycles

20p per mile

MAIN CAPITAL AND OTHER ALLOWANCES

2010/2011

Plant & machinery 100% annual investment allowance (first year)	£100,000
Plant & machinery (reducing balance) per annum	20%
Patent rights & know-how (reducing balance) per annum	25%
Certain long-life assets, integral features of buildings (reducing balance) per annum	10%
Industrial & agricultural buildings (straight line)	1%
Energy & water-efficient equipment	100%
Zero emission goods vehicles (new)	100%
Qualifying flat conversions, business premises & renovations	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%	20%	10%
	first year	reducing balance	reducing balance

* If new

Research & Development:	Capital expenditure	100%
Revenue expenditure:	Small/medium companies:	175%
	Large companies:	130%

MAIN SOCIAL SECURITY BENEFITS

		2009/2010	2010/2011
		£	£
Child Benefit	first child	20.00	20.30
	subsequent children	13.20	13.40
Incapacity Benefit	short-term lower rate*	67.75	68.95
	short-term higher rate*	80.15	81.60
	long-term rate	89.80	91.40
Attendance Allowance	lower rate	47.10	47.80
	higher rate	70.35	71.40
Retirement Pension	single	95.25	97.65
	married	152.30	156.15
Pension Credit	single person standard minimum guarantee	130.00	132.60
	married couple standard minimum guarantee	198.45	202.40
	maximum savings ignored in calculating income	6,000.00	10,000.00
Bereavement Benefit (lump sum)		2,000.00	2,000.00
Widowed Parent's allowance		95.25	97.65
Jobseekers Allowance		64.30	65.45

* under State Pension Age

CAPITAL GAINS TAX

RATES OF TAX

Chargeable gains, less allowable losses, are charged to tax as follows from 23 June 2010:

- for individuals who are non-taxpayers or basic-rate taxpayers, the rate chargeable is 18%.
- for individuals who are higher-rate taxpayers or additional-rate taxpayers, the rate chargeable is 28%.
- for trustees of trusts and personal representatives the rate chargeable is 28%.
- Entrepreneurs' Relief reduces the rate to 10% on qualifying assets subject to a lifetime limit of £5,000,000.

ANNUAL EXEMPTION

- The annual exemption is £10,100.
- Most trusts have an annual exemption of £5,050.

CHATELS EXEMPTION

- Gains on chattels are exempt if proceeds do not exceed £6,000 per item.

CORPORATION TAX

	2009/2010	2010/2011
Full rate	28%	28%
Small companies rate	21%	21%
Small companies limit	£300,000	£300,000
Effective marginal rate	29.75%	29.75%
Upper marginal limit	£1,500,000	£1,500,000

VALUE ADDED TAX

Standard rate to 03/01/11	17.5%
Standard rate from 04/01/11	20%
Annual Registration limit	£70,000

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