



AF1

THE CHARTERED INSURANCE INSTITUTE

MONDAY 19 APRIL 2010

**ADVANCED DIPLOMA IN FINANCIAL PLANNING
AF1 — PERSONAL TAX AND TRUST PLANNING**

SPECIAL NOTICES

- **All questions in this paper are based on English law and practice applicable in the tax year 2009/2010, unless stated otherwise 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 2010 Budget.**

INSTRUCTIONS

- **Three hours are allowed for this paper.**
- **Read the instructions overleaf carefully before answering any questions.**
- Fill in the information requested on the answer book and form B.
- 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 and you must enter the serial number, model and make on the 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.**

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AF1—Personal tax and trust planning

CANDIDATE INSTRUCTIONS

READ THE INSTRUCTIONS BELOW BEFORE ANSWERING ANY QUESTIONS

Three hours are allowed for this paper. You should answer **all** questions in Sections A and B.

The paper 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** the required 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.

Any rough notes made in your answer book must be crossed through before you hand it in.

Tax tables are provided at the back of this paper.

Answer each question on a new page and leave six lines blank after each question part.

It is important to show all steps in a calculation, even if you have used a calculator.

Please ensure that you understand the Special Notices printed in the box on the front page.

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

David Brown, aged 57, has been divorced from his ex-wife, Vicky, for three years. They have two children, Gerald, aged 29 and Emma, aged 26, who are both married. Gerald has a daughter, aged 7, and Emma has a son, aged 6.

Two years ago David met Melanie Adams and they are now making plans to marry early next year. Melanie has no children.

David has had a very successful business career and he has built up substantial personal savings, investments and pension funds. This enabled him to take early retirement in September last year in order to spend more time with Melanie. His pensions provide a gross income of £50,000 per annum.

Over the years, David has been concerned about the potential Inheritance Tax (IHT) liability that his estate would incur in the event of his death. In order to reduce this liability, he has made the following lifetime transfers:

- 10 June 2000 – David established a discretionary trust with an investment of £265,000, which was fully invested in an onshore with-profits investment bond. The NIL rate band at the time was £234,000. He named himself as appointer and appointed himself and his brother as trustees.
- 2 February 2005 – David established a bare trust for the benefit of his two grandchildren with an investment of £200,000, which was fully invested in an onshore unit-linked investment bond with ABC Life. The bond was invested fully in the ABC Managed fund. The NIL rate band at the time of the transfer was £263,000. The appointer and trustees are the same as for the above discretionary trust.
- 15 October 2009 – David made cash gifts of £70,000 each to his son and his daughter.

David has made no other previous gifts or transfers and no changes have been made to the above trusts since they were set up. The with-profits investment bond held by the discretionary trust was encashed in March 2010 for £315,000. David has reinvested the proceeds in a mixture of deposit savings, gilts and open ended investment companies (OEICs), because he would like to start making distributions from the discretionary trust to assist his grandchildren's education and he now has more time to manage the trust investments.

David made a valid will ten years ago while married to Vicky. The will made provisions for his wife and children and named Vicky as executor. As he now has a new partner, David feels he should take steps to revoke his will and replace it with a new one.

Questions

- (a) State and calculate where applicable, **showing all your workings**, the Inheritance Tax (IHT) payable on each of the lifetime transfers, **at the time of the transfer**, assuming the recipients or trustees pay any IHT due. (9)
- (b) Calculate, **showing all your workings**, the IHT payable on each of the transfers below and state clearly who has the primary liability for paying the tax.
- (i) 2 February 2005. (11)
- (ii) 15 October 2009. (8)
- (c) With regard to the discretionary trust, explain:
- (i) the tax treatment of the encashment of the with profits investment bond; *no calculation required* (10)
- (ii) the ongoing Income Tax treatment of the trust in respect of the new investments; (10)
- (iii) the ongoing Capital Gains Tax treatment of the trust in respect of the new investments. (6)
- (d) In view of the restructure of investments within the discretionary trust, explain the main duties of trustees in respect of:
- (i) its investments; (10)
- (ii) distributing the income and capital to beneficiaries. (4)
- (e) With regard to David's intention to change his will, explain the implications:
- (i) if he dies without making a new will or revoking the existing one; (4)
- (ii) if he revokes the existing will and defers making a new will until he remarries; (5)
- (iii) if he makes a new will now and subsequently remarries. (3)

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

Francesca Biagoni, born 1 April 1935, was widowed three years ago.

Francesca has two financially independent adult children, Peter and Renata. Peter lives close to Francesca but Renata is married to an American navy officer and has lived in the USA for many years.

Francesca has an annual pension of £19,000, gross, and the following investments:

Asset type	Current Value	Interest/yield received 2009/2010
NS&I Guaranteed Income Bond	£55,000	£1,320
UK Equity OEICs	£70,000	£1,890
Purchased life annuity	N/A	Gross payment of £3,000 of which the capital content is £1,200.
Investment bond (onshore)	£40,000	N/A

She invested £48,000 in the investment bond in December 2000. It was segmented into 20 policies. In January 2008 she encashed five complete segments for which she received proceeds of £13,000. She is now considering encashing the remainder of the bond in order to provide her grandchildren with funds to help eliminate their student debts.

Francesca enjoys good health, except for suffering from reduced mobility. She is planning to visit her daughter for an extended stay in the US of six to nine months as she foresees any future visits becoming less likely due to her increasing lack of mobility. She would like Peter to manage her financial affairs whilst she is away.

She has increasing concerns about how she would manage her affairs if she became mentally incapacitated and she wonders how Peter can support her. In the past, she has made financial gifts to her family and charities and would like to continue to have this facility.

Questions

- (a) Calculate, **showing all your workings**, Francesca's Income Tax payable for the 2009/2010 tax year, assuming she fully encashes her investment bond during the same tax year. (17)
- (b) If Francesca decides to retain the investment bond instead of encashing it, explain briefly how she could use it to provide tax-efficient income. *No calculation required.* (5)
- (c) With regard to Francesca's proposed visit to her daughter:
- (i) state the type of power of attorney that is specifically designed for this purpose; (1)
 - (ii) describe the relevant circumstances when the power of attorney in (c)(i) above would be revoked. (5)
- (d) With regard to Francesca's concerns about any future onset of mental incapacity:
- (i) state the type of power of attorney she is likely to set up to deal with such an eventuality. (1)
 - (ii) Explain how Francesca's affairs could continue to be managed if the power of attorney in (d)(i) above is created. (5)
 - (iii) Explain briefly the rules and their relevance to Francesca with regard to any future gifting if she sets up a power of attorney. (6)

Total marks available for this question: 40

Question 3

Paul Robertson, aged 57, is married to Anna, aged 55. Paul's family come from England, where he has always lived. Anna's late parents were both German. Paul and Anna have always intended to retire to Germany where Anna was born. Paul is now considering the offer of a part-time consulting role from a firm in Germany.

Paul and Anna have been married for 20 years, during which time they have lived continuously in the UK.

Paul recently sold 50% of the shares in RV Engineering Limited, an engineering consultancy which he founded with his fellow director, Colin, ten years ago. Paul sold his shares to Colin and they have agreed a value of £800,000 for Paul's shares. The base cost of Paul's shares is NIL and costs of sale were £10,000.

In addition to his shares in RV Engineering, Paul also sold the business premises, for which RV Engineering has always paid a full market rent to Paul, who was the sole owner. The agreed sale price of the property was £600,000, based on an independent valuation. The property was purchased on 20 March 2000 and the base cost for Capital Gains Tax (CGT) purposes was £220,000, and the selling costs were £15,000. The transaction date for the sale of the shares and the property was 5 April 2010.

Paul realises that he will be liable for CGT in respect of both disposals but understands he may be eligible for Entrepreneurs' Relief. Paul has made no other disposals for CGT purposes to bring forward and has no allowable losses to bring forward.

Paul also owns shares in two offshore funds, the Delta Global Fund, which has distributor status for UK tax purposes and the AXC European Fund, which does not have distributor status. The Delta fund is invested in global equities and produces an annual dividend, which Paul reinvests. The AXC European fund does not produce an income.

Anna has received a substantial inheritance from her late mother. This inheritance is currently invested in a portfolio of German Société d'Investissement à Capital Variables (SICAVs) and Anna is worried about UK Inheritance Tax. Anna holds £40,000 in cash in a UK bank and she owns the UK family home jointly with her husband as tenants in common.

Questions

- (a) (i) Explain to Paul the relevant features of Entrepreneur's Relief in respect of Capital Gains Tax (CGT) and the extent of his eligibility. (7)
- (ii) Calculate, **showing all your workings**, the total **chargeable gains** for CGT purposes on the disposal of Paul's shares and the business premises. (10)
- (b) (i) Explain the rules used to ascertain domicile for UK tax purposes and, giving reasons, identify Paul and Anna's current domicile status. (10)
- (ii) Explain to Anna which of her assets would be subject to UK Inheritance Tax (IHT) if she had died in the 2009/2010 tax year. (2)
- (c) Assuming Paul and Anna become non UK residents when they move to Germany, describe any restrictions they will face on visiting their family in the UK if they wish to maintain their non resident status. (5)
- (d) Based on his current residency status, explain to Paul the tax treatment of the Delta Global and AXC European Funds in regard to:
- (i) Income Tax; (4)
- (ii) Capital Gains Tax. (2)

Total marks available for this question: 40

TAX TABLES

INCOME TAX RATES

2009/2010		2008/2009	
Rate	Band	Rate	Band
%	£	%	£
10	1 - 2,440*	10	1 - 2,320*
20	1 - 37,400	20	1 - 34,800
40	Over 37,400	40	Over 34,800

* A new 10% starting rate is applied for savings income only from 06.04.2008. Only applicable where non-savings income after allowances is under £2,440 for 2009/2010.

NATIONAL INSURANCE CONTRIBUTIONS

2009/2010 Rates

Class 1 Employee	Weekly	Monthly	Yearly
	£	£	£
Lower Earnings Limit (LEL)	95	412	4,940
Upper Earnings Limit (UEL)	844	3,656	43,875
Upper Accruals Point	770	3,337	40,040

Class 1 Employee contributions 2009/2010

Total earnings £ per week	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

Class 1 Employer contributions 2009/2010

Total earnings £ per week	Contracted-in rate	Contracted-out rate	
	%	Final salary	Money purchase
	%	%	£
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 £95 per week. This £95 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

INCOME TAX RELIEFS

	2009/2010	2008/2009
	£	£
Personal (basic)	6,475	6,035
Personal (age 65-74)	9,490	9,030
Personal (aged 75 and over)	9,640	9,180
Married/civil partners (minimum) at 10% †	2,670	2,540
Married/civil partners (age under 75) at 10% †	N/A	6,535
Married/civil partners (age 75 and over) at 10%	6,965	6,625
Age-related relief reduced by 50% of income over	22,900	21,800
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
Blind person's allowance	1,890	1,800
Enterprise Investment Scheme relief limit @ 20%	500,000	500,000
Venture Capital Trust relief limit @ 30%	200,000	200,000

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

PENSIONS

Lifetime Allowance		Annual Allowance	
2006/2007	£1.5 million	2006/2007	£215,000
2007/2008	£1.6 million	2007/2008	£225,000
2008/2009	£1.65 million	2008/2009	£235,000
2009/2010	£1.75 million	2009/2010	£245,000
2010/2011	£1.8 million	2010/2011	£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

	2009/2010	2008/2009
Nil-rate band*	£325,000	£312,000
Rate of tax on excess	40%	40%
Lifetime transfers to and from certain trusts	20%	20%
Overseas domiciled spouse/civil partner exemption	£55,000	£55,000

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

	0-3	3-4	4-5	5-6	6-7
Years before death					
% of death charge	100	80	60	40	20
Annual exempt gifts	£3,000 per donor			£250 per donee	

* From 8 October 2007 up to 100% of the unused proportion of a deceased spouse's/civil partner's nil-rate band can be claimed on the surviving spouse's/civil partner's death.

MAIN SOCIAL SECURITY BENEFITS

		From 06.04.09	From 06.04.08
		£	£
Child Benefit	first child	20.00	20.00*
	subsequent children	13.20	13.20*
Incapacity Benefit	short-term lower rate**	67.75	63.75
	short-term higher rate**	80.15	75.40
	long-term rate	89.80	84.50
Attendance Allowance	lower rate	47.10	44.85
	higher rate	70.35	67.00
Retirement Pension	single	95.25	90.70
	married	152.30	145.05
Pension Credit	single person standard minimum guarantee	130.00	124.05
	married couple standard minimum guarantee	198.45	189.35
	maximum savings ignored in calculating income	6,000	
	increased from November 2009	10,000	
Bereavement Benefit (lump sum)		2,000.00	2,000.00
Widowed Parent's allowance		95.25	90.70
Jobseekers Allowance		64.30	60.50

* From 5 January 2009

** Under State Pension Age

VALUE ADDED TAX

Standard rate	15%*/17.5%**
Annual registration limit - from 1 May 2009	£68,000

* Effective from 1 December 2008

** Effective from 1 January 2010

CORPORATION TAX

Financial Year	2009 to 31/3/10	2008 to 31/3/09
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

CAPITAL ALLOWANCES

Plant & machinery 100% annual investment allowance (first year)	£50,000
Plant & machinery in excess of annual investment allowance (first year)	40%
Plant & machinery, patent rights, know-how (reducing balance) per annum	20%
Certain long-life assets, integral features of buildings (reducing balance) per annum	10%
Industrial & agricultural buildings (straight line)	2%
Energy & water-efficient investments	100%
Qualifying flat conversions & business premises renovations	100%
Motor cars: with emissions in excess of 160g/km	10%
generally	20%*
with CO2 emissions of 110g/km or less	100%
Research & Development: Capital expenditure	100%
Revenue expenditure - small/medium-size firms	175%
- large firms	130%

* Maximum £3,000

CAPITAL GAINS TAX

Exemptions	2009/2010	2008/2009
Individuals, estates etc	£10,100	£9,600
Trusts generally	£5,050	£4,800
Chattels proceeds (5/3 excess gain is taxable)	£6,000	£6,000
Rates		
Individuals	18%	18%
Trusts and estates	18%	18%

ENTREPRENEURS' RELIEF

Entrepreneurs' Relief 2009/2010

4/9^{ths} of gain tax free. Lifetime limit eligible for relief: £1,000,000

For trading businesses and companies (minimum 5% employee shareholding) held for 1yr+

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