



AF1

THE CHARTERED INSURANCE INSTITUTE

MONDAY 19 OCTOBER 2009

**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.**

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

Margaret and Jack Mitchell, aged 53 and 52 respectively, are married with one adult son. Margaret was employed by a retail company and left on 31 July 2009 to start her own business.

Margaret's salary with the retail company was £52,500 gross per annum. She also had the benefit of a petrol driven company car that had a purchase price of £18,600 with CO₂ emissions of 142g/km. Margaret paid for all fuel for private use. Margaret commenced a personal pension plan in 1999 and has paid personal contributions of £80, net, per month since then to the present date. On leaving the retail company, Margaret's P45 showed total Income Tax paid under PAYE for 2009/2010 to the date of leaving was £5,500.

Margaret started business as a self-employed interior design consultant on 1 October 2009. Her projected first year's net income, after allowable expenses to 30 September 2010 from the new business, is £45,000. Margaret's only initial expenditure for the business was the purchase of a car for £16,000, with CO₂ emissions of 135g/km. Personal use of the car accounted for 20% of its usage. Margaret plans to wait for her first year's accounts to be finalised before submitting her self-assessment tax return for 2009/2010 and is concerned that she may not have enough time to meet HM Revenue & Customs (HMRC) deadlines.

Margaret has received an annual copyright royalty of £6,000 for the tax year 2009/2010. She will also receive annual net interest of £624 from a UK building society account and dividend distributions of £540 from a portfolio of UK equity growth unit trusts for the tax year 2009/2010.

Jack is employed by a firm of architects as office manager. His firm have offered him the chance of a six month secondment to their New York office.

Jack is a joint trustee with his brother, Phillip, in respect of an accumulation and maintenance trust set up on 1 June 2001 by their father for Phillip's daughter, now aged 12. Their father died in 2003. As Phillip has suffered permanent brain damage, Jack feels he needs to consider appointing a replacement trustee for Phillip. In addition, Jack wonders if he could delegate any of his own trustee responsibilities to Margaret during his likely absence in New York. Since the trust was set up, it has been fully invested in a single premium onshore investment bond from which no withdrawals have been taken. The initial investment of £25,000 has grown to £32,000 as at 1 October 2009. Jack feels the bond should be encashed and replaced with investments that have better growth potential.

Margaret and Jack make capital gifts each year to use both their Inheritance Tax (IHT) annual exemptions of £3,000 each. In addition they would like to invest from their surplus income a total of £140 per month divided between two joint qualifying regular premium maximum investment plans (MIPs). These will be written in absolute trust for the benefit of their two grandchildren at age 18 who are currently aged four and nine respectively. Margaret and Jack have made no other gifts.

Under her will, Margaret would like her investments and copyright royalties to provide a life interest for Jack on her death and then on his death the capital to revert to their son.

Questions

- (a) Calculate, **showing all your workings**, Margaret's total Income Tax liability and Income Tax payable for the tax year 2009/2010. (23)
- (b) (i) State when Margaret must file her tax return for 2009/2010 with HM Revenue & Customs (HMRC). (4)
- (ii) Explain the penalties if Margaret's tax return is not submitted by the due date. (4)
- (c) With regard to Margaret and Jack's intention to invest in qualifying regular premium maximum investment plans (MIPs) using absolute trusts, explain:
- (i) the Inheritance Tax (IHT) benefits for Margaret and Jack; (8)
- (ii) the other benefits of using the trust, excluding tax; (5)
- (iii) the benefits for Margaret and Jack of using a qualifying policy as the trust property. (6)
- (d) With regard to the accumulation and maintenance trust for Jack's niece, explain:
- (i) the extent to which he is permitted to appoint a replacement trustee; (5)
- (ii) the extent to which he can delegate to Margaret his responsibilities as a trustee under the Trustee Delegation Act 1999; (4)
- (iii) the extent to which he can delegate to Margaret his responsibilities as a trustee under the Trustee Act 2000. (6)
- (e) Calculate, **showing all your workings**, the tax payable if Jack had encashed on 1 October 2009 the investment bond held by the accumulation and maintenance trust. (5)
- (f) Explain the rules on conversion and apportionment and the extent to which they will apply to Margaret's wish for her copyright royalties and other investments to be placed in trust on her death. (10)

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

Peter and Sue Sanderson, aged 40 and 37 respectively, are married and have two children, aged five and seven. In 2005, Peter received an inheritance from his grandfather's estate that enabled him to move house with his family and turn his hobby of carpentry into a full-time occupation.

With some of the inheritance Peter and Sue completed the purchase of a new house in Devon as joint owners on 1 April 2005 and moved from their Bristol home. They had owned the Bristol property jointly and had lived in it since they purchased it on 1 October 1999. The Bristol property has been kept as an investment and has been rented out. The joint interest only mortgage on the Bristol property has not been repaid.

Peter commenced business as a self-employed furniture maker on 1 May 2005 for which he purchased a van and all the necessary tools. The business made good profits for the first two years but over the past 18 months has slowed considerably. Costs have increased and suppliers are wanting debts settled quicker than in the past. There is a very real chance that Peter could be declared bankrupt. A particular concern is the first charge his bank has on the Devon house in respect of overdraft facilities. Peter requires advice on his position in the event of bankruptcy and possible alternative courses of action. Since starting the business, Peter has not disposed of any assets or acquired any new ones.

As a possible solution, Peter is considering selling the Bristol property. Peter only needs a short-term solution to his business problems as he expects a substantial inheritance on the death of his terminally ill mother. His father died several years ago and he is an only child.

In addition to a small amount built up in Individual Savings Accounts (ISAs) and a small joint savings account with Sue, the only other investments Peter has are his private pension arrangements. He has deferred final salary pension benefits from previous employment and a small personal pension which is subject to a master trust. Sue has been nominated as beneficiary under both arrangements.

In view of the initial success of his business and the rental income from the Bristol property, in December 2006 Peter placed most of the balance of his grandfather's inheritance in a bare trust for his children. Peter and Sue are the trustees. Peter and Sue are also trustees of a discretionary trust set up by Peter's grandfather in 2004, which includes a wide range of potential beneficiaries, including Peter himself. They had hoped to maintain this trust and use it for the benefit of their children.

Questions

- (a) Explain how exemptions and reliefs could be used to reduce any Capital Gains Tax (CGT) payable if the Bristol property was sold on 1 November 2009 for a total gain of £158,000 and there were no other gains and no losses brought forward. *No calculation required.* (10)
- (b) In the event of Peter being declared bankrupt:
- (i) list the property that the trustee in bankruptcy would not be able to take **immediate** possession of; (6)
 - (ii) state the order of priority for payment of his debts and liabilities. (6)
- (c) Explain the extent to which the bare trust, set up by Peter in 2006, is protected from creditors in the event of bankruptcy. (7)
- (d) Explain any impact on the discretionary trust set up by Peter's grandfather in 2004, if Peter were declared bankrupt. (3)
- (e) As an alternative to bankruptcy, Peter could apply to the court to set up an Individual Voluntary Arrangement (IVA). Explain the procedures that follow with regard to creditors' responsibilities and entitlements. (8)

Total marks available for this question: 40

Question 3

Charles Manion, aged 53, is widowed with two adult daughters, the elder of whom has just given birth to his first grandchild. Charles is in good health. His wife died in 2003. Under the terms of her will, she left cash amounting to her full Inheritance Tax (IHT) nil rate band to her daughters in equal shares and the rest of her estate to Charles.

Charles is currently employed as Engineering Director of Durables plc with a salary of £60,000 per annum. In 2002, the company granted him options over 20,000 shares under an approved company share option scheme. At that time the shares were priced at £1.50 per share. The current price of Durables plc shares is £5.00 per share and the company has recently written to Charles, to inform him that he can now exercise his options under the terms of the share option scheme. Charles intends to exercise the options in full.

Charles would like to set up a discretionary trust to fund the private education of his first grandchild and any subsequent grandchildren. He wishes to maintain a substantial degree of control over whether and to whom the income from the trust is paid. It is intended that the trust should invest in a combination of shares, corporate bond unit trusts and sterling cash deposits. Any income received by the trust should be accumulated, not distributed.

To set up the trust Charles had intended to use £250,000 of his deposit savings together with the proceeds from the sale of the shares acquired under his share options. Charles understands the sale of the shares would incur a Capital Gains Tax (CGT) liability but has been told that this could be deferred by claiming holdover relief and transferring the shares to the trust. Charles has made no other disposals in this tax year and no losses have been brought forward.

The only other gifts of value that Charles has made were in May 2008 when he gave his daughters £20,000 each to help them with house purchases.

Charles' estate is valued as follows:

| Asset Type | Current Value £ |
|--|---|
| Main residence | 750,000 |
| Bank and building society deposits | 450,000 |
| Shares and open-ended investment companies (OEICs) | 314,000 |
| Individual Savings Accounts (ISAs) | 85,000 |
| Property in Valencia, Spain | 180,000 (based upon current exchange rate) |

Questions

- (a) With regard to Charles' approved share option scheme:
- (i) explain briefly the Income Tax and National Insurance treatment of the option at the exercise date; (3)
 - (ii) calculate, **showing all your workings**, any Capital Gains Tax (CGT) payable by Charles if he were to sell immediately the shares in Durables plc that he would acquire by exercising the share options. *Assume he sells them at the current share price;* (6)
 - (iii) explain how Charles could defer the CGT liability by using holdover relief. (5)
- (b) Assuming Charles claims holdover relief for the proposed transfers into trust, calculate, **showing all your workings**, the Inheritance Tax (IHT) liability:
- (i) if Charles pays it; (5)
 - (ii) if the trustees pay it. (2)
- (c) Calculate, **showing all your workings**, the periodic IHT charge at the 10th anniversary of the trust, assuming that the trust property has grown to £500,000 and the nil rate band is £400,000 at the time and assuming all the tax rates stay the same. (4)
- (d) Explain the ongoing tax position for the trust investments Charles proposes to set up for his grandchild and future grandchildren with regard to:
- (i) Income Tax; (9)
 - (ii) CGT. (6)

Total marks available for this question: 40

T A X T A B L E S

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.

CAR AND FUEL BENEFITS

The charge for company car benefits is based on the carbon dioxide (CO₂) emissions. There is no reduction for high business mileage users.

For 2009/2010:

The percentage charge is 15% of the car's list price for CO₂ emissions at or below the qualifying level of 135g/km.

The base percentage charge of 15% increases in 1% steps for every additional full 5g/km over the 135g/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.

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 (£16,900 for 2009/2010) e.g. car emission 160g/km = 20% on car benefit scale. 20% of £16,900 = £3,380.

Notes:

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

2009/2010 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

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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