

AF2

Advanced Diploma in Financial Planning

Unit AF2 – Business financial planning

October 2011 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2011/2012, 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.

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 and possible, using note format and short sentences on separate lines wherever possible.

SECTION A

This question is compulsory and carries 80 marks.

Question 1

Richard and Janet, aged 64 and 62 respectively, are married and have one son, Tom, aged 36. Tom is married to Clara and they have two minor children. Richard and Janet founded Bricks and Bits Ltd, a private limited company incorporated in England and Wales, in 1990. They both subscribed equally for the 100,000 shares issued at a par value of £1.00 each.

In 2001, Tom joined the company as a shareholding director, at which time the shareholdings were: Richard 34%, Janet 33%, Tom 33%. No further changes have been made and all three were directors of the company.

The shareholders sold the company as a going concern to Mega Bricks Ltd on 31 August 2011, the date of the company year end, and resigned their directorships. Richard and Janet have opted to retire but have no immediate plans to crystallise their pensions, whereas Tom has started a new, unrelated business with Clara.

All the cash was removed from the company prior to the sale date. The agreement between the purchaser and shareholders provided for all the 100,000 issued and fully paid up shares to change hands with an immediate cash payment of £10.00 per share and a balancing payment of £2.50 per share nine months later. None of the shareholders have made any other capital disposals this year or claimed any Capital Gains Tax relief.

The company sold surplus plant for £38,000 prior to the sale. The company accounts show this equipment had a book value of £65,000. The written down value of the tax pool relating to these assets was £50,000.

Knowing they were selling the business, the directors decided the company should make a donation of £2,500 to a political party and £5,000 to a local charity. The company's accountants have subsequently confirmed the 'taxable profits for Corporation Tax' as £350,000 for the year ending 31 August 2011.

Historically, the directors have remunerated themselves with a combination of salary, dividends and pension contributions. All have personal pensions which they have been members of for several years. The pension input period for each policy ends on the 5 April each year. Richard wishes to retire at age 70 and maximise his pension contributions for the current tax year.

Pension fund values and recent contributions

Policy Holder	08/09 Total Contribution £	09/10 Total Contribution £	10/11 Total Contribution £	Current Fund Value £
Richard	30,000	55,000	50,000	752,000
Janet	15,000	25,000	25,000	323,524
Tom	15,000	20,000	20,000	212,056

Tom and Clara's new business, which they purchased with the proceeds from the sale of Tom's shares, requires short term funding of £200,000. The company can afford to pay this back over the next five years. The business owns an unencumbered property worth £250,000. Clara has a personal pension worth £198,000 and they wish to use their pension funds to help the new company. They are not willing to sell the property to their pension schemes.

Richard and Janet have gifted £5,000 each to Tom and Clara's children to enable them to purchase shares in their parents' new company. Tom and Clara have decided to match this amount with a similar gift of shares.

Questions

- (a) Calculate, **showing all your workings**, the Corporation Tax due using the taxable profits figure for the period ending 31 August 2011 and the appropriate rates of Corporation Tax. (15)
- (b) Calculate, **showing all your workings**, Richard's Capital Gain Tax liability following the sale of his shares. *Assume all relevant allowances are available.* (9)
- (c) (i) Explain how the book value and capital allowances from the sale of the surplus plant are treated in determining the taxable profit for Corporation Tax. (6)
- (ii) Calculate, **showing all your workings**, the capital allowances available in the computation of the company's Corporation Tax liability from the sale of the surplus plant. (3)
- (d) Explain to the directors the formalities that must be observed with the preparation and submission of the directors' report to Companies House. (7)
- (e) (i) Explain to Richard the timing and main changes proposed to the lifetime allowance and comment on whether or not they are likely to affect him when he retires at age 70. (7)
- (ii) Explain to Richard all the factors pertinent to utilising any unused annual allowance available this year and from previous years. *No calculations are required.* (8)
- (f) Recommend to Tom and Clara the course of action that will best meet their objective of utilising their pension fund for the benefit of the company. Your recommendation should include an explanation of the benefits and detail any limitations. (15)
- (g) Explain the Income Tax and Capital Gains Tax implications of Tom and Clara's children acquiring shares in their parents' company and receiving dividends. (10)

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

Greg, Steve and Bernard are all former employees of SBG Parts Ltd. They recently resigned and agreed to set up a business together to supply parts to the motor industry.

Greg is a salesman and Steve is an administrator and both are in their thirties. Bernard, a former senior manager of SBG Parts Ltd, is in his late-fifties and due to deteriorating health, does not want to be involved in the day to day running of the business. Bernard is well known and respected in the industry and his role will be to provide contacts, capital and gravitas to the business.

In their haste to get the new venture up and running, they have made no formal agreement as to how the business should be structured, nor have they formalised the specific duties and authorities each will have on behalf of the business. As a result, there are already commercial disagreements emerging between them. Greg, without consulting the others, has signed a contract to purchase stock on behalf of the business before it has even started to trade. They all agreed that stock was required and Greg is of the opinion that it is part of his duties to purchase it. Steve, on the other hand, is not impressed with the quality of the stock to be purchased and feels his agreement should have been obtained before the order was signed as he does not wish to proceed with the purchase.

You have been called in to help resolve the disagreement over the stock order and to provide advice on a range of issues including the most suitable legal form the business should adopt.

Your enquiries demonstrate that Greg, Steve and Bernard wish to keep legal formalities to a minimum and protect their financial privacy. They do not wish their former colleagues to be able to obtain details of their financial affairs in the public domain. They are also keen that their beneficiaries would be compensated for a deceased partner's share of the business free of Inheritance Tax.

Questions

- (a) (i) Explain the principles that would be taken into account to determine whether Greg has bound the business to purchase the stock from the seller. (9)
- (ii) Explain the practical consequences including any legal considerations to the business and its partners if Steve refuses to accept Greg had the authority to place the stock order. (7)
- (b) Explain why an ordinary partnership is the most suitable legal form for the business based on their personal preferences. (8)
- (c) Explain to Bernard his rights as defined by the Partnership Act 1890 in the following circumstances:
- (i) if the partnership were to be dissolved and Bernard seeks to reclaim his capital from the business; (4)
- (ii) Bernard's death and his estate's entitlement to his interest in the partnership. (4)
- (d) (i) Describe to the partners the benefits to them of putting in place an automatic accrual agreement. (5)
- (ii) Identify any potential problems for this business inherent in the automatic accrual approach. (8)

Total marks available for this question: 45

Questions continue over the page

Question 3

Tim, aged 47, is a sole trader running his own business which supplies golf equipment and clothing. The business has been struggling for the last two years. Over the past year, Tim has had to heavily discount the price of stock.

It is approaching the year end of the business on 31 October and Tim's accounts assistant, Sabrina, has estimated an annual profit and loss forecast which is as follows:

	Total £
Sales	1,490,000
Cost of goods for sale	845,000
Sales expenses	53,000
Staff costs	500,000
Administration	126,000
Interest	40,000
Other costs	46,000

Sabrina has expressed her concerns to you about the financial state of the business. She informs you that one of Tim's key indicators, the gross profit margin, has declined from 68% to 52% in the previous two years.

Tim's bank will not extend him any further credit because there are significant debts in the form of loans taken out in recent years. He is very worried about the survival of the business and is concerned a bankruptcy order may be filed against him any day. The balance currently owed to creditors is now in excess of £100,000 and they are pushing for payment. One of the major golf supply companies is Tim's largest creditor. It has contacted Tim and has suggested that he considers an Individual Voluntary Arrangement.

Sabrina, who has been employed by Tim since Monday 11 April 2011, is pregnant and about to go on maternity leave at the start of November. Sabrina's baby is due on 18 December 2011.

Questions

- (a) From the projected profit & loss statement:
- (i) calculate, **showing all your workings**, the projected gross profit for the year; (2)
 - (ii) calculate, **showing all your workings**, the projected profit before tax for the year; (2)
 - (iii) calculate, **showing all your workings**, the projected gross profit margin using your answer from (a)(i) above. (2)
 - (iv) explain what the trend in the gross profit margin indicates. (3)
- (b)
- (i) Explain to Tim the business restrictions he will face if he is declared a non-culpable bankrupt. (8)
 - (ii) Explain the **advantages** to Tim and his supplier of entering into an Individual Voluntary Arrangement. (7)
- (c)
- (i) State what Tim's responsibility is to Sabrina in respect of Maternity Leave. (6)
 - (ii) Explain to Tim whether Sabrina will qualify for Statutory Maternity Pay. (5)

Total marks available for this question: 35

The tax tables can be found on pages 11 – 15

INCOME TAX

RATES OF TAX	2010/2011	2011/2012
Starting rate for savings*	10%	10%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	50%	50%
Starting-rate limit	£2,440*	£2,560*
Threshold of taxable income above which higher rate applies	£37,400	£35,000
Threshold of taxable income above which additional rate applies	£150,000	£150,000

*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) §	£6,475	£7,475
Personal Allowance (age 65-74) §	£9,490	£9,940
Personal Allowance (aged 75 and over) §	£9,640	£10,090
Married/civil partners (minimum) at 10% †	£2,670	£2,800
Married/civil partners (age 75 and over) at 10%	£6,965	£7,295
Income limit for age-related allowances	£22,900	£24,000
Blind Person's Allowance	£1,890	£1,980
Enterprise Investment Scheme relief limit on £500,000 max	20%	30%
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)		
- family element	£545	£545
- family element baby addition	£545	Withdrawn
CTC usually reduced by 41% of joint income (6.67% for 2010/2011) over	£50,000	£40,000

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	Weekly	Monthly	Yearly
Lower Earnings Limit (LEL)	£102	£442	£5,304
Primary threshold	£139	£602	£7,225
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 rate
Up to 139.00*	Nil	Nil
139.01 – 770.00	12%	10.4%
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 £102 per week. This £102 to £139 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 136.00**	Nil	Nil	Nil
136.01 – 770.00	13.8%	10.1%	12.4%
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 £2.50 where earnings exceed £5,315 per annum.
Class 3 (voluntary)	Flat rate per week £12.60.
Class 4 (self-employed)	9% on profits between £7,225 - £42,475 plus 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

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	2010/2011	2011/2012			
Transfers made after 5 April 2011					
- 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 exemption per donor	£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 (CO₂) emissions. There is no reduction for high business mileage users.

For 2011/2012:

The percentage charge is 15% of the car's list price for CO₂ emissions at or below the qualifying level of 125g/km.

- Cars with CO₂ emissions of less than 75g/km have an appropriate percentage of 5%.
- Cars with CO₂ emissions of 76g/km to 120g/km have an appropriate percentage of 10% and thereafter the rate is 15% increasing by 1% for every 5g/km to the current maximum of 35% (emissions of 225g/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 CO₂ emissions % relevant to the car and that % applied to a set figure (£18,800 for 2011/2012) e.g. car emission 155g/km = 21% on car benefit scale.
21% of £18,800 = £3,948

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

Cars	
On the first 10,000 business miles in tax year	45p 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

2011/2012

Plant & machinery (excluding cars) 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%
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%
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MAIN SOCIAL SECURITY BENEFITS

2010/2011 2011/2012

		£	£
Child Benefit	first child	20.30	20.30
	subsequent children	13.40	13.40
Employment and Support Allowance	Assessment Phase		
	Age 16 – 24	N/A	Up to 53.45
	Aged 25 or over	N/A	Up to 67.50
	Main Phase		
	Work Related Activity Group	N/A	Up to 94.25
	Support Group	N/A	Up to 99.85
Attendance Allowance	lower rate	47.80	49.30
	higher rate	71.40	73.60
Retirement Pension	single	97.65	102.15
	married	156.15	163.35
Pension Credit	single person standard minimum guarantee	132.60	137.35
	married couple standard minimum guarantee	202.40	209.70
	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		97.65	100.70
Jobseekers Allowance	Age 16 - 24		53.45
	Age 25 or over	65.45	67.50

CAPITAL GAINS TAX

EXEMPTIONS	2010/2011	2011/2012
Individuals, estates etc	£10,100	£10,600
Trusts generally	£5,050	£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	18%/28%*	28%
Trustees and Personal Representatives	18%/28%*	28%
Entrepreneurs' Relief – Gains taxed at:	10%	10%
Lifetime limit	£5,000,000 / £2,000,000**	£10,000,000

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

* 18% rate applies to disposals on or before 22/06/10. 28% thereafter.

** For disposals 06/04/10 to 22/06/10: £2,000,000. £5,000,000 until 05/04/11

CORPORATION TAX

	2010/2011	2011/2012
Full rate	28%	26%
Small companies rate	21%	20%
Small companies limit	£300,000	£300,000
Effective marginal rate	29.75%	27.5%
Upper marginal limit	£1,500,000	£1,500,000

VALUE ADDED TAX

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

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