



AF2

THE CHARTERED INSURANCE INSTITUTE

WEDNESDAY 21 APRIL 2010

**ADVANCED DIPLOMA IN FINANCIAL PLANNING
AF2—BUSINESS FINANCIAL 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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AF2—Business financial 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

Lizzy Smith and Nigel Brown have both worked at a senior level for a national mail order stationery & office supply company. Lizzy and Nigel have left these jobs to establish their own internet based stationery supply company and have secured funding from a venture capitalist and a major clearing bank.

They have incorporated a private limited company called Stationery Fast! Ltd. The business will employ approximately 50 persons in telesales, packaging and dispatch, IT and management. The primary objectives of the company are to achieve a turnover in the first year of £4,000,000 and profits of £500,000. The projected profit is stated to be operating profit after finance costs but before Lizzy and Nigel's remuneration.

Lizzy tells you of her staffing plans for the call centre, packaging and dispatch areas. Workers will be paid £5.50 per hour, apart from the dispatchers who will be paid £6.50 per hour. Workers will be expected to work five basic shifts of eight hours and a minimum of ten hours overtime each week. Sixteen days annual paid leave will be based on the basic working week.

Stationery Fast! operates in a sector with potentially high staff turnover rates in the call centre, packing and dispatch positions. Lizzy and Nigel need to develop an incentive package designed to keep staff from leaving in the first one to two years of service in these grades, as well as motivating and engendering loyalty in the higher grades. The elements you are recommending, in addition to basic salary are:

- sales incentives and generous overtime payments;
- employer contribution to a group personal pension scheme;
- group Critical Illness and death-in-service.

Lizzy proposes only to provide a job description to her workers as she feels formal contracts lead to problems with potentially troublesome staff members.

You have previously advised Lizzy and Nigel as individuals and they are looking to you now to advise them on certain key aspects of their business plans.

Questions

- (a) Describe to Lizzy and Nigel the problems they may have with Lizzy's staffing proposals and explain the wider responsibilities they will have to their employees in respect of the following:
- (i) pay; (7)
 - (ii) working hours; (6)
 - (iii) leave; (7)
 - (iv) provision and contents of written terms. (7)
- (b) Describe to Lizzy and Nigel the obligations they may expect their employees to show them as the employer. (5)
- (c) With regard to the proposed incentive package:
- (i) explain why sales incentives and generous overtime payments will help the company's financial objectives. (6)
 - (ii) Lizzy and Nigel have agreed an employer pension contribution of 5% of salary but will not start this until six months' service has been completed. Explain to them the practical difficulty of this proposal and suggest **three** possible ways to overcome the problem and permit them to operate a six month service qualification period. (5)
 - (iii) State **one** other aspect of workplace pension provision related to forthcoming legislative changes of which Lizzy and Nigel should be aware. (2)
 - (iv) Nigel asks you to advise him how group death-in-service schemes are set up and operated. Describe the broad features of a group death-in-service scheme, in respect of:
 - its constitution;
 - its tax status;
 - the underwriting of the risk;
 - the calculation of premiums. (8)

- (d) In the draft agreement with their venture capitalist, Lizzy and Nigel can remunerate themselves either with a salary, costing the company no more than 35% of the operating profit, or draw a dividend from 35% of the post tax profit. Assume the operating profit is £500,000 in the first trading period and for the purpose of your answers use the 2009/2010 tax tables.

Calculate, **showing all your workings**:

- (i) the amount of post tax profit that can be paid as a dividend to Lizzy and Nigel; (4)
- (ii) the gross salary they could award themselves allowing for the cost of the employer's National Insurance contributions within the agreed budget; (4)
- (iii) Calculate Lizzy's net of tax receipt if she takes either:
- 50% of the amount you have identified in (d)(i) above as a dividend, or;
 - 50% of the amount you have identified in (d)(ii) above as a salary.
- Assume that Lizzy's income arises in a single tax year and that she has no other sources of taxable income for the year.* (14)
- (iv) Outline the problems Lizzy and Nigel will encounter if they take the whole of their income as a dividend. (5)

Total marks available for this question: 80

Section B questions can be found on pages 8-13

SECTION B

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

Question 2

Cool Toys Ltd is a manufacturer of toys for children. The business experienced limited success for a number of years in what is a very competitive market, until a failure to correctly judge the market led to the business experiencing its first trading loss in the accounting period ending 31 August 2007.

The trading loss for the accounting period ending 31 August 2007 has been carried forward and there remains an unused balance of £48,753.

Having survived this downturn in its fortunes, the firm succeeded in designing a new toy that it believed to have the potential to be a great success. In order to provide the necessary working capital, the business sold its office building for £745,000 in September 2008 and made a taxable capital gain of £215,000. Once the company had cleared its outstanding debts, the remainder of the sale proceeds were used as working capital.

The new toy was launched in October 2008, and after spending £24,500 on entertainment expenses, was very well received by the purchasers from the UK's leading toy and department stores, who went on to place large orders. It has since gone on to be a considerable success, with sales exceeding all expectations.

The Profit and Loss account for the accounting period ending 31 August 2009 is shown below. Capital allowances for the year amount to £145,000.

PROFIT & LOSS	Year ending 31 August 2009
	£
Sales	3,250,500
Less cost of goods sold	(1,617,500)
Gross Profit	1,633,000
Less Operating expenses:	
Sales & distribution expenses	580,000
Finance & administration expenses	257,000
Other overheads	46,000
	883,000
Operating profit	750,000
Plus other income:	
Franked Investment Income	5,000
Bank interest received (gross)	6,216
Rental income received	3,031
Profit from sale of office	215,000
	229,247
Less other expenses:	
Interest payable	2,263
Depreciation	97,472
	99,735
Less charitable contributions	5,000
Net profit before tax	874,512

Questions (a), (b) and (c) can be found on page 11

- (a) Using the information provided, calculate, **showing all your workings**, the following profit figures for the account period 31 August 2009:
- (i) trading profits; (12)
 - (ii) revised trading profits; (3)
 - (iii) profits chargeable to Corporation Tax. (7)
- (b) (i) Calculate, **showing all your workings**, and giving explanations where necessary the Corporation Tax payable for the accounting period ending 31 August 2009. (5)
- (ii) State the date on which the tax return must be filed with HM Revenue and Customs (HMRC). (1)
- (iii) State the date on which the tax must be paid. (1)
- (c) The directors of Cool Toys Ltd are keen to retain the development team responsible for their recent success, and are considering implementing an Enterprise Management Incentive Scheme (EMI) with which to reward them.
- The company are proposing to place options for shares worth £250,000 into a scheme in which the five members of the team can participate.
- (i) Outline the qualifying criteria that the company must meet to operate an EMI. (4)
 - (ii) Explain briefly the Income Tax treatment of the EMI for the employees. (3)

Question 3

Alan and David are brothers, they are both aged 50 and are the directors and sole shareholders of Clare Supplies Ltd, a plumbing supplies company. They set up a Small Self-Administered Pension Scheme (SSAS) five years ago. The funds within the SSAS are valued at £300,000 and are wholly invested in the freehold of one of the company's sites, which is valued at £400,000 and subject to a mortgage of £100,000. The company has historically made a contribution of £10,000 per annum to the scheme and has not yet paid a contribution in the current year. Alan and David have each drawn a salary of £80,000 per annum from the company for the last three years and have taken dividends of around £10,000 per annum over the same period. Neither Alan nor David are making any other pension contributions.

Clare Supplies Ltd operates from two sites, one of which it leases, having recently sold a third site owned by the company to a property developer. There is now a sum of £1,200,000 in the company's bank account after allowing for Corporation Tax on the sale and Alan and David have both agreed with their accountant that half of this is surplus to the capital requirements of the company and they would like to place it in the pension scheme. They then wish to purchase the other company site from the landlord using the pension scheme. Alan and David are willing to consider further borrowing within the scheme to finance the purchase of the site if necessary.

Alan has a daughter, Abigail, who is a Director of a retail business which is structured as a private limited company, selling luxury European leather goods. Alan is also a Director of his daughter's business which has been badly affected by the recession and the pound/euro exchange rate. Abigail's accountant has recently warned her that her business is close to insolvency, however she is hopeful that market conditions will improve and that she can trade her way back to profitability.

Questions

- (a) (i) Explain the test which a pension contribution by Clare Supplies Ltd must pass to be allowable as a deductible business expense. (3)
- (ii) Assuming Clare Supplies Ltd contributes £600,000 to the pension scheme, explain how the contributions will be relieved for Corporation Tax purposes, and why it will be subject to this treatment. (5)
- (iii) Calculate, **showing all your workings**, the recovery charge which will be levied on Alan if Clare Supplies Ltd makes a contribution of £300,000 on his behalf to the scheme. (3)
- (iv) State **two** circumstances under which the recovery charge you have calculated in (iii) above would not be payable. (4)

- (b) (i) Assuming that Clare Supplies Ltd makes the maximum possible contribution without triggering a recovery charge for Alan or David, calculate, **showing all your workings**, how much cash the scheme will have available with which to acquire the site, assuming that the maximum permissible loan is taken. (5)
- (ii) Explain **three** disadvantages for the members of the pension scheme of holding all of the pension assets in property occupied by Clare Supplies Ltd. (3)
- (c) (i) One of Abigail's creditors, whom her company has not paid on time, is considering applying for the company to be declared insolvent. Identify and explain briefly **two** alternatives to insolvency that will enable Abigail to continue trading. (8)
- (ii) Abigail has heard about the concept of a members voluntary liquidation and that a declaration of solvency is required. Explain the procedures relating to a declaration of solvency and what it must contain. (5)
- (d) Explain what the consequences could be for the directors if Abigail's company is insolvent and they allow the company to continue to trade. (4)
- (e) Describe how any unpaid wages due to Abigail's staff will be recovered in the event that the company becomes insolvent. (4)

The tax tables can be found on pages 15 – 19

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.

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 & Capital expenditure	100%
Development: 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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