

THE CHARTERED INSURANCE INSTITUTE

AF3

Advanced Diploma in Financial Planning

Unit AF3 – Pension 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 handing 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 AF3 – Pension 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 and 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 provided 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

David and Lesley Taylor, aged 64 and 59 respectively, are considering their retirement. David's total taxable income is £110,000. The directors of the firm that employs David have suggested that they might continue to offer him some consultancy work in the future but he is keen to access the benefits he has in a personal pension plan with a fund value of £325,000, of which £50,000 is protected rights. David also has a small pension from a defined benefit scheme which he intends to draw. The pension payable from this is £3,500 per annum.

Lesley has one small personal pension plan to which her current employer has contributed since she started working for them six years ago. The fund value of this policy is £14,000. In addition, she has a deferred pension from a contracted-out defined benefit scheme. At the date of leaving in 1993, her pension was £2,500 per annum. The scheme's normal retirement age is 65.

The couple have a small mortgage of approximately £20,000 which they intend to repay with some savings they currently have in the building society. In addition, they have both funded ISAs fully for the past five years which are invested in both cash and equity-based investments. They have no liabilities other than their mortgage and their children have both left home and are financially independent.

Questions

- (a) Calculate, **showing all your workings**, the percentage of the lifetime allowance David will use should he crystallise both his pensions now. (5)
- (b) David is considering phasing his benefits as he does not need all the tax-free cash available to him at the outset.
- (i) Explain how phased lifetime annuity purchase works. (6)
- (ii) State **four** potential benefits and **five** potential drawbacks for David of using phased income withdrawal rather than phased annuity purchase. (9)
- (c) Assuming David effects phased income withdrawal, state:
- (i) **ten** factors that should be considered when conducting his annual review; (10)
- (ii) the circumstances that may influence a recommendation to change the underlying asset allocation. (9)
- (d) In the event of David's death during phased income withdrawal, describe the benefits that could be payable to Lesley and their tax treatment. (10)
- (e) Lesley has asked whether she can commute her personal pension using the triviality rules.
- State, giving your reasons, whether this is possible. (4)

- (f) Lesley is considering transferring the cash equivalent transfer value (CETV) of her defined benefit pension into her personal pension.
- (i) Explain, in detail, how the CETV would be calculated. (9)
 - (ii) Describe the statutory minimum revaluation that would apply to Lesley's pension. (4)
- (g) David is considering using his full ISA allowance during the tax year. As an alternative, he is considering making a pension contribution of the same amount.
- (i) Describe the tax treatment and how any tax relief would be granted on the contributions for both a pension and an ISA. (9)
 - (ii) Describe the tax treatment of any resulting benefits for each product. (5)

Total marks available for this Question: 80

Questions continued over the page

SECTION B

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

Question 2

Simon Rowbotham, aged 58, is a deferred member of the Martin Industries Ltd defined benefit pension scheme. Simon was made redundant six months ago as a result of Martin Industries Ltd financial difficulties. Simon is single, with no children or financial dependents.

He has recently received a summary funding statement from the scheme trustees stating that the latest International Accounting Standards (IAS 19) actuarial valuation of the scheme has shown a deficit. Simon is concerned about this although he does not understand the statement fully and he has approached you for advice regarding his situation.

Simon has been unsuccessful in finding alternative employment following his redundancy and whilst he has some redundancy payment left if he cannot find employment within the next 6 – 12 months, it is likely he would wish to draw benefits from his preserved pension. He also has a mortgage he would like to repay at that time. He believes one of the reasons he has found it difficult to find employment is that his health is poor.

Questions

- (a) When conducting the IAS 19 scheme valuation:
- (i) describe the purpose and main features of the valuation; (6)
 - (ii) state the main assumptions that the scheme actuary needs to make. (7)
- (b) (i) Describe briefly the actions that must be taken by the trustees when a funding shortfall has been identified. (4)
- (ii) Other than increasing funding levels, state **five** options open to the trustees and employer to reduce the deficit in future. (5)
- (c) State, giving your reasons, the potential impact of the scheme deficit on:
- (i) Simon's benefits; (3)
 - (ii) the cash equivalent transfer value. (3)
- (d) Simon is considering accessing his benefits. Taking into account his personal circumstances and objectives, identify the factors that will influence his decisions in regard to:
- (i) early retirement from the scheme; (6)
 - (ii) immediate vesting following a transfer to a personal pension. (6)

Total marks available for this question: 40

Question 3

Colin Buxton recently started to receive his State Pension benefits, having reached age 65 in March 2011. His wife, Glenda, was already in receipt of her State Pension benefits, having reached State Pension age in January 2010.

With the exception of a 10 year period, when Glenda gave up work following the birth of their son Mark, she was continuously in employment from leaving school at age 18 right through until her retirement at age 60.

Mark will be age 39 in July 2011. He is a managing director of a small engineering firm on a salary of £60,000.

To date, Mark has accumulated a total value of funds of £265,000 in a variety of different pension arrangements including a contracted-in money purchase scheme (CIMP) and an appropriate personal pension (APP). Of this total £42,000 of the personal pension fund is protected rights (PR) and he remains contracted out of the State Second Pension.

Mark is keen for advice on how these funds should be structured in the future and wonders if either a self-invested personal pension (SIPP) or stakeholder pension would be appropriate for him.

Questions

- (a) State, giving your reasons, the eligibility criteria in order to receive a full Basic State Pension for:
- (i) Colin; (3)
 - (ii) Glenda. (3)
- (b) Should Mark remain contracted-out, state:
- (i) **six** potential benefits; (6)
 - (ii) **four** potential drawbacks. (4)
- (c) State **six** features of a CIMP that differentiate it from an APP. (6)
- (d) In assessing the suitability of consolidating Mark's pensions, state, giving your reasons, the main issues that must be taken into account in making your recommendation. (8)
- (e) Outline how a stakeholder pension differs from a SIPP in the following areas:
- (i) charges; (6)
 - (ii) investments. (4)

Total marks available for this question: 40

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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