

AF3

Advanced Diploma in Financial Planning

Unit AF3 – Pension 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 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 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

Samuel, aged 64, is a widower with two adult children who are financially independent and three grandchildren.

Samuel retired from his position as the Finance Director of a PLC on his 60th birthday on 5 February 2007. In addition to this employment, he accrued self-employed earnings from various articles published in the financial press. He has continued writing since his retirement and this has provided him with an income of around £35,000 per annum.

Samuel was a member of his previous employer's occupational contracted-in money purchase (CIMP) scheme. The scheme's normal retirement age is 65 and the trustees have written to Samuel stating that his current fund value is £1,350,000 and that they can, if he wishes, use this to purchase a scheme pension of £41,000 per annum plus provide him with a pension commencement lump sum of £337,500.

Samuel is considering whether to accept this offer or alternatively transfer the funds into a drawdown pension contract.

Samuel started a personal pension plan (PPP) in 1998 in respect of his self-employed earnings. On 1 May 2009 he crystallised £100,000 of his PPP into an income drawdown arrangement. The funds in drawdown are currently valued at £45,000 and the funds remaining in the PPP are currently valued at £295,000 including a single premium of £10,000 Samuel made on 1 October 2011.

Samuel did not elect for any form of transitional protection in respect of his pension arrangements.

Samuel has been approached by a publisher with an offer to write a book on financial management. He has decided to accept the offer and intends to cease his other writing and to move to his holiday home in South Africa whilst he works on the book. As a result he will require a greater level of income from his pensions.

Questions

- (a) Calculate, **showing all your workings**, the percentage of the lifetime allowance Samuel will have remaining if, in January 2012:
- (i) he takes the scheme pension option offered by the trustees of the contracted-in money purchase (CIMP) scheme; (7)
 - (ii) he uses the whole fund to enter drawdown pension. (3)
- (b) The lifetime allowance will be reduced to £1,500,000 from 6 April 2012.
- (i) Explain, **using calculations to support your answer**, why this may influence Samuel to take the benefits from the CIMP as a scheme pension rather than via income drawdown. (6)
 - (ii) State how fixed protection could help protect Samuel's benefits and outline the actions he must take and the timescales that apply. (3)
 - (iii) Assuming Samuel applies for fixed protection, state **two** circumstances in which this protection would be lost. (2)
- (c) Samuel will need additional income from next year. If he designates additional funds to his existing unsegmented drawdown plan on 1 January 2012:
- (i) explain how Samuel's revised maximum income limit will be calculated. *No calculation is required*; (5)
 - (ii) describe briefly when this new limit will take effect and state for how long it will apply; (3)
 - (iii) state **three** other events that would trigger a review of Samuel's maximum income limit. (3)
- (d) Samuel is interested in switching some funds into flexible drawdown.
- (i) State the minimum income requirement and outline how this may be met. (6)
 - (ii) Explain the other conditions that Samuel must meet in order for him to be eligible for flexible drawdown. (4)

Questions continued over the page

- (e) Samuel wishes his children and grandchildren to benefit from his pension funds upon his death. Outline the form and the tax treatment of the benefits payable if, on his death, Samuel's retirement benefits consist of:
- (i) a scheme pension; (8)
 - (ii) a drawdown pension; (4)
 - (iii) an uncrystallised PPP. (6)
- (f) (i) Explain briefly how and when future increases in the Basic State Pension will be awarded. (6)
- (ii) Outline how Samuel's decision to move to South Africa may affect any increases to his State pensions once they come into payment. (4)
- (g) State the main factors that should be considered when determining how Samuel's retirement benefits can be best structured to meet his needs. (10)

Section B questions can be found on pages 8 – 10

SECTION B

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

Question Two

Aimee, aged 47, is a French national. She moved to the UK in October 2001 to further her career as a chef. After working for two hotel chains and a short period of self-employment, she has set up a limited company with effect from 1 October 2011 in preparation for opening her own restaurant.

Aimee would like to be in a position to retire by the time she reaches age 60. She has the following pension arrangements:

Private Pension Plan in France

Fund value	£45,800
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All contributions were made when she was living in France and the contract is deemed by HM Revenue & Custom to be a Recognised Overseas Pension Scheme.

Hightop Hotels - Group Stakeholder Pension Plan (GSHP)

Fund value	£128,000
Contributions commenced	1 October 2001
Contributions ceased	31 March 2008

Aztec Hotels – Contracted-in Occupational Money Purchase Pension (CIMP) Scheme

Fund value	£82,000
Commenced service and joined scheme	1 December 2009
Left service and scheme	30 September 2011
Employer contributions	12% of basic gross monthly pay
Employee contributions	8% of basic gross monthly pay

Contributions were paid on the 28th of every month and Aimee's basic salary during her employment with Aztec Hotels were:

- £66,000 per annum for the period 1 December 2009 to 30 November 2010
- £72,000 per annum for the period 1 December 2010 to 30 September 2011

Aimee received a significant bonus payment in January 2011 and immediately arranged for a gross payment of £40,000 to be paid into her CIMP. This was done via payroll deduction and Aimee received full tax relief at source.

Questions

- (a) Aimee would like to transfer her pension funds currently held in France to the UK. Explain the impact this transfer would have on her available lifetime allowance, including any action that would need to be taken by Aimee. (5)
- (b) Aimee has been informed that she can take a short service refund lump sum in respect of the contributions held in the Aztec Hotels contracted-in money purchase pension scheme.
- (i) Calculate, **showing all of your workings**, the net amount she would receive. (6)
- (ii) Outline the reasons why taking a short service refund lump sum may not be in Aimee's best interests. (6)
- (c) Aimee is considering transferring her Hightop Hotel Group Stakeholder Pension Plan to a self-invested personal pension (SIPP).
- Outline:
- (i) the factors she should consider in relation to this potential transfer; (6)
- (ii) how the SIPP can be used to support Aimee's new business, stating any restrictions that apply. (4)
- (d) Aimee has decided not to take the short service refund lump sum and would like to maximise the contributions paid to her pension for the 2011/2012 tax year by utilising carry forward of unused annual allowance.
- (i) Calculate, **showing all your workings**, the maximum tax relievable pension contribution for the 2011/2012 tax year. *Assume that all of her schemes have a pension input period in line with the tax year.* (10)
- (ii) Explain how this payment should be made in order to maximise the tax relief available. (3)

Questions continued over the page

Question Three

Mike, aged 52 and married, is the Managing Director of MJ Printing Ltd. He established the company in 1990 and now wishes to purchase new equipment at a cost of £125,000.

On the advice of his financial adviser, a Small Self Administered Pension Scheme (SSAS) was set up in 1996. The scheme currently comprises:

Commercial property	£240,000
Outstanding loan	(£80,000)
Cash	£20,000
Share portfolio	£125,000

He intends to use the loanback facility from the SSAS to help with the purchase of the equipment.

Mike has a deferred benefit from his previous membership of a contracted-out defined benefit scheme and feels that this could be more useful to him if it were transferred into the SSAS. He received a deferred benefit statement in 2009 showing a cash equivalent transfer value (CETV) of £95,000, however the statement he has just received shows a reduced CETV of £87,000, of which £36,000 would become protected rights upon transfer to a defined contribution pension scheme.

Questions

- (a) (i) Calculate, **showing all your workings**, the maximum loan the SSAS can make to MJ Printing Ltd. (4)
- (ii) Outline the conditions that must apply to the loan. (5)
- (b) Outline how the following factors may have contributed to the fall in Mike's CETV:
- (i) a change from RPI linking to CPI linking for scheme benefits; (3)
- (ii) a change in the funding position of the scheme; (2)
- (iii) a change in the assumptions used by the actuary. (8)
- (c) Mike would like to transfer the full CETV of his deferred benefits away from his previous employer's scheme.
- (i) Explain why protected rights form part of Mike's CETV. (5)
- (ii) Explain why it may not currently be possible to transfer his benefits into the SSAS and outline the options available to him. (6)
- (d) List the additional factors that should be considered by Mike before deciding whether to transfer his benefits. (7)

The tax tables can be found on pages 12 – 16

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%

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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