



**AF3**

**THE CHARTERED INSURANCE INSTITUTE**

**TUESDAY 20 OCTOBER 2009**

**ADVANCED DIPLOMA IN FINANCIAL PLANNING  
AF3 — PENSION 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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# THE CHARTERED INSURANCE INSTITUTE

## AF3 — Pension 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

Ron Riley, aged 49, is married with two teenage children. He is a partner in Siegfried LLP, a law firm. His share of profits in the 2009/2010 tax year will be £135,000. This is similar to previous years and is his only source of income.

He is aware that he has inadequate pension provision and is keen to address this by contributing as much as possible while his income permits. He would like to retire by age 60 and intends to use as much of the lifetime allowance as possible. His current pension provision is as follows:

- a personal pension started in 1999. It has a current value of £200,000. The only payment made into the plan since A-Day was a £50,000 single premium paid on 31 December 2007. The contributions have been invested in a cautious managed fund;
- a contracted-in money purchase occupational pension fund in respect of a previous employment with a value of £70,000. It is invested in a poorly performing managed fund. On 6 April 2006, the fund was valued at £75,000 and there was a scheme specific lump-sum entitlement of £35,000;
- a paid up contracted-out personal pension with a fund value of £30,000 made up entirely of protected rights and invested in a with-profits fund;
- a deferred contracted-out final salary scheme with a deferred pension of £1,750 at the date of leaving the scheme in March 1988. He has recently been offered an enhanced transfer value amounting to £27,000 (an enhancement of £3,500) by the trustees of the scheme and his former employer. In addition, they have also offered a modest cash incentive.

In recent years, Ron has been using surplus income to repay his mortgage and fund Individual Savings Accounts (ISAs). He is now debt-free and has an ISA portfolio worth £57,000. He has a cautious to moderate attitude to risk.

In addition to maximising the tax advantages of his pension, he would also like your opinion on the consolidation of his various deferred pensions into a single pension arrangement.

## Questions

- (a) (i) State, giving your reason, the maximum tax relievable contribution Ron can pay into his personal pension plan. (2)
- (ii) Describe the way in which tax relief is given on the contribution and the impact on his future tax payments. (6)
- (iii) Calculate, **showing all your workings**, the net cost of the contribution and the effective rate of tax relief. *Assume he paid the maximum contribution calculated in (a)(i) above.* (11)
- (b) In assessing the suitability of consolidating Ron's money purchase benefits within a single pension plan; state, giving your reasons, the main issues that must be taken into account in making your recommendation. (12)
- (c) With reference to the potential consolidation of the protected rights policy, there are currently some rules setting out the format in which benefits can be paid.
- (i) Describe the current rules prescribing the format of benefits on death before retirement. (5)
- (ii) Describe the current rules prescribing the format that secured retirement benefits must take. (6)
- (iii) State the impact of the Pensions Act 2008 on these restrictions. (2)
- (iv) State the minimum age at which Ron can start to draw retirement benefits. (4)
- (d) (i) State **eight** of the key issues that must be communicated to the member by his former employer in making the enhanced transfer value offer. (8)
- (ii) Describe the process you should follow to advise Ron on whether or not to accept the enhanced transfer value offer. (6)
- (iii) If Ron was to accept the transfer offer, state the impact on his annual allowance and lifetime allowance. (5)
- (iv) State the tax treatment of the cash incentive payable by his former employer. (2)

(e) (i) State the issues you would consider before recommending and implementing an investment strategy for Ron. *Assume some of his funds are consolidated.* (7)

(ii) You suggest to Ron that part of the fund is invested in cash initially and phased into his longer-term investment strategy over the next 12 to 18 months.

State **two** advantages and **two** disadvantages of this strategy. (4)

**Total marks available for this question: 80**

**Section B questions can be found on pages 8 – 11**

## SECTION B

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

### Question 2

George Dolan, aged 60, has had a successful career in advertising.

He retired from his position as a senior manager with a major plc due to a health scare shortly after he reached age 50 and took his benefits from the company's pension scheme. The benefit from this scheme is a level pension of £54,000 per annum.

In 2000, George and his wife set up their own advertising agency, Dolan and Dolan Ltd, which has proved successful and George continued to accumulate pension funds in a personal pension plan. In March 2007, the couple separated and are now in the process of divorcing.

As part of this process, George left the marital home and in October 2007 he crystallised his personal pension plan into an unsecured Pension Fund Withdrawal plan (PFW) so he could use the pension commencement lump sum (PCLS) as a deposit on a flat. At that time, the pension fund was valued at £200,000 and he took the full £50,000 PCLS and set the income payments at nil.

He has regularly been drawing £80,000 per annum from the business in a combination of salary and dividends. This together with his occupational pension is sufficient for his needs.

George now has a new partner Gail, aged 48, whom he met when she came to work at Dolan and Dolan Ltd. Gail, who divorced a number of years ago, has only recently returned to working full-time. She has a basic salary of £32,000 per annum.

George and Gail plan to continue working until George reaches age 65 in 2014. At this time they would like to sell the business and retire to live in Spain.

## Questions

- (a) George would like to continue funding his pension.
- (i) Calculate, **showing all your workings**, the percentage of George's lifetime allowance that remains available. (7)
  - (ii) State the factors George should consider in respect of future pension funding. (10)
- (b) The financial settlement for George's divorce is being finalised and one option being discussed is for George's wife to receive a pension credit of £100,000 on his Pension Fund Withdrawal (PFW) contract.
- (i) State briefly how a pension debit may affect his lifetime allowance and the impact this may have on his future pension planning. (3)
  - (ii) Assuming a pension sharing order is attached to George's PFW contract as of 1 December 2009; explain, in detail, the effect this will have on the maximum income he can take. (4)
- (c) George would like to make substantial contributions into a pension plan in Gail's name as she currently has no pension benefits other than the entitlements she has built up under the Basic State Pension.
- (i) State, giving your reason, the maximum contribution that Dolan and Dolan Ltd can pay into a pension plan for Gail without triggering an annual allowance charge. (2)
  - (ii) State the factors taken into account by the local inspector of taxes in determining whether such a contribution would be an allowable business expense. (5)
  - (iii) Explain how Gail's entitlement to the Basic State Pension will be determined at State retirement age. (7)
  - (iv) State the earliest ages Gail will be able to take her private and State Pension benefits. (2)

**Total marks available for this question: 40**

### Question 3

Larry Marshall, aged 53, is the managing director of Marshall Security Ltd. The company offers a contracted-in trust based money purchase occupational pension scheme for its employees. The scheme, which is not an insured scheme, currently has 60 active members, 45 deferred members and 20 pensioner members.

The company makes contributions of 3% of each employee's basic salary into the scheme and employees are also required to contribute at least 3% of their basic salary as a condition of membership. Membership of the scheme is offered once the employee has completed one year's service with the company. The scheme has a normal pension age of 65.

The scheme currently has six trustees, two of which are member nominated trustees. One of the member nominated trustees has completed his term as a trustee and needs to be replaced.

Larry has decided to review the company's pension arrangements. He feels that the requirements introduced by the Pensions Acts 1995 and 2004 are becoming more and more onerous and would like to consider a more straightforward alternative. He has been reading about the proposed introduction of Personal Accounts and wonders how this may affect the company.

Larry himself has built up a substantial fund within the pension scheme. As at 5 April 2006, his pension fund was valued at £180,000 and the protected pension commencement lump sum (PCLS) amounted to £67,500. He does not have any other pension arrangements and is considering taking his PCLS from his pension. However, he would have to purchase a lifetime annuity if the cash is taken from the occupational pension scheme and as he does not require any income at this time, he is considering transferring his fund to a personal pension which offers the unsecured pension (USP) option. His fund is currently valued at £230,000.

## Questions

- (a) In respect of the trustee requirements that apply to the company's occupational pension scheme:
- (i) state, giving your reasons, who may be eligible to nominate a new member nominated trustee; (6)
  - (ii) explain the trustee knowledge and understanding requirements that a new member nominated trustee must have. (5)
- (b) Explain the reasons why Marshall Security Ltd may prefer a group personal or stakeholder pension to an occupational pension scheme in future. (6)
- (c) Explain, in detail, the changes that would have to be made to the current occupational scheme for the company to be exempt from having to offer Personal Accounts. (10)
- (d) At April 2006, Larry had protected tax-free cash of £67,500.
- (i) Calculate, **showing all your workings**, Larry's entitlement to tax-free cash if he were to take his benefits from the occupational pension scheme in the 2009/2010 tax year. (7)
  - (ii) Explain the circumstances in which Larry could protect his tax-free cash entitlement on transfer. (6)

**Total marks available for this question: 40**

# 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.



## INHERITANCE TAX

	<b>2009/2010</b>	<b>2008/2009</b>
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

		<b>From 06.04.09</b>	<b>From 06.04.08</b>
		£	£
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
<b>Rates</b>		
Individuals	18%	18%
Trusts and estates	18%	18%

## ENTREPRENEURS' RELIEF

### Entrepreneurs' Relief 2009/2010

4/9<sup>ths</sup> 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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