

J04

Diploma in Financial Planning

Unit J04 – Pension funding options

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

- Two 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 J04 – Pension funding options

Instructions to candidates

Read the instructions below before answering any questions

- **Two hours** are allowed for this paper which consists of 15 short answer questions and carries a total of 130 marks.
- 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 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 as possible, using note format and short sentences on separate lines wherever possible.

Attempt ALL questions**Time: 2 hours**

1. List **five** circumstances in which a UK individual will not be auto-enrolled into the National Employment Savings Trust (NEST). **(5)**

2. Simon, aged 52, was a member of his employer's contracted-out defined benefit pension scheme from 1985 until he left service in September 2011.

The scheme revalues all benefits in line with statutory minimum requirements.

Explain, in detail, how Simon's benefits will be revalued in deferment. **(7)**

3. John has a self-invested personal pension (SIPP) valued at £350,000 invested in unit trusts and commercial property. John has his own personal share portfolio and would like to consider holding the portfolio within his SIPP.
 - (a) Describe in detail **two** methods which will enable the SIPP to own the shares. **(6)**
 - (b) Explain the tax implications to John should he proceed with either method. **(6)**

4. Luke reached age 75 on 1 August 2011 and he is married to Miriam, aged 78. He has a non-protected rights personal pension, from which he has yet to draw benefits. He has no plans to draw his benefits for at least two or three years.
 - (a) Assuming that Luke dies before drawing benefits, outline the death benefits that will be available for Miriam and how they will be taxed. **(6)**
 - (b) Explain whether or not the payment of lump sum benefits in the event of Luke's death will be a benefit crystallisation event. **(2)**

5. Sarah will reach her State Pension Age in January 2012. However, she has no plans to retire immediately and has decided to defer drawing her Basic State Pension.
 - (a) State the **two** ways in which Sarah's deferred Basic State Pension can be paid. **(2)**
 - (b) For each method identified in (a) above, outline how the amount Sarah will receive will be calculated. **(4)**

6. Outline the minimum level of benefits that must be provided by a defined benefit pension scheme in order to meet the Reference Scheme requirements. **(8)**

7. Susan has just been appointed as a Member Nominated trustee of her employer's defined benefit pension scheme. She has no previous pension trustee experience.
- List the requirements, as set out in the Pensions Act 2004, regarding trustees' knowledge and understanding. (8)
8. Henry's employer offers membership of either a trust based defined contribution occupational pension scheme or a contract based group personal pension. In each case, the employer will match the employee's contribution.
- State **three** potential benefits and **three** potential drawbacks of Henry joining:
- (a) the defined contribution occupational pension scheme; (6)
- (b) the group personal pension. (6)
9. Ian, aged 57, has a personal pension arrangement with a fund value of £235,000. He intends to take the maximum pension commencement lump sum and use the balance of the fund to buy an annuity when he retires at age 65. His fund is invested wholly in an emerging markets fund and he has benefitted from strong performance in recent years.
- (a) List the reasons why he might now consider switching to other assets. (2)
- (b) State, giving your reasons, the asset classes you would recommend and the timescale over which reallocation should take place. (6)
10. Jamie has a gross salary of £18,000 per annum and is a member of his company's group personal pension. He currently makes an employee's contribution of 5% of his salary and his employer matches the contribution. His employer is considering introducing salary sacrifice for future pension contributions.
- (a) Describe how salary sacrifice works. (7)
- (b) State the conditions that must be fulfilled in order for a salary sacrifice arrangement to be effective. (3)
- (c) State **three** potential drawbacks to the employee of salary sacrifice. (3)
11. The actuary for the Big Paint Box defined benefit pension scheme has recently carried out an actuarial valuation of the pension scheme. The pension scheme is underfunded and the trustees and employer are preparing a recovery plan.
- Outline the main factors which will be taken into account when preparing the recovery plan. (6)

Questions continue over the page

12. Nigel is currently an active member of his company's defined benefit scheme. He has no other pension arrangements. The value of his benefits exceeds £1,500,000 and he wishes to elect for fixed protection.

(a) List the requirements that must be satisfied for an election to be valid. (4)

(b) State the conditions that must be satisfied to avoid loss of fixed protection after it has been granted. (4)

13. Joanna, aged 40, is moving to Spain. She intends transferring her personal pension fund to an overseas pension scheme in Spain.

Explain, giving your reasons:

(a) how the transfer will be treated for tax purposes by HM Revenue & Customs (HMRC) if it is paid to a Qualifying Recognised Overseas Pension Scheme (QROPS); (4)

(b) how the transfer will be treated for tax purposes by HMRC if it is paid to a scheme that is not a QROPS. (2)

14. Ahmed, aged 51, left the employment of Silver-Eight Limited after 21 years pensionable service to set up his own business. He was a member of their contracted-in defined benefit pension scheme which has a normal retirement age of 65.

Ahmed is thinking of transferring the benefits from his defined benefit scheme into his self-invested personal pension.

List **twelve** key factors which Ahmed should take into account when considering whether to transfer his fund. (12)

15. Chloe, who is self-employed, was never subject to the special annual allowance anti-forestalling provisions. She has paid the following contributions into her personal pension:

Date Paid	Gross Contribution
24 June 2008	£23,000
21 June 2009	£25,000
17 June 2010	£100,000
28 June 2011	£70,000

The pension input period runs to 5 April each year.

Calculate, **showing all your workings**:

(a) the amount of annual allowance that may be carried forward to the tax year 2011/2012; (7)

(b) the amount of contribution subject to the annual allowance charge in the tax year 2011/2012. (4)

The tax tables can be found on pages 8 – 12

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/ £2,000,00**	£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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