

J05

Diploma in Financial Planning

Unit J05 – Pension income 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 J05 – Pension income 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. (a) Explain briefly how each of the following factors may contribute to a fall in annuity rates:
 - (i) long term bond yields; (3)
 - (ii) longevity expectations. (3)
- (b) Outline the effect that the Government's policy of quantitative easing has had on the income yields from long term bonds. (5)

2. Cheryl has reached age 75 with uncrystallised pension rights of £900,000. She has 40% of the standard lifetime allowance remaining.
 - (a) Calculate, **showing all your workings**, the lifetime allowance charge payable at age 75. (5)
 - (b) Explain how Cheryl's entitlement to a pension commencement lump sum will be calculated when benefits are ultimately taken. *No calculation is required.* (4)

3. Flexible drawdown, which was introduced on 6 April 2011, allows a drawdown pension to be taken without reference to the HM Revenue & Customs Government Actuary's Department limits.

Outline the conditions that must be met in order to qualify for flexible drawdown. (8)

4. Gerald turned 75 on 1 May 2011 and he has no dependants. He has various pension plans and following his death he wants to leave everything to his non-dependant nephew Dean. He is in receipt of the following pension income:
 - defined benefit scheme pension that commenced at age 65;
 - lifetime annuity, including a five year guarantee, purchased two years ago with a protected-rights only pension fund;
 - phased drawdown plan which he uses to top up his income as required each year.

Explain, in detail, the death benefits that would be payable to Dean for each of the pensions held following Gerald's death and the tax treatment that may apply. (10)

5. (a) Outline the level of protection that would be provided under the Pension Protection Fund for a pensioner member of a defined benefit scheme who retired at the scheme's normal retirement age. (5)
- (b) Outline the Government protection available for an annuitant in the event of the default of the annuity provider. (3)

6. Katherine, aged 58, earns £15,000 per annum gross from her part-time employment. She supplements her income by utilising phased capped drawdown taking the maximum Government Actuary's Department (GAD) income from her crystallised fund. The uncrystallised portion of her pension is currently valued at £550,000.

In the tax year 2011/2012, Katherine wishes to receive total income from her pension fund of £14,000 net of basic-rate tax. She drew an income of £4,000 gross from her crystallised fund in May 2011 and the current GAD rate is £55 per £1,000.

Taking the existing income into account, calculate, **showing all your workings**, the minimum amount that must be crystallised from her uncrystallised fund in order to provide the total income required. (10)

7. Patricia plans to crystallise all of her pension benefits in November 2011. She will receive a scheme pension from her defined benefit scheme of £60,000 per annum plus a pension commencement lump sum (PCLS) of £180,000.

She also has a personal pension plan (PPP), which has a current fund value of £650,000. She plans to take the maximum PCLS and use the balance of the fund to secure an income. The income can either be provided by a lifetime annuity or by a scheme pension. The most competitive annuity rate that is currently available for the scheme pension is 2.46%.

Calculate, **showing all your workings**, the total amount that will be assessed against the lifetime allowance if Patricia uses the PPP to secure:

(a) a lifetime annuity; (5)

(b) a scheme pension. (7)

8. HM Revenue & Customs has introduced 'fixed protection' to protect pensions valued in excess of £1,500,000 from the lifetime allowance charge from 6 April 2012.

In relation to fixed protection, state:

(a) how an application must be made; (2)

(b) **four** ways in which it may be lost. (4)

Questions continue over the page

9. Mark, aged 67, has recently crystallised his self-invested personal pension (SIPP). He took the maximum pension commencement lump sum and the remaining fund is currently worth £375,000. He plans to draw an income from the fund via the drawdown pension option for several years, but ultimately plans to purchase a lifetime annuity.
- (a) Explain why the following investments may be suitable for the underlying portfolio of Mark's SIPP:
- (i) Equities. (2)
 - (ii) Property. (2)
 - (iii) Fixed-Interest Securities. (2)
 - (iv) Cash. (2)
- (b) Outline how Mark's initial investment strategy may need to change as he approaches annuity purchase. (3)
10. The Financial Services Authority Conduct of Business Sourcebook lists particular aspects of a client's personal and financial circumstances that should be considered by an adviser recommending a drawdown pension.
- List **eight** of these circumstances. (8)
11. Explain how a survivor's entitlement to a deceased spouse's State Earnings-Related Pension Scheme and State Second Pension is calculated. *No calculation is required.* (5)
12. Martin, who recently retired, is entitled to a full Basic State Pension. He has decided to retire abroad and will be non-UK resident for tax purposes.
- In respect of Martin's Basic State Pension entitlement state:
- (a) whether it will be affected and how his yearly indexation increases will be affected, if at all, if he moves to:
- (i) a country within the European Economic Area (EEA) that has a double taxation treaty with the UK; (2)
 - (ii) a non EEA country other than Switzerland or a country without a social security agreement with the UK. (2)
- (b) how his pension will be taxed if he retires abroad. (2)
13. Two years ago, Andrew stopped working to care for his terminally ill wife. He crystallised his personal pension fund of £750,000 and is currently drawing his income via drawdown pension. His wife has now died and Andrew, now aged 58, is planning to return to work part-time.
- Outline the reasons why Andrew may choose to continue to utilise his drawdown pension to supplement his income rather than purchasing a lifetime annuity. (12)

- 14.** Edward has a retirement annuity contract valued at £65,000 with a guaranteed annuity rate of 11% per annum. This rate only applies on his 60th birthday and must be taken as a single life level pension with no guarantees.

Edward has decided to take advantage of his annuity rate. He is single and earns £55,000 per annum. He has no need for the extra income at this time and therefore has decided to recycle the annuity income into a personal pension plan.

Explain:

- (a)** the impact on Edward's current Income Tax position; **(4)**
 - (b)** the level of death benefits available from the different elements of Edward's pensions. **(4)**
- 15.** Joanne has recently started to receive an income granted to her under an earmarking order from her ex-husband's defined benefit pension scheme as part of their divorce settlement. Outline briefly the following:
- (a)** the taxation of the income payments; **(2)**
 - (b)** the drawbacks of receiving an income under an earmarking order. **(4)**

The tax tables can be found on pages 9 – 13

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/ £2,000,000**	£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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