



J05

THE CHARTERED INSURANCE INSTITUTE

THURSDAY 22 APRIL 2010

**DIPLOMA IN FINANCIAL PLANNING
J05 – PENSION INCOME OPTIONS**

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.**
- **Candidates should answer based on the legislative position immediately BEFORE the 2010 Budget.**

INSTRUCTIONS

- **Two hours are allowed for this paper.**
- **Read the instructions on page 3 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.****

THE CHARTERED INSURANCE INSTITUTE
© The Examinations Department, CII, 20 Aldermanbury, London EC2V 7HY

THE CHARTERED INSURANCE INSTITUTE

J05 – Pension income options

CANDIDATE INSTRUCTIONS

READ THE INSTRUCTIONS BELOW BEFORE ANSWERING ANY QUESTIONS

Two hours are allowed for this paper.

The paper consists of 15 short answer questions and carries a total of 130 marks.

Read carefully the questions and information provided. 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.

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 the 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.

Attempt ALL questions

Time: 2 hours

1. In relation to the valuation of benefits for lifetime allowance purposes, list **eight** of the benefit crystallisation events. (8)

2. In August 2006, when Nicola's self-invested personal pension (SIPP) was valued at £800,000 she opted to crystallise half of her fund. She took the maximum pension commencement lump sum (PCLS) and then invested the balance into an unsecured pension (USP) contract.

In May 2010, Nicola intends to crystallise the remaining uncrystallised SIPP fund, which is now valued at £500,000. She also plans to crystallise a deferred defined benefit pension scheme which will provide her with an income of £45,000 per annum.

Calculate, **showing all your workings**, the lifetime allowance charge payable if Nicola elects to take the excess over the lifetime allowance as a lump sum. (9)

3. Kevin, aged 69, is a widower and about to retire. He plans to purchase a lifetime annuity with his pension funds and although income is his primary concern, he would like his godson Robert, aged 28, to benefit following his death. Robert is not financially dependant on him.

(a) State the **two** options available to Kevin that may allow Robert to benefit upon his death. (2)

(b) State **two** potential advantages and **two** potential disadvantages of each option. (8)

4. Joanne has a retirement annuity contract with a guaranteed annuity rate of 10% per annum. This rate only applies if she takes the benefits on her 60th birthday in May 2010 and these benefits must be taken as a single life level annuity with no guarantees.

Joanne has decided to take advantage of this annuity rate. She is single and a higher-rate tax payer. She has no need for the income at this time and she has decided to recycle it into a personal pension scheme. In respect of her intentions, explain the:

(a) impact on Joanne's Income Tax position; (4)

(b) level of death benefits available from the different elements of Joanne's pensions. (3)

5. Outline the assumptions made by HM Revenue & Customs (HMRC) under Section 3 of the Inheritance Tax Act (IHTA) 1984 when determining the value of an individual's pension death benefits for Inheritance Tax purposes. (7)
6. Benjamin crystallised his entire fund to commence maximum income withdrawals via an unsecured pension (USP) on 1 February 2007. He is now considering using half of his fund, which is currently valued at £600,000 to purchase a lifetime annuity on his 68th birthday on 12 August 2010.
- (a) Explain, in detail, how the annuity purchase will affect the maximum income withdrawals available to Benjamin, stating the dates from which any changes will take effect. (5)
- (b) State the date on which Benjamin's next five year review will be due. *Assume he purchases the annuity as planned.* (1)
7. Robert and Ellen, aged 70 and 68 respectively, are married. They consider that their combined income from Robert's private portfolio and their State Pension benefits will cover their income needs for the next few years.
- Robert has an uncrystallised self-invested personal pension (SIPP) which is currently valued at £350,000. As he intends to leave all his property to Ellen should he predecease her, his accountant has recommended that he set up a Spousal Bypass Trust in respect of his SIPP as part of an Inheritance Tax mitigation exercise.
- (a) Describe how Robert should set up the trust if he wishes to be certain that Ellen will benefit from this course of action. (2)
- (b) Explain how a Spousal Bypass Trust may benefit Ellen and her estate following Robert's death. (6)
8. Stephen, aged 55, has opted for an unsecured pension (USP) to provide his retirement income. He is looking at two options in particular for his investment portfolio – an earmarked withdrawals strategy or a performance driven withdrawals strategy.
- (a) Briefly outline the features of these two portfolio options. (4)
- (b) State **one** potential advantage and **one** potential disadvantage of **each** option. (4)

9. John, aged 55, is in good health and about to retire. He has a non-protected rights personal pension valued at £650,000 from which he wishes to draw a tax efficient income of £20,000 in the first year. He has explained that this may increase or decrease in subsequent years depending upon his needs. He has substantial other assets and does not need any additional capital lump sums at this time.

He is single and wants to ensure that the maximum tax-free lump sum is available to his beneficiaries following his death.

- (a) Describe, giving your reasons, the most appropriate method of providing John with the income he requires. (7)

- (b) Briefly explain the lump sum death benefits that will be available following John's death, and how they will be taxed. *Assume the recommendations in (a) above are implemented and death occurs prior to age 75.* (4)

10. Alma, aged 78, is married and in alternatively secured pension (ASP). Her fund value is £430,000. The ASP is going through its annual review and the insurance company administering her fund advises that the applicable Government Actuary's Department (GAD) rate is £85 per £1,000.

- (a) Calculate, **showing all your workings**, the maximum and minimum income that Alma may draw from her ASP. (5)

- (b) Alma is interested in leaving her fund to charity. However, she has not yet made a nomination.

State the procedure that would be followed if she were to die before making the nomination. (4)

11. The Financial Services Authority Conduct of Business Rules lists specific client circumstances that should be considered by an adviser recommending an unsecured pension (USP).

List **eight** of these circumstances. (8)

12. Where a member is diagnosed as being in serious ill-health, it is possible for any contracted-out benefits they hold to be paid out before they reach minimum pension age.

Briefly describe the format these payments may take and any limitations that may apply in respect of:

- (a) a protected rights fund; (6)

- (b) benefits held in the form of a guaranteed minimum pension (GMP). (3)

13. Andrew plans to crystallise his benefits under his occupational money purchase scheme on 1 May 2010. The fund is valued at £2,000,000 and he has no form of transitional protection and no other pension benefits.

He has been given the option of a scheme pension with an annuity rate of 4.4% or he can take the open market option and purchase a lifetime annuity, where the best available rate is 4.5%.

Assuming that he takes the whole fund as pension income, calculate, **showing all your workings**, Andrew's gross annual income after any lifetime allowance charge has been paid, under the:

(a) scheme pension; (5)

(b) lifetime annuity. (5)

14. Margaret is married and will reach State Pension age in September 2010.

(a) State the conditions that must be met in order for Margaret to receive a category B pension. (4)

(b) Briefly describe the maximum income she may be entitled to receive. (3)

15. Five years ago, Brian ceased work to care for his terminally ill wife. At this time he crystallised his personal pension fund of £800,000 to provide an income via an unsecured pension fund withdrawal contract. His wife has now died and Brian, now aged 58, is planning to return to work part-time.

Outline the reasons why Brian may choose to continue to utilise income withdrawals to supplement his income rather than purchasing a lifetime annuity. (13)

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.

CAR AND FUEL BENEFITS

The charge for company car benefits is based on the carbon dioxide (CO₂) emissions. There is no reduction for high business mileage users.

For 2009/2010:

The percentage charge is 15% of the car's list price for CO₂ emissions at or below the qualifying level of 135g/km.

The base percentage charge of 15% increases in 1% steps for every additional full 5g/km over the 135g/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.

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 (£16,900 for 2009/2010) e.g. car emission 160g/km = 20% on car benefit scale. 20% of £16,900 = £3,380.

Notes:

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

2009/2010 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

INHERITANCE TAX

	2009/2010	2008/2009
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

		From 06.04.09	From 06.04.08
		£	£
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
Rates		
Individuals	18%	18%
Trusts and estates	18%	18%

ENTREPRENEURS' RELIEF

Entrepreneurs' Relief 2009/2010

4/9^{ths} of gain tax free. Lifetime limit eligible for relief: £1,000,000

For trading businesses and companies (minimum 5% employee shareholding) held for 1yr+

BLANK PAGE

BLANK PAGE

BLANK PAGE

