



J05

THE CHARTERED INSURANCE INSTITUTE

THURSDAY 22 OCTOBER 2009

**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.**

INSTRUCTIONS

- **Two 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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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 Notice 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. John joined his employer's defined benefit scheme in 1995. He is due to retire later this year when he will be entitled to a pre-commutation pension of £20,000 per annum.

Prior to A Day, the scheme paid the HM Revenue & Customs (HMRC) maximum tax-free cash lump sum. The scheme has continued to calculate the lump sum on this basis using a commutation factor of 13:1. However, the scheme plans to change to the post A Day method of calculating the pension commencement lump sum (PCLS) and this method will use a commutation factor of 15:1.

Calculate, **showing all your workings**, the maximum PCLS and residual pension:

- (a) available under the current scheme rules; (4)
- (b) if the scheme were to change its rules. (5)
2. Kerry will be aged 60 on 3 May 2010. Her private pension provision consists of two small personal pension plans: one valued at £7,000 and the other valued at £10,600. Kerry would like to access her personal pension funds immediately and wishes to know whether she can commute her personal pensions for a triviality lump sum.
- (a) State **two** reasons why Kerry is currently unable to commute her funds on the grounds of triviality. (2)
- (b) Explain why Kerry may be able to take a lump sum on the grounds of triviality in the future. (4)
3. Rachel is married and has a personal pension plan that consists solely of protected rights. She plans to use this fund to purchase a lifetime annuity.
- Describe the options available to Rachel in respect of her annuity and outline any restrictions that will apply. (5)
4. Outline the regulatory requirements regarding the way in which critical yields must be shown on income withdrawal illustrations. (6)

5. Kim Williams began phased income drawdown on her 50th birthday in October 2007. She currently draws £10,000, net, per annum from the arrangement as a combination of tax-free cash and maximum Government Actuary's Department (GAD) income, as she wishes to maximise the tax-free lump-sum benefits available upon her death.

Kim intends to continue to draw £10,000 net until her husband, Mark, retires in January 2011. At this time she intends to increase the income she takes to £20,000, net, per annum.

- (a) Explain why the introduction of the minimum pension age in April 2010 may prevent Kim from continuing to take her income in the way she wishes. (5)
- (b) State briefly how Kim can overcome this problem, highlighting any drawbacks to her. (4)

6. Laura, a basic-rate taxpayer, is currently receiving a retirement income via phased annuity purchase. So far she has purchased one annuity which pays a level income of £3,400 per annum gross.

She now needs to crystallise additional funds to provide her income for the coming year. She has determined that she needs a net income of £20,000 and has established that the best annuity rate available to her is 4.7%.

Calculate, **showing all your workings**, the least amount of fund that will have to be crystallised in order for Laura to receive the net income that she requires. (8)

7. Glenn is about to retire and has been a member of his employer's contracted-out defined benefit scheme since 1987. The scheme has always increased pensions in payment by the statutory minimum rates of escalation.

Explain how the different elements of Glenn's pension will increase in payment. (10)

8. (a) State the circumstances under which a widow can claim a pension based on her deceased husband's State Earnings-Related Pension Scheme (SERPS) and State Second Pension (S2P) entitlement. (4)
- (b) Explain how a survivor's entitlement to a deceased spouse's SERPS and S2P is calculated. *No calculation required.* (5)

9. Isabel died recently at the age of 65. At the date of her death, her crystallised and uncrystallised pension funds were split between:

- an uncrystallised non-protected rights fund;
- an uncrystallised protected rights fund;
- a non-protected rights unsecured pension (USP) fund from which she was taking income withdrawals;
- a non-protected rights USP fund from which she was taking income in the form of a short-term annuity.

Isabel is survived by her husband David, aged 67. Outline the death benefit that may be available to him in respect of each element of Isabel's pension funds and explain the tax treatment of these benefits. (13)

10. Outline **four** advantages and **six** disadvantages of opting for an alternatively secured pension (ASP) at age 75, compared to the alternative of a lifetime annuity. (10)

11. In October 2008, Janet retired on the basis of serious ill health. Upon receipt of the appropriate medical evidence, her employer agreed to pay her a pension of £55,000 per annum, plus a pension commencement lump sum (PCLS) of £300,000 from the company's defined benefit scheme. In addition, the scheme continued to provide her with life cover of £450,000. In October 2009, Janet died and the life cover was paid out as a lump sum to her widower, Kevin.

Calculate, **showing all your workings**, the:

(a) value of Janet's benefits that were tested against the lifetime allowance when the serious ill-health pension started; (3)

(b) lifetime allowance charge that will be payable in respect of the life cover. (7)

12. Gordon, aged 64, currently earns £50,000 per annum. He expects to continue to earn at this level until his 70th birthday when he intends to retire. When he finishes work, his only source of taxable income will come from his State Pension and a personal pension plan from which he expects to receive a level income of £20,000 per annum gross.

As he has no need currently for the income from his State Pension he is considering deferring its payment.

(a) Outline the options available to Gordon if he decides to defer his State Pension and explain how the deferred benefits will be treated for tax purposes when they are eventually paid to him. (8)

(b) State the reasons why the deferral option may be suitable for Gordon. (3)

- 13. (a)** List the **three** main factors that have caused the fall in annuity rates since the mid 1990s. *Ignoring insurance company charges and any individual personal circumstances.* (3)
- (b)** For each of the factors identified in **(a)** above, explain how they may have contributed to a fall in annuity rates. (6)
- 14.** Edward is single with no dependants and retired in October 1999 on his 60th birthday. At that time he began to receive a pension from a previous employer's final salary scheme and crystallised all of his other pension funds into an income withdrawal plan from which he draws a small income.
- The annual review of his income withdrawal plan is due shortly. Edward has already stated that he plans to purchase a lifetime annuity when he reaches age 75. In respect of this decision, state the areas that should be discussed with Edward at the review. (8)
- 15.** It is possible for an unsecured pension (USP) under a registered pension scheme to be transferred to another registered pension scheme.
- (a)** State briefly the conditions that must be met in order for such a transfer to be considered as an authorised transfer. (2)
- (b)** Explain how the receiving scheme must treat the benefits of such a transfer. (5)

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

Entrepreneur's 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+

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