



J08

THE CHARTERED INSURANCE INSTITUTE

THURSDAY 22 OCTOBER 2009

**DIPLOMA IN FINANCIAL PLANNING
J08 – FINANCIAL PLANNING PRACTICE**

SPECIAL NOTICES

- **All questions in this paper are based on English law and practice applicable in the 2009/2010 tax year, 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 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. **Failure to comply with this regulation will result in your paper not being marked and you may be prevented from entering this examination in future.**

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J08 – Financial planning practice

CANDIDATE INSTRUCTIONS

READ THE INSTRUCTIONS BELOW BEFORE ANSWERING ANY QUESTIONS

The question paper consists of **two** case study based questions and carries a total of 150 marks. You should answer all question parts for each case study in the answer book.

Read the questions and information provided carefully. The time allowed for this examination is 3 hours. You are advised to spend approximately 90 minutes on the questions for each case study. You are strongly advised to attempt **all** parts of each question in order to gain maximum possible marks for each question. The number of marks allocated to each question part is given next to the question.

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 for each case study

Time: 3 hours

Case Study 1

Henry and Sharon Jones, aged 48 and 38 respectively, are married. They have two children, Jacob and Sophie, aged seven and nine respectively.

Henry owns an engineering company and earns a salary of £60,000 per annum. When he started the limited company many years ago he set-up a defined benefit pension scheme which was wound-up in 2005. The firm now has an occupational money purchase pension scheme with a 5% employee contribution and nil employer contribution. The company continues to operate a group life assurance scheme whereby all employees receive a benefit of five times salary.

Sharon has been a self-employed physiotherapist for the last 15 years and makes a profit of £11,000 per annum. She realises her State Pension and State Second Pension (S2P) will be reduced by her low earning over the years.

They have accrued a holding of ad-hoc investments and they would prefer this to be managed professionally but have no understanding of risk.

They have a house valued at £600,000 with a mortgage of £200,000 which is an interest only mortgage. This is covered by a joint life endowment policy that was taken out 12 years ago. They are concerned that the endowment will not repay the mortgage at maturity, having received a red letter from the insurance company projecting a shortfall. Other than that mentioned above, they have no protection cover.

Portfolio

Investments	£
Any Bank UK equity unit trust	56,000
Axis investment bond	42,000
Big Bank plc shares	18,000
Total	116,000

These investments are in Henry's name. There is also an emergency fund of £40,000 held in a deposit account in Henry's name.

Their financial aims are:

- to have their investments managed;
- to pay off the mortgage when Henry is 60;
- to cover their mortgage if one of them dies or falls ill;
- both to be able to retire at 60 and to have sufficient income to maintain their lifestyle;
- to maximise the tax efficiency of their investments.

Question 1

- (a) Identify and explain any errors or inconsistencies in the information provided in the case study. (8)
- (b) (i) Identify the information you would seek in order to establish the income in retirement Henry and Sharon are likely to receive from their existing pension arrangements. (12)
- (ii) List the questions you would ask Henry and Sharon to establish their requirements for income in retirement. (8)
- (c) (i) Explain why the current projected maturity values on the endowment are lower than the outstanding mortgage. (7)
- (ii) Detail the options available to Henry and Sharon to repay their mortgage using the existing endowment, explaining the benefits and drawbacks of **each**. *Ignore the use of any new investments.* (13)
- (d) Identify and describe the features of the cover available to fully repay their outstanding mortgage if either Henry or Sharon were taken seriously ill. Identify the level of cover and term that is appropriate and how this should be structured. (10)
- (e) Henry and Sharon are interested in understanding investment risk.
- State the **two** main types of investment risk and explain how diversification may be used to manage and reduce these risks. (10)
- (f) Explain the actions Henry and Sharon could take to improve the tax efficiency of their investments. *Exclude Inheritance Tax (IHT).* (7)

Total marks available for this question: 75

Case Study 2

David and Sarah Williams, both aged 50, are married with two non-dependent children. They both work as employees in the publishing industry. David earns £62,000 per annum and Sarah earns £32,000 per annum. They are both members of their respective employer's group stakeholder pension schemes, into which they each contribute 5% of their gross salary per annum. These contributions are paid monthly and the employer does not make a contribution.

David and Sarah are new clients and ask in the first instance how they should pay for any financial advice. They have heard about fees and commissions and are wondering which option might be the best for them, given their financial circumstances.

David and Sarah have a modest investment portfolio, as follows:

Portfolio

Assets	David £	Sarah £	Joint £
Bank accounts ¹			12,000
Investment bonds	15,000 ³	12,000 ²	
UK equity income unit trust			22,000
Total	15,000	12,000	34,000

Notes on the portfolio:

1. the bank accounts are instant access cheque accounts providing a low level of interest;
2. Sarah's investment bond is a with-profits only investment and has Market Value Reductions (MVRs) applying if she wishes to encash it;
3. David's investment bond is invested in a UK equity fund and there are no penalties for encashment.

Their main home is valued at £600,000, held as joint tenants and has a mortgage of £400,000.

You have undertaken an asset allocation exercise for them and as a result, you have agreed with them that their investments should be 50% UK and overseas equities, 40% government and corporate fixed interest securities and 10% in cash.

David and Sarah have mirror wills which leave everything to each other on first death and their assets are split equally between the children on the survivor's death.

Their financial aims are:

- to improve the tax efficiency of their investments;
- to review their portfolio in the light of the asset allocation;
- to protect their mortgage in the event of long-term illness.

Question 2

- (a) Describe the benefits and drawbacks for David and Sarah of remunerating their adviser by:
- (i) fees; (7)
 - (ii) commission. (9)
- (b) Calculate, **showing all your workings**, both David and Sarah's net monthly income after Income Tax and National Insurance. (16)
- (c) Describe the considerations which should be taken into account when reviewing David and Sarah's investment portfolio. (20)
- (d) Recommend and justify the product which would best suit David and Sarah to protect their mortgage in the event of long-term illness by comparing, in detail, income protection insurance (IPI) and accident and sickness insurance. (18)
- (e) State **five** areas that you should consider when reviewing David and Sarah's investments at the first review in 12 months' time. (5)

Total marks available for this question: 75

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+

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