THE CHARTERED INSURANCE INSTITUTE

CII

R06

Diploma in Regulated Financial Planning

Unit 6 – Financial planning practice

July 2011 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2010/2011, 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 2011 budget.

Instructions

- Three 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 R06 – Financial planning practice

Instructions to candidates

Read the instructions below before answering any questions

- **Three hours** are allowed for this paper.
- The question paper consists of **two** case studies and carries a total of 150 marks.
- 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 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 for each case study

Time: 3 hours

Case study 1

James and Meg, aged 44 and 34 respectively, are married and have two children, Tom, aged six, and Peter, aged three.

James, the sole director and only shareholder of his own media relations company, earns a salary of £20,000 per annum and takes dividends of £40,000 per annum. Meg is employed in the business on a salary of £12,000 per annum. They are the only two people employed by the company.

This year, the company has started making annual pension contributions of £16,000 into a personal pension plan for James. The company provides James with death-in-service cover of £80,000.

The company also provides a personal pension plan for Meg and has recently started making contributions of £1,200 per annum on her behalf. This is expected to provide a pension of £1,500 per annum when Meg reaches age 55. The company does not provide death-in-service cover for Meg. James and Meg do not make any personal contributions into their personal pensions. James plans to stop working and take his retirement benefits at age 60.

James and Meg have a repayment mortgage which has 16 years left to run. The current outstanding balance is £288,000.

They currently each have their own level term assurance policy. Each policy has a sum assured of £100,000. The policies were originally taken out for a 10 year term when Tom was born. They also have a joint life first event decreasing term assurance policy providing life and critical illness cover for the term of the mortgage with a current benefit of £171,000. James is considering increasing his critical illness and life cover.

Their current outgoings are £39,000 per annum and they have stated that in retirement they would like an income to meet half this amount, even if there was only one survivor. They have £40,000 in a deposit account in James's name.

Their financial aims are to:

- ensure their mortgage is repaid in the event of death or critical illness;
- provide financial security for the family in the event of death or critical illness;
- invest in a tax-efficient manner for growth;
- maintain their current standard of living in retirement.

Questions

(a) James and Meg have not previously received financial advice.

(i) State **three** different methods of fee charging, as they would prefer to pay fees for financial advice. **(3)**

(ii) Explain to James and Meg the **benefits** of a current cash flow statement when devising a financial plan. **(5)**

(b) **(i)** List the questions you would ask James concerning his protection needs for his family. The questions *must be in a format that the client will understand.* **(8)**

(ii) Comment on James and Meg's current life cover provision and identify any shortfalls. *Ignore any value in the pension funds.* **(8)**

(iii) Recommend and justify a suitable protection solution, should either James or Meg die. *Amounts of life cover are not required.* **(8)**

(iv) James wishes to make up the shortfall in his mortgage protection planning by taking out a level term Critical Illness policy. Explain the **benefits** and **drawbacks** of this approach. **(4)**

(c) **(i)** List the questions you would ask James and Meg in order to establish their requirements for income in retirement. *The questions must be in a format that the client will understand.* **(6)**

(ii) State the implications for James and Meg's financial plans of James retiring at age 60. **(6)**

(iii) Identify the financial planning risks associated with James's personal pension plan should he fall ill before reaching age 60, and recommend a suitable solution. **(7)**

(d) **(i)** State and identify each part of the formula you would use to calculate the future value of James's pension fund at age 60. *Assume that contributions are made at the beginning of each year and the initial value of the fund is nil. No calculation is required.* **(4)**

(ii) Calculate, **showing all your workings**, the amount of income shortfall when James reaches age 60, from James and Meg's stated retirement income needs. *Assume a joint annuity rate of 5%, James's pension fund is £397,446, no pension commencement lump sum and no other income. Carry out all calculations in today's monetary terms.* **(6)**

(iii) Calculate, **showing all your workings**, how much James and Meg would need to invest now to make up the income shortfall calculated in part **(d)(ii)** above, between James attaining age 60 and his attaining age 66. *Assume an investment growth rate of 6% per annum after charges up to age 60. You do not need to allow for investment growth from age 60 or for inflation. Assume all of this lump sum is used to address the shortfall. You do not need to take into account Meg's income.* **(3)**

Questions continue over the page

(e) **(i)** Describe the drawbacks for James and Meg of retaining their current cash fund of £40,000 on deposit, and recommend actions which could be taken to improve the returns on the cash holdings. **(5)**

(ii) Outline the considerations you would take into account before recommending any investments to James and Meg. **(7)**

Total marks available for this question: 80

Case Study 2 and questions can be found on pages 8 and 9

Case study 2

David, aged 63, is married to Anne, aged 61. They have two daughters, Bethany, aged 28, and Alice, aged 25. David has recently retired as a senior manager at Foxley Electronics plc, a minor stock market listed company. Anne is a legal secretary and currently works part-time at a local solicitor's practice.

David has been a keen investor in PEPs and ISAs for many years. He has generally invested in sector specialist and smaller companies' funds basing his investment decisions on the performance tables in his Sunday newspaper. David would now like all of his assets to be invested in low risk investments.

During his career, David has worked for several different employers and has built up a number of pension arrangements, including a mix of defined benefit and defined contribution arrangements. His defined contribution pensions are worth £100,000. Anne has some deferred benefits from a previous employment. All pensions are in suitable trusts. David holds a number of shares in his previous employer, Foxley Electronics plc.

David and Anne would like to help Alice buy her first home and are also concerned about maximising their children's inheritances when they die. Their Wills leave everything to each other on first death and to their daughters in equal shares on second death.

Their total assets are as follows.

Asset	**David £**	**Anne £**	**Joint £**
Main residence			600,000
Chattels			70,000
Current account	150,000		12,000
Deposit account	25,000	91,000	
ISAs (stocks and shares)	150,000		
Shares (Foxley Electronics plc)	95,000		

David and Anne say they need a secure income in retirement from their defined contribution funds, which could reduce by one third if one of them died. £100,000 of the money held in the current account was an inheritance from David's mother when she died last year. Anne's parents are still alive but are in poor health.

Their financial aims are to:

- invest in a tax-efficient and appropriate manner;
- maintain their standard of living in retirement;
- maximise the amount their children will inherit;
- assist Alice with house purchase.

Questions

(a) **(i)** With regard to each of David and Anne's stated financial aims, identify the additional information you will require from them, other than their risk profiles, in order to be able to advise them. **(12)**

(ii) Describe to David and Anne what is meant by the term 'risk profile' and its implications for them. **(4)**

(iii) Explain why shares in Foxley Electronics plc may be more volatile than a UK stock market tracker fund. **(4)**

(iv) David used to invest in specialist funds which are normally seen as high risk, but he now wishes to invest in low risk investments. State **four** reasons why David's attitude to risk may have changed. **(4)**

(b) Explain to David the **benefits** of taking a retirement income in respect of his defined contribution pensions by:

(i) conventional annuity; **(6)**

(ii) pension fund withdrawal. **(7)**

(c) Recommend and justify a specific retirement income product for David from the two options stated in part **(b)** above. **(6)**

(d) **(i)** Calculate, **showing all your workings**, the current value of the estate, after deduction of Inheritance Tax, on the second death of David and Anne. **(3)**

(ii) Describe **three** methods by which David and Anne could immediately reduce the Inheritance Tax value of their estates. **(6)**

(iii) Recommend and justify a suitable type of insurance policy to cover David and Anne's Inheritance Tax liability on second death and state how the policy should be set up. **(7)**

(e) State **three** methods by which David and Anne could help Alice buy her home and state **one** drawback of each method. **(6)**

(f) Identify **five** events which should prompt a review of your recommendations for David and Anne. **(5)**

Total marks available for this question: 70

The tax tables can be found on pages 11 - 15

INCOME TAX

RATES OF TAX	2009/2010	2010/2011
Starting rate for savings*	10%	10%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	N/A	50%
Starting-rate limit	£2,440*	£2,440*
Threshold of taxable income above which higher rate applies	£37,400	£37,400
Threshold of taxable income above which additional rate applies	N/A	£150,000

**restricted to savings income only and not available if taxable non-savings income exceeds starting rate band.*

MAIN PERSONAL RELIEFS		
Income limit for Personal Allowance §	N/A	£100,000
Personal Allowance (basic) §	£6,475	£6,475
Personal Allowance (age 65-74) §	£9,490	£9,490
Personal Allowance (aged 75 and over) §	£9,640	£9,640
Married/civil partners (minimum) at 10% †	£2,670	£2,670
Married/civil partners (age 75 and over) at 10%	£6,965	£6,965
Income limit for age-related allowances	£22,900	£22,900
Blind person's allowance	£1,890	£1,890
Enterprise Investment Scheme relief limit at 20%	£500,000	£500,000
Venture Capital Trust relief limit at 30%	£200,000	£200,000

§ *the Personal Allowance reduces by £1 for every £2 of income above the income limit irrespective of age from 2010/2011.*
† *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	£545
CTC usually reduced by 6.67% of joint income over	£50,000	£50,000

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	Weekly	Monthly	Yearly
Lower Earnings Limit (LEL)	£97	£421	£5,044
Primary threshold	£110	£477	£5,715
Upper Earnings Limit (UEL)	£844	£3,656	£43,875
Upper Accruals Point	£770	£3,337	£40,040

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS	
	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%

Total earnings £ per week	CLASS 1 EMPLOYER CONTRIBUTIONS		
	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 £97 per week. This £97 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

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

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.

INHERITANCE TAX

RATES OF TAX ON DEATH	2009/2010	2010/2011
Transfers made after 5 April 2010		
- 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 to same person	£250	£250
Wedding/civil partnership gifts by		
- parent	£5,000	£5,000
- grandparent/party to marriage/civil partnership	£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 2010/2011:
The percentage charge is 15% of the car's list price for CO2 emissions at or below the qualifying level of 130g/km.
The base percentage charge of 15% increases in 1% steps for every additional full 5g/km over the 130g/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 and 5% for emissions at or below 75g/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 CO_2 emissions % relevant to the car and that % applied to a set figure (£18,000 for 2010/2011) e.g. car emission 160g/km = 21% on car benefit scale. 21% of £18,000 = £3,780.

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

2010/2011 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

MAIN CAPITAL AND OTHER ALLOWANCES

	2010/2011
Plant & machinery 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%
Industrial & agricultural buildings (straight line)	1%
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% first year	20% reducing balance	10% reducing balance

* If new

Research & Development:	Capital expenditure	100%
Revenue expenditure:	Small/medium companies:	175%
	Large companies:	130%

MAIN SOCIAL SECURITY BENEFITS

		2009/2010	2010/2011
		£	**£**
Child Benefit	first child	20.00	20.30
	subsequent children	13.20	13.40
Incapacity Benefit	short-term lower rate*	67.75	68.95
	short-term higher rate*	80.15	81.60
	long-term rate	89.80	91.40
Attendance Allowance	lower rate	47.10	47.80
	higher rate	70.35	71.40
Retirement Pension	single	95.25	97.65
	married	152.30	156.15
Pension Credit	single person standard minimum guarantee	130.00	132.60
	married couple standard minimum guarantee	198.45	202.40
	maximum savings ignored in calculating income	6,000.00	10,000.00
Bereavement Benefit (lump sum)		2,000.00	2,000.00
Widowed Parent's allowance		95.25	97.65
Jobseekers Allowance		64.30	65.45

** under State Pension Age*

CAPITAL GAINS TAX

RATES OF TAX

Chargeable gains, less allowable losses, are charged to tax as follows from 23 June 2010:

- for individuals who are non-taxpayers or basic-rate taxpayers, the rate chargeable is 18%.
- for individuals who are higher-rate taxpayers or additional-rate taxpayers, the rate chargeable is 28%.
- for trustees of trusts and personal representatives the rate chargeable is 28%.
- Entrepreneurs' Relief reduces the rate to 10% on qualifying assets subject to a lifetime limit of £5,000,000.

ANNUAL EXEMPTION

- The annual exemption is £10,100.
- Most trusts have an annual exemption of £5,050.

CHATTELS EXEMPTION

- Gains on chattels are exempt if proceeds do not exceed £6,000 per item.

CORPORATION TAX

	2009/2010	2010/2011
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

VALUE ADDED TAX

Standard rate to 03/01/11	17.5%
Standard rate from 04/01/11	20%
Annual Registration limit	£70,000