THE CHARTERED INSURANCE INSTITUTE

R06

Diploma in Regulated Financial Planning

Unit 6 – Financial planning practice

October 2012 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2012/2013, 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.
- **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.**

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Unit R06 – Financial planning practice

Instructions to candidates

Read the instructions below before answering any questions

- **Three hours** are allowed for this paper.
- This 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

Dean, aged 30, is single, in good health and has no dependants. He has recently purchased a residential property with the assistance of a mortgage of £230,000 on an interest only basis. He would like to consider the most appropriate way to repay this loan for the property.

Dean runs his own consultancy business which he set up as a sole trader five years ago. The business is unincorporated and employs five full-time employees. Dean's taxable net profit, which he takes as drawings, for the tax year 2011/2012 was £107,000. He has stated that he expects this amount to remain the same for the tax year 2012/2013.

Dean started saving for his retirement with the establishment of a personal pension in May 2010 and he has contributed £240 per month, net of basic rate tax, since inception. The pension is invested in a UK equity fund. Dean wants to increase his contributions as he wants to be able to retire at age 55 and realises that the current level of contributions is unlikely to be sufficient.

Dean inherited a portfolio of investments from his late grandfather in October 2004 that were then worth £20,000. They are currently valued at £44,000. In addition, he has previously invested in stocks & shares and cash ISAs currently worth £42,400 in total. The contributions to the ISAs were made in previous tax years.

Type of Investment	Fund	Current Value £	Gross Yield %
Stocks & Shares ISA	Global Equity	21,600	0.4
Cash ISA	Cash	20,800	3.2
Unit Trust	UK Equity	24,000	1.5
Open-ended Investment Company Scheme	European Equity	20,000	1.0

Dean has no protection cover in place and has not made a Will. He has a moderately adventurous attitude to risk.

Dean's financial aims are to:

- fund for sufficient retirement income at age 55;
- to receive advice on a repayment vehicle for his interest only mortgage;
- obtain sufficient protection in the event of a serious or long-term illness;
- reduce his future tax liabilities.

Questions

(a) Describe briefly the stages in the process an adviser should follow to advise Dean on investment planning. **(6)**

(b) For each of the following, list **five** benefits and **five** drawbacks, if Dean were to:

(i) encash his existing investments to reduce his mortgage balance; **(10)**

(ii) contribute to his ISAs to repay his mortgage. **(10)**

(c) State the additional information that an adviser would require to advise Dean about his protection needs in the event of long-term or serious illness. **(8)**

(d) Describe briefly the **benefits** of effecting:

(i) an income protection policy to cover his protection needs; **(6)**

(ii) a critical illness policy to cover his protection needs. **(6)**

(e) **(i)** State the additional information an adviser would require to advise Dean on his retirement planning. **(8)**

(ii) Explain the **benefits** to Dean of making the maximum tax relievable contribution in the tax year 2012/2013. **(5)**

(iii) Explain how the maximum amount of tax relief will be calculated should Dean decide to make the maximum tax relievable contribution to his personal pension in the tax year 2012/2013. *No calculations are required.* **(6)**

(f) Recommend and justify how Dean could improve the overall tax efficiency of his portfolio. **(10)**

Total marks available for this question: 75

Questions continue over the page

Case study 2

John and Margaret are married and have both reached age 60 this year, John on 23 April and Margaret on 6 August. They have two children who are not financially dependent on them.

John is the sole shareholder of his company, BLT Ltd which he founded 30 years ago. He draws a salary of £8,000 per annum gross and dividends of £50,000 per annum from the company. He fully intends to continue working in some capacity until he is eligible to receive his Basic State Pension. John has recently received an offer for the business from a rival company which valued BLT Ltd at £1,400,000.

Over time, John's company has made substantial pension contributions on his behalf and has built a fund in a personal pension of £600,000 which is invested in a range of equities and bonds. John has nominated the death benefits from this scheme to his two children. Both John and Margaret have recently received confirmation that they will be entitled to a full Basic State Pension.

Margaret has operated a small holiday let close to their home for the past ten years. Margaret provides child minding services for her guests and arranges tours around the local area. The property that Margaret uses for the holiday let was inherited from her aunt 10 years ago with a probate value of £120,000, and it was recently valued at £300,000. This provides her with an income of £22,000 per annum gross.

John and Margaret each have a Will in place that leaves everything to each other and then to their children equally on second death.

John and Margaret have provided the following information regarding their assets:

Asset	John (£)	Margaret (£)	Jointly owned (£)
BLT Shares	1,400,000		
Onshore Investment Bond	150,000		
Stocks & Shares ISA	100,000	100,000	
Current account			100,000
Home (Joint Tenancy)			1,200,000
Holiday Let		300,000	
Chattels			40,000
Personal Pension	600,000		

John has always regarded his pension fund as a joint pension for both him and Margaret. He would consider using drawdown options to provide flexibility in drawing retirement benefits. John and Margaret have a medium attitude to risk.

John and Margaret's financial aims are to:

- invest in a tax efficient manner until their retirement;
- maintain their standard of living in retirement;
- ensure that appropriate arrangements are in place in the event of death or incapacity;
- maximise the amount their children will inherit.

Questions

*To gain maximum marks for calculations you **must** show **all** your workings and express your answers to **two** decimal places.*

(a) **(i)** State the differences between capped drawdown and flexible income drawdown that John should consider when drawing his retirement benefits. **(6)**

(ii) State the exact ages at which John and Margaret will qualify for their State Pensions. **(2)**

(b) In the event that both John and Margaret were to die now, calculate, **showing all your workings**, the amount of the estate and the total Inheritance Tax that would be charged on second death. **(8)**

(c) Margaret has asked you to explain how her furnished holiday let will be taxed.

(i) Explain the requirements that must be satisfied in the tax year 2012/2013 for her business to qualify as a furnished holiday let. **(6)**

(ii) If Margaret were to sell the furnished holiday let now, calculate, **showing all your workings**, the Capital Gains Tax she would incur and state when this would need to be paid. *Assume that the costs of sale would be £5,000 and she has not made any other disposals in the current tax year.* **(6)**

(d) John and Margaret have decided to rewrite their Wills and arrange for a facility for their financial affairs to be managed in the event that either of them suffers a loss of mental capacity.

(i) Explain the main requirements that a Will must satisfy in order to be valid. **(6)**

(ii) State with reasons to John who may be appropriate to appoint as his attorney under a Lasting Power of Attorney for property and financial affairs. **(6)**

(e) Recommend and justify the changes which can be made now to John and Margaret's assets to maximise tax efficiency for them. **(13)**

(f) **(i)** State the additional information an adviser would require to advise John and Margaret on Inheritance Tax planning. **(10)**

(ii) Recommend and justify ways in which John and Margaret can begin to reduce their potential Inheritance Tax liability. **(12)**

Total marks available for this question: 75

The tax tables can be found on pages 9 - 13

INCOME TAX

RATES OF TAX	2011/2012	2012/2013
Starting rate for savings*	10%	10%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	50%	50%
Starting-rate limit	£2,560*	£2,710*
Threshold of taxable income above which higher rate applies	£35,000	£34,370
Threshold of taxable income above which additional rate applies	£150,000	£150,000
Child Benefit charge from 7 January 2013:		
1% of benefit for every £100 of income over	N/A	£50,000

**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) §	£7,475	£8,105
Personal Allowance (age 65-74) §	£9,940	£10,500
Personal Allowance (aged 75 and over) §	£10,090	£10,660
Married/civil partners (minimum) at 10% †	£2,800	£2,960
Married/civil partners (age 75 and over) at 10%	£7,295	£7,705
Income limit for age-related allowances	£24,000	£25,400
Blind Person's Allowance	£1,980	£2,100
Enterprise Investment Scheme relief limit on £1,000,000 max (£500,000 in 2011/12)	30%	30%
Seed Enterprise Investment relief limit on £100,000	N/A	50%
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)		
- Child element per child (maximum)	N/A	£2
- family element	£545	£545
Threshold for tapered withdrawal of CTC	N/A	£15,860

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	Weekly	Monthly	Yearly
Lower Earnings Limit (LEL)	£107	£464	£5,564
Primary threshold	£146	£636	£7,605
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 (money purchase)	Contracted-out rate (final salary)
Up to 146.00*	Nil	Nil
146.01 – 770.00	12%	10.6%
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 £107 per week. This £107 to £146 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 144.00**	Nil	Nil	Nil
144.01 – 770.00	13.8%	10.4%	13.8%
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 £2.65 where earnings exceed £5,595 per annum.
Class 3 (voluntary)	Flat rate per week £13.25.
Class 4 (self-employed)	9% on profits between £7,605 - £42,475 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
2012/2013	£1,500,000	£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	2011/2012	2012/2013
Transfers made after 5 April 2012		
- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
- Lifetime transfers to and from certain trusts	20%	20%

**For deaths after 5 April 2012, a lower rate of 36% applies where at least 10% of deceased's net estate is left to charity.*

MAIN EXEMPTIONS	2011/2012	2012/2013
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	£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 2012/2013:

- Cars that cannot emit CO_2 have a 0% charge.
- The percentage charge is 5% of the car's list price for CO2 emissions of 75g/km or less.
- For cars with CO_2 emissions of 76g/km to 99g/km the percentage is 10%.
- Cars with CO_2 emissions of 100g/km have a percentage charge of 11% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 35% (emissions of 220g/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 CO_2 emissions % relevant to the car and that % applied to a set figure (£20,200 for 2012/2013) e.g. car emission 100g/km = 11% on car benefit scale. 11% of £20,200 = £2,222.

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

2012/2013 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

	2012/2013
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£25,000
Plant & machinery (reducing balance) per annum	18%
Patent rights & know-how (reducing balance) per annum	25%
Certain long-life assets, integral features of buildings (reducing balance) per annum	8%
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	18% reducing balance	8% reducing balance

* If new

Research & Development:	Capital expenditure	100%

MAIN SOCIAL SECURITY BENEFITS

		2011/2012	2012/2013
		£	£
Child Benefit	First child	20.30	20.30
	Subsequent children	13.40	13.40
	Guardian's allowance		15.55
Employment and Support Allowance	Assessment Phase		
	Age 16 – 24	Up to 53.45	Up to 56.25
	Aged 25 or over	Up to 67.50	Up to 71.00
	Main Phase		
	Work Related Activity Group	Up to 94.25	Up to 99.15
	Support Group	Up to 99.85	Up to 105.05
Attendance Allowance	Lower rate	49.30	51.85
	Higher rate	73.60	77.45
Retirement Pension	Single	102.15	107.45
	Married	163.35	171.85
Pension Credit	Single person standard minimum guarantee	137.35	142.70
	Married couple standard minimum guarantee	209.70	217.90
	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		100.70	105.95
Jobseekers Allowance	Age 16 - 24	53.45	56.25
	Age 25 or over	67.50	71.00
Statutory Maternity, Paternity and Adoption Pay		128.73	135.45

CAPITAL GAINS TAX

EXEMPTIONS	2011/2012	2012/2013
Individuals, estates etc	£10,600	£10,600
Trusts generally	£5,300	£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	28%	28%
Trustees and Personal Representatives	28%	28%
Entrepreneurs' Relief* – Gains taxed at:	10%	10%
Lifetime limit	£10,000,000	£10,000,000

*For trading businesses and companies (minimum 5% employee or director shareholding) held for at least one year.

CORPORATION TAX

	2011/2012	2012/2013
Full rate	26%	24%
Small companies rate	20%	20%
Small companies limit	£300,000	£300,000
Effective marginal rate	27.5%	25.0%
Upper marginal limit	£1,500,000	£1,500,000

VALUE ADDED TAX

	2012/2013
Standard rate	20%
Annual Registration limit	£77,000

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