

J02

Diploma in Financial Planning

Unit J02 – Trusts

April 2013 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 in the question, 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 2013 budget.

Instructions

- Two 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 J02 – Trusts

Instructions to candidates

Read the instructions below before answering any questions

- **Two hours** are allowed for this paper which consists of 15 short answer questions and carries a total of 130 marks.
- 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.
- 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**Time: 2 hours**

To gain maximum marks in a calculation you **must** show **all** your workings and express your answers to **two** decimal places.

1. List **six** common ways in which trusts are used other than tax planning and mitigation. (6)

2. Craig is the attorney of a registered Lasting Power of Attorney (LPA) with both Property & Financial affairs and Health & Welfare, established by his mother Aileen in 2010. Aileen's doctor recently confirmed that she has signs of losing mental capacity. Craig has not yet used the LPA, but Aileen's financial advisor has now recommended that several funds within her investment portfolio should be switched.

(a) Explain briefly, giving reasons, the action Craig will now need to take in his role as attorney. (4)

(b) State the rules Craig must abide by in respect of making gifts. (3)

3. Angela and Graham are brother and sister and are equal beneficiaries of three separate interest in possession trusts. Each trust was established on the 1 April 1988 via the purchase of a £50,000 offshore life assurance bond. Each has a current value of £250,000 and no withdrawals have been taken.

Trust 1

Set up by their grandfather, who died on 1 June 1996.

Trust 2

Set up by their grandmother Mary, who died on 1 July 2007.

Trust 3

Set up by their great uncle Mike, who is still alive.

The trustees of each trust were the settlor, along with Angela and Graham.

Angela, Graham and Mike are all higher rate tax payers and UK resident.

All of the bonds were encashed yesterday.

In respect of each of the **three** trusts, explain, giving your reasons, the tax consequences of the chargeable gains and against whose income they are assessed. *No calculation is required.* (9)

4. Sarah is considering setting up a financial arrangement for the benefit of her five grandchildren who are all under 10 years old. She wants to know the legal position of such an arrangement.

Compare **five** key differences between a non-statutory trust and an enforceable contract. (10)

5. Philip, aged 19, is the sole beneficiary of an absolute trust. The trust was established by his grandfather and both his parents are the trustees. Philip earns £15,000 per annum. The trust is worth £140,000 based on the latest valuation and in the tax year 2012/2013, received net income of £600 from bank interest and £720 from dividends. In addition, the trust has made a gain of £12,000 on the sale of shares. No other gains have been made.
- (a) (i) State who is liable for paying both the Income and Capital Gains Tax within the trust. (1)
- (ii) State how this must be reported. (1)
- (b) Calculate, **showing all your workings**, in respect of the trust assets for the tax year 2012/2013:
- (i) the Income Tax liability; (5)
- (ii) the Capital Gains Tax liability. (3)
6. Maximising the return on a trust fund is one of the duties of a trustee as defined in the Trustee Act 2000.
- (a) In addition to applying standard investment criteria, explain briefly what behaviour the trustees must exhibit when complying with this duty. (5)
- (b) State when the trustees would need to apply the duty of conversion and apportionment. (2)
7. (a) State the **five** key principles of the Mental Capacity Act 2005. (5)
- (b) List the key aspects of the decision making process in relation to determining capacity of an individual. (4)
8. Explain briefly the mechanism by which the death benefits under an occupational pension scheme may be paid to a member's beneficiaries without forming part of the member's estate. (5)
9. Bob's first wife Karen died in 1998 when 40% of her Nil Rate Band was used. Bob married again but his second wife Jane died in January 2011 using 50% of her Nil Rate Band. Bob died in March 2013.
- (a) (i) Explain the maximum Nil Rate Band available on his estate. (5)
- (ii) State the process, including any time limits, that must be undertaken. (3)
- (b) If Jane had died in January 2012, explain briefly what other Inheritance Tax planning measure may have been available to use. (2)

Questions continue over the page

10. David and Sophia set up an absolute trust for each of their grandchildren, Kim, aged 11 and James, aged 16. Currently the trusts are invested in a range of gross yielding assets which also provide some modest capital growth.

The trustees are undertaking their annual review of both trusts. They have been notified that Kim is starting a fee paying education from September 2013. James is starting an apprenticeship and will be earning £180 per week immediately on leaving school this summer.

Bearing in mind their respective circumstances, explain the immediate factors and actions that the trustees should take into account when reviewing the trust for:

(a) Kim; (4)

(b) James. (7)

11. Helen is seeking your advice. Following a family dispute between her four adult children, two of whom are the trustees of a trust she established in 2008, Helen has asked you to identify:

(a) who holds the power to appoint new trustees; (3)

(b) the circumstances which allow for an existing trustee to be replaced by a new trustee. (7)

12. Sabrina's business has experienced financial difficulties and she is now contemplating applying for bankruptcy. Before doing this, Sabrina is seeking a little more information on the consequences, as she has heard that if she becomes bankrupt she will no longer own any property.

(a) State the restrictions that would be imposed on Sabrina and her property during bankruptcy. (8)

(b) (i) State the property she can retain during bankruptcy. (2)

(ii) Explain briefly the process for any property to be returned to Sabrina. (2)

13. (a) Explain briefly the tax treatment, in respect of donations made, to a charitable trust. (5)

(b) Other than being exclusively for a charitable nature, state **five** additional ways in which a charitable trust is different from other trusts. (5)

14. Ellen intends to use £500,000 of her investment portfolio to establish her first discretionary trust. She has made no previous gifts.

Explain what impact the setting up of this trust may have on Ellen's personal Inheritance Tax position, both at outset and subsequently. (8)

15. Explain for a trust that was set up in 2001:

(a) the maximum term that the trust may run (the perpetuity period); (2)

(b) the possible accumulation periods before any income must be distributed by the trustees. (4)

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 2011/2012)	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	£2,690
- 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	£634	£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%
<i>*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.</i>		

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 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 CO₂ 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 CO₂ emissions of 76g/km to 99g/km the percentage is 10%.
- Cars with CO₂ 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 CO₂ 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

	2011/2012 Rates	2012/2013 Rates
Cars		
On the first 10,000 business miles in tax year	45p per mile	45p per mile
Each business mile above 10,000 business miles	25p per mile	25p per mile
Motor Cycles	24p per mile	24p per mile
Bicycles	20p per mile	20p per mile

MAIN CAPITAL AND OTHER ALLOWANCES

	2011/2012	2012/2013	
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£100,000	£25,000	
Plant & machinery (reducing balance) per annum	20%	18%	
Patent rights & know-how (reducing balance) per annum	25%	25%	
Certain long-life assets, integral features of buildings (reducing balance) per annum	10%	8%	
Energy & water-efficient equipment	100%	100%	
Zero emission goods vehicles (new)	100%	100%	
Qualifying flat conversions, business premises & renovations	100%	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%	18%	8%
	first year	reducing balance	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

	2011/2012	2012/2013
Standard rate	20%	20%
Annual Registration limit	£73,000	£77,000

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