

# AF1

## Advanced Diploma in Financial Planning

### Unit AF1 – Personal tax and trust planning

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

- 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 AF1 – Personal tax and trust planning

## Instructions to candidates

### Read the instructions below before answering any questions

- **Three hours** are allowed for this paper which carries a total of 160 marks as follows:
- Section A: 80 marks
- Section B: 80 marks
- You are advised to spend approximately 90 minutes on Section A and 90 minutes on Section B.
- 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.**

## SECTION A

This question is compulsory and carries 80 marks

## Question 1

Tim and Andrea Wilcox are both aged 40. They have been married for 14 years and have two children, aged eight and five, for whom Andrea is receiving child benefit. They paid off their mortgage with the money Tim's father willed to them when he died three years ago.

Tim is a self-employed writer, working from home. His taxable profits have been £62,000 per annum for each of the last four years. He pays £400 per month, net, into the personal pension plan he started 15 years ago. The pension fund is currently valued at £120,000 and is subject to a master trust. His trading year ends on 5 April, in line with the tax year. Tim's books have all been illustrated by his friend Henri, originally from Canada, who has lived and worked in the UK for the last 11 years.

Andrea has been employed for 21 years as a fraud investigator for a plc that specialises in offering loans that provide two-year start-up deals for aspiring entrepreneurs. Her current salary is £34,000 per annum. She has recently been awarded a cash bonus of £12,000 for submitting an idea to her manager that will save the company a substantial amount of money. In addition Andrea has been awarded £1,050 in recognition of her time with the company.

Apart from the house, which is owned by Tim and is currently valued at £245,000, Tim and Andrea's assets are:

Asset	Ownership	Current Value (£)	Income received 2012/2013 (£)	Acquisition/ Start Date
Anybank current account	Joint	10,000	0	January 1997
Stocks & shares ISA	Tim	65,000	3,120	March 2000
Cash ISA	Tim	26,500	609	June 2003
UK equity unit trust	Tim	54,000	1,620	February 2010
Cash ISA	Andrea	21,350	448	July 2004

Tim has been pleased with the performance of his UK equity unit trust and he is thinking about investing some of the gains he has made in an offshore investment fund. He understands that not all offshore funds are taxed in the same way and needs more information on the matter.

Tim and Andrea do not intend to have their children educated privately or to save for further education costs as Tim's late father's Will made adequate provision for this. Neither Tim nor Andrea have a valid Will.

**Questions**

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

- (a) For the tax year 2012/2013, calculate, **showing all your workings**, Tim's:
- (i) Income Tax liability; (18)
  - (ii) total National Insurance Contributions. (6)
- (b) Explain how Tim's estate would be distributed if he had died on 31 March 2013. *No calculation is required.* (10)
- (c) Explain, in detail, the Income Tax treatment of the payments Andrea's employer has made in relation to her:
- (i) cost saving idea; (8)
  - (ii) long-service award. (5)
- (d) Some of the businesses Andrea is investigating have taken advantage of the seed enterprise investment scheme (SEIS). Explain briefly how the SEIS differs from the enterprise investment scheme for the tax year 2012/2013. (9)
- (e) Explain how Henri's income will be taxed, assuming he has not elected to change his domicile. (12)
- (f) Outline the possible tax treatment of any income or gains on Tim's proposed investment into an offshore investment fund. (12)

**Total marks available for this question: 80**

**Questions continue over the page**

## SECTION B

**Both questions in this section are compulsory  
and carry an overall total of 80 marks**

**Question 2**

Ellen, aged 45 and single, operates a software business as a sole trader. Her earnings have declined significantly over the last three years due to the economic downturn. For the tax year 2012/2013 her net earnings after deductions and allowances are £32,570. She is worried that her business will continue to struggle for the foreseeable future and she may eventually be declared bankrupt.

In addition to her main residence, Ellen owns a cottage which she purchased for £95,000, net of costs, on 1 May 1999 and used as her main residence until 1 August 2005. Since moving into her current main residence, she has only used the cottage for holidays. During the time she lived at the cottage there were two periods of non-occupancy; three years when she worked abroad and 12 months when she lived with her mother who was unwell. She returned to the cottage immediately after each period of non-occupancy. She has now agreed to sell the cottage for £285,000 net of sale costs.

Ellen, has a £42,500 investment portfolio which consists mainly of UK bank shares that are currently earning dividends of £400 per annum gross. The remainder of the portfolio is invested in a range of fixed-interest securities that have paid net interest of £800 for the tax year 2012/2013. Ellen made a £5,000 loss on the sale of some of her shares on 20 July 2012. She has not made any other disposals in the tax year 2012/2013. Ellen has a personal pension plan, currently valued at £100,000, which she stopped contributing to in March 2012.

In February 2005, Ellen's mother placed £270,000, split equally into three discretionary trusts, for the benefit of her grandchildren. These are the only transfers Ellen's mother has ever made. The trusts are invested entirely in equities and the trustees are Ellen and her two brothers. The eldest granddaughter is hoping to go to university this year and the trustees are considering using the dividends as they arise within her trust each year to help towards the university fees.

**Questions**

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

- (a) Ellen would like to ensure that her pension and investments are secure in the event of her bankruptcy. Explain to Ellen, the effect her bankruptcy would have on them. (7)
- (b) Calculate, **showing all your workings**, Ellen's liability to Capital Gains Tax (CGT) if she had completed the sale of her cottage on 31 March 2013. (12)
- (c) Explain to Ellen the Income Tax and CGT treatment of her investment portfolio should she decide to put it into one of the three discretionary trusts established by her mother. (12)
- (d) Explain, in detail, the tax implications of the proposed income distribution from the trust. (9)

**Total marks available for this question: 40**

**Question 3**

Alan, who divorced from his wife some years ago, owned and operated a farm until his death in November 2012. At his death he left savings and investments valued at £600,000, a farmhouse with both an agricultural and market value of £350,000, farm equipment valued at £60,000 and 100 acres of agricultural land valued at £4,000 per acre. Alan also had a personal pension plan, valued at £500,000 at his death, nominating his three adult children under an expression of wish.

In June 2010 Alan set up a discretionary trust for his three infant grandchildren, by transferring funds to the trustees totalling £650,000, generated by the sale of land for building. In addition, in June 2011, he gave his eldest son, John, £50,000 as a down payment on a house. In June 2011 he also gave £250,000 to a registered charity.

He made no other gifts during his lifetime and had a valid Will leaving his entire estate equally between his three children.

Alan appointed his solicitor as the sole executor of the estate and his son John, as the sole trustee of the trusts.

**Questions**

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

- (a) (i) Calculate, **showing all your workings**, the total Inheritance Tax (IHT) liability as a result of Alan's death and state how this liability will be apportioned. (19)
- (ii) State when the IHT would have to be paid and explain what sources of funds could be used to meet the liability. (8)
- (b) Describe briefly the Solicitor's role as the executor in this situation. (7)
- (c) Describe briefly the key areas that John, as the sole Trustee, should consider when reviewing the discretionary trust following Alan's death. (6)

**Total marks available for this question: (40)**

**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.

<b>Class 2 (self-employed)</b>	Flat rate per week £2.65 where earnings exceed £5,595 per annum.
<b>Class 3 (voluntary)</b>	Flat rate per week £13.25.
<b>Class 4 (self-employed)</b>	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 (CO<sub>2</sub>) emissions. There is no reduction for high business mileage users.

### For 2012/2013:

- Cars that cannot emit CO<sub>2</sub> have a 0% charge.
- The percentage charge is 5% of the car's list price for CO<sub>2</sub> emissions of 75g/km or less.
- For cars with CO<sub>2</sub> emissions of 76g/km to 99g/km the percentage is 10%.
- Cars with CO<sub>2</sub> 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<sub>2</sub> 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
<b>Cars</b>		
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
<b>Motor Cycles</b>	24p per mile	24p per mile
<b>Bicycles</b>	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%
<b>Motor cars:</b> Expenditure on or after 01/04/09 (Corporation Tax) or 06/04/09 (Income Tax)		
CO <sub>2</sub> emissions of g/km:	110 or less*	111-160
		161 or more
Capital allowance:	100%	18%
	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
	Subsequent children	13.40
	Guardian's allowance	15.55
Employment and Support Allowance	Assessment Phase	
	Age 16 – 24	Up to 53.45
	Aged 25 or over	Up to 67.50
	Main Phase	
	Work Related Activity Group	Up to 94.25
	Support Group	Up to 99.85
Attendance Allowance	Lower rate	49.30
	Higher rate	73.60
Retirement Pension	Single	102.15
	Married	163.35
Pension Credit	Single person standard minimum guarantee	137.35
	Married couple standard minimum guarantee	209.70
	Maximum savings ignored in calculating income	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
	Age 25 or over	67.50
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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