THE CHARTERED INSURANCE INSTITUTE

R06

Diploma in Regulated Financial Planning

Unit 6 – Financial planning practice

July 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 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 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

Jack, aged 32, and Greg, aged 35, have been civil partners since September 2010. In October 2011 they completed the adoption of Sarah and Luke, three year old twins.

At the time of the adoption, Jack left his employment with a large architect's practice to take care of the twins. He is now in the process of establishing his own architect's practice. Jack expects this to produce an income of around £15,000 - £20,000 per annum gross for the first two years but once the children are older he intends to devote more time to his business at which point he expects his income to increase significantly. He is uncertain whether he should establish the business on a self-employed or limited company basis.

Greg has worked as a loss adjuster for a large insurance company since 2000. In 2012/2013 he received a basic annual salary of £45,000 and a discretionary bonus of £6,000. He has recently received a promotion and from 6 July 2013 his basic salary has increased to £54,000 with a guaranteed bonus of £6,000 per annum. As a result of his promotion he now receives a death in service lump sum of four times his basic salary plus membership of his employer's income protection plan.

Greg was a member of his employer's non-contributory final salary pension scheme until it closed to further accrual in 2010. He then became a member of the replacement occupational defined contribution scheme and he and his employer both contribute 10% of his basic salary into the scheme. Jack and Greg intend to retire when Greg reaches age 65.

On 1 April 2000 Greg purchased a house for £210,000 with an interest only mortgage of £140,000 over 20 years. At the same time he took out a life and critical illness level term assurance plan for the amount and term of the mortgage. Greg lived there until 30 June 2006. The house, which is owned in his name only, was then rented out, with the last tenants moving out on 31 March 2013. Greg is now selling the house for £420,000 with the sale due to complete on 31 July 2013. The couple intend to place the profit from the sale into a trust for the future benefit of the children.

Jack and Greg currently live in a house inherited by Jack from his grandparents in 2006. The property is held in Jack's name only and is currently valued at £420,000 with no mortgage outstanding. The couple have a joint savings account with a balance of £35,000, Greg has equity ISAs valued at £42,000 and Jack has equity ISAs valued at £47,000. Both Greg and Jack state that they have a medium attitude to risk.

They each have Wills set up in 2006 that leave their entire estates to each other.

Their financial aims are to:

- review their current arrangements to ensure the family is adequately protected in the event of death, accident or illness;
- ensure they have an adequate income in retirement;
- receive advice on the best trust arrangement to hold the funds from the house sale;
- understand how the change in Greg's income will impact on the tax paid on their Child Benefit.

Questions

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

(a) State the additional information you would require in order to advise Jack and Greg on their aim to have an adequate income in retirement. **(12)**

(b) **(i)** Explain in detail how the Child Benefit Income Tax charge paid by Greg will be calculated following the increase in his salary. *No calculation is required.* **(8)**

(ii) State **two** actions Greg could take to reduce the Child Benefit Income Tax charge payable. **(2)**

(c) **(i)** State the process an adviser should follow when advising Jack and Greg on their protection needs. **(8)**

(ii) Greg is considering whether he will still need the existing life and critical illness policy once the property is sold. Outline the factors that should be taken into account when assessing the policy's ongoing suitability. **(8)**

(iii) Recommend and justify a suitable product to provide Jack with an income in the event that he suffers an accident or long term illness. **(8)**

(d) Calculate, **showing all your workings**, the amount of Capital Gains Tax (CGT) that will be due following the sale of Greg's property. *You should assume that the costs of sale are £5,000 and the CGT annual exemption is £10,900.* **(10)**

(e) State the additional information you would require from Jack and Greg in order to advise them on the most appropriate trust arrangement to set up for the children. **(6)**

(f) Outline **four** benefits and **four** drawbacks for Jack if he chooses to set his business up as a limited company rather than operate on a self-employed basis. **(8)**

(g) Jack and Greg wish to ensure that on first death the survivor is left in control of all assets with minimal administration. Explain the actions Jack and Greg should take **now** in order that this aim can be met. **(8)**

Total marks available for this question: 78

Questions continue over the page

Case study 2

Andrew, aged 62, and his wife Sophie, aged 64, have two non dependent children and five grandchildren.

Sophie worked as a self-employed accountant until she became ill two years ago. At a recent check-up Sophie was told that her life expectancy is around three to four years and that it is likely that she will lose mental capacity in the final months of her life. When Sophie became ill, Andrew, who is in excellent health, stopped working to take care of her. Sophie is currently receiving an income from an income protection policy (IPP) but this will cease in September 2013 when she reaches her 65th birthday. The income from the IPP has been sufficient to meet the couple's day to day income needs.

Sophie has a personal pension fund valued at £500,000 and intends to start drawing an income from this using phased capped drawdown when the income from her IPP ceases. The initial withdrawal she requires is £10,000 gross, payable as a combination of pension commencement lump sum and capped drawdown income.

When Andrew reaches age 65, he will be entitled to a pension from his former employer's contracted-out defined benefit pension scheme of £42,000 per annum. The couple both have a full entitlement to the Basic State Pension, however, Sophie deferred receipt of her pension when she reached her State Pension Age.

Andrew and Sophie own their property outright and it is currently valued at £825,000. They intend to sell this and purchase a smaller property, at a total cost of £500,000, and wish to gift the balance of the funds realised to their children. They have both fully utilised their £3,000 annual gift exemptions over the past few years, including the current tax year, but have made no other gifts during this time.

In addition to this property they have the following assets:

Type	**Amount (£)**
Joint instant access deposit account	35,000
Onshore investment bond (jointly held)	215,000
Share portfolio (Andrew)	275,000
Share portfolio (Sophie)	165,000

Andrew and Sophie updated their Wills when Sophie became ill and have left everything to each other on first death and then to their children. They have a medium attitude to risk.

Their financial aims are to:

- ensure their assets are invested appropriately and that they have sufficient income to live on when the income protection policy ceases;
- gift the money from the house sale to their children as tax efficiently as possible;
- ensure that all necessary decisions can be made regarding Sophie's welfare.

Questions

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

(a) Calculate, **showing all your workings**, the minimum amount Sophie must crystallise using phased capped drawdown to receive £10,000 gross if the Government Actuary Department rate applicable is £54 per £1,000. **(6)**

(b) Andrew and Sophie wish to minimise the impact of Inheritance Tax on second death.

(i) Explain why they should consider making the gift to the children in Andrew's name only rather than as a joint gift. **(6)**

(ii) Assuming the gift is made by Andrew only, outline why he should take out a seven year level term assurance contract with a sum assured of £130,000 on his life at the time the gift is made. **(6)**

(c) Sophie would like some advice on whether she should start to take the income from her Basic State Pension. Outline the factors that an adviser should take into account when advising Sophie in this area. **(8)**

(d) **(i)** State the additional information you would require in order to advise Andrew and Sophie on how their investment portfolio could be used to provide them with a tax efficient income. **(12)**

(ii) Outline the process an adviser should follow in order to confirm Andrew and Sophie's risk profiles. **(6)**

(e) State **five** benefits and **five** drawbacks for Andrew and Sophie of using a discretionary fund manager to manage their investments. **(10)**

(f) Andrew and Sophie are both concerned about her deteriorating state of health. Describe the actions that they can take **now** to ensure that all appropriate decisions can be made on Sophie's behalf. *You should assume that no change in ownership of their assets will take place.* **(8)**

(g) Outline the areas that should be considered at Andrew and Sophie's review in twelve months' time. **(10)**

Total marks available for this question: 72

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%

**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

	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% 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

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

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