THE CHARTERED INSURANCE INSTITUTE

J05

Diploma in Financial Planning

Unit J05 – Pension income options

October 2014 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2014/2015, unless stated otherwise in the question, and should be answered accordingly.

It should be assumed that all individuals are domiciled and resident in the UK unless otherwise stated.

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 J05 – Pension income options

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

1. Darren, who is in his early 60's, has always been employed and has never been contracted out. He has paid sufficient National Insurance contributions to be eligible for all State Pension benefits.

(a) List the State Pension benefits that Darren might receive if he reached State Pension age on 1 December 2014. **(5)**

(b) List the State Pension benefits that Darren might receive if he reached State Pension age on 1 December 2017. **(2)**

(c) Outline the tax treatment of State Pension benefits. **(2)**

2. Outline the circumstances that must be satisfied before the trustees of a defined benefit scheme can reduce or stop a scheme pension. **(8)**

3. Samuel is currently aged 68. He has a primary protection factor of 0.2. In 2008/2009, when the standard lifetime allowance was £1,650,000, he crystallised benefits held in a previous employer's occupational defined contribution scheme. At that time his fund was valued at £400,000 and the trustees used the whole fund to purchase a scheme pension of £24,750 per annum.

Samuel also has a personal pension plan fund, currently valued at £1,900,000 which he plans to use to purchase a lifetime annuity in October 2014.

Calculate, **showing all your workings**, the amount Samuel will have available to purchase a lifetime annuity once the lifetime allowance tax charge has been paid. *Assume that the excess above the lifetime allowance is taken as an income and that he does not intend taking any pension commencement lump sum.* **(10)**

4. Explain briefly what is included in an 'input of value', in respect of a declaration for flexible drawdown. **(5)**

5. Richard, aged 72, retired at the age of 60 and is in receipt of his State Pension of £10,000 per annum and Civil Service Pension of £31,000 per annum. Richard also has an uncrystallised self-invested personal pension (SIPP) fund of £925,000, which is currently invested largely in equities. He has no plans to crystallise his SIPP fund before he reaches the age of 75.

(a) Outline the circumstances which would trigger a benefit crystallisation event in respect of the SIPP fund. **(5)**

(b) Outline the areas that should be discussed at Richard's next SIPP review. **(8)**

6. Outline **two** benefits and **two** drawbacks of choosing an investment linked annuity over:

(a) a conventional lifetime annuity; **(4)**

(b) a drawdown pension. **(4)**

7. Philip, aged 62, is a deferred member of an underfunded defined benefit pension scheme which started to wind up in 1999. Phillip's entitlement at the scheme's normal retirement age of 65 is a pension of two-thirds of his final pensionable salary with a 60% spouse's pension, escalating at 5% per annum whilst in payment. The employer is insolvent and the scheme can only afford to pay 20% of the entitlement.

The Financial Assistance Scheme (FAS) has confirmed they will provide assistance to the scheme members.

Explain the restrictions that will be placed on Phillip's benefits as a result of the scheme entering the FAS. **(10)**

QUESTIONS CONTINUE OVER THE PAGE

8. In 2006, Gavin crystallised his only pension, valued at £800,000, into a drawdown pension. He died, aged 57, in 2009. His wife Heather opted to retain the funds in drawdown and drew an occasional income until her death, aged 58, in October 2014. At that time she had an uncrystallised personal pension plan valued at £700,000 and the drawdown pension was valued at £650,000.

Gavin and Heather are survived by their two children, Luke, aged 25, and Emma, aged 23. Luke has been physically disabled since birth and needs 24 hour care. Emma, who has no physical or mental disability, is currently unemployed. Nomination forms that have been completed for both pensions leave the benefits equally to both children.

Explain, in detail, the options Luke and Emma have for receiving these benefits and their tax treatment. *No calculations are required.* **(11)**

9. Graham, aged 52, has just returned to work following a minor stroke, albeit in a reduced capacity. Graham's pension benefits consist of an uncrystallised executive pension plan.

(a) Outline the conditions that must be met for Graham to be able to crystallise his executive pension plan on the grounds of ill health, if his health deteriorates further in 2014. **(4)**

(b) Outline the options available to the Scheme Administrator if Graham's health improves, assuming he takes benefits before the age of 55. **(3)**

10. Mary, who is in good health, has two small uncrystallised personal pension funds. The funds are valued at £12,000 and £14,000.

Outline the conditions that must be satisfied for Mary to fully commute both pensions. **(5)**

11. Describe how the maximum initial income level is calculated in respect of a capped drawdown pension arrangement commencing in October 2014. **(9)**

12. Peter purchased a lifetime annuity in 2008. He and his wife Susan divorced in February 2010. The courts ordered a pension sharing order to the value of 50% of Peter's pension and Susan was awarded a pension credit valued at £490,000. The standard lifetime allowance at that point was £1,750,000.

Calculate, **showing all your workings**, Susan's enhanced lifetime allowance in the tax year 2014/2015 as a result of the pension credit. *Assume Susan has not registered for any form of transitional protection.* **(5)**

13. Cynthia has been a member of her employer's contracted-out defined benefit pension scheme since 1982. She is about to retire at the scheme's normal retirement age of 65. The scheme has always increased pensions in payment by the statutory minimum rates of escalation.

Outline the rate(s) of escalation, if any, that will be applied to the pension in payment for the:

(a) Guaranteed Minimum Pension (GMP), including who is responsible for paying the increases. **(8)**

(b) Excess benefits accrued before 6 April 1997. **(1)**

(c) Benefits accrued after 5 April 1997. **(5)**

14. John intends to use phased retirement when he retires on 1 November 2014.

Outline **five** benefits and **five** drawbacks of using this method of drawing an income in retirement compared to the alternative of purchasing a lifetime annuity at outset. **(10)**

15. Kevin, aged 73, is about to crystallise his personal pension plan. He is thinking of taking his retirement income via a capped drawdown pension arrangement rather than purchasing a lifetime annuity.

(a) Outline what is meant by the term 'mortality drag'. **(3)**

(b) Outline the effects of mortality drag, assuming Kevin does choose the drawdown pension option. **(3)**

The tax tables can be found on pages 9 – 15

INCOME TAX

RATES OF TAX	2013/2014	2014/2015
Starting rate for savings*	10%	10%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	45%	45%
Starting-rate limit	£2,790*	£2,880*
Threshold of taxable income above which higher rate applies	£32,010	£31,865
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	£50,000	£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 if born after 5 April 1948) §	£9,440	£10,000
Personal Allowance (if born between 6 April 1938 and 5 April 1948) §	£10,500	£10,500
Personal Allowance (if born before 6 April 1938) §	£10,660	£10,660
Married/civil partners (minimum) (if born before 6 April 1935) at 10% †	£3,040	£3,140
Married/civil partners (if born before 6 April 1935) at 10% †	£7,915	£8,165
Income limit for age-related allowances	£26,100	£27,000
Blind Person's Allowance	£2,160	£2,230
Enterprise Investment Scheme relief limit on £1,000,000 max	30%	30%
Seed Enterprise Investment relief limit on £100,000	50%	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 (under the income threshold).
† where at least one spouse/civil partner was born before 6 April 1935.

Child Tax Credit (CTC)		
- Child element per child (maximum)	£2,720	£2,750
- family element	£545	£545
Threshold for tapered withdrawal of CTC	£15,910	£16,010

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	**Weekly**	**Monthly**	**Yearly**
Lower Earnings Limit (LEL)	£111	£481	£5,772
Primary threshold	£153	£663	£7,956
Upper Accrual Point	£770	£3,337	£40,040
Upper Earnings Limit (UEL)	£805	£3,489	£41,865

Total earnings £ per week	**CLASS 1 EMPLOYEE CONTRIBUTIONS**	
	Contracted-in rate	**Contracted-out rate (final salary)**
Up to 153.00*	Nil	Nil
153.01 – 770.00	12%	10.6%
770.01 – 805.00	12%	12%
Above 805.00	2%	2%

**This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £111 per week. This £111 to £153 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 153.00**	Nil	Nil	Nil
153.01 – 770.00	13.8%	10.4%	13.8%
770.01 – 805.00	13.8%	13.8%	13.8%
Excess over 805.00	13.8%	13.8%	13.8%

*** Secondary earnings threshold.*

Class 2 (self-employed)	Flat rate per week £2.75 where earnings exceed £5,885 per annum.
Class 3 (voluntary)	Flat rate per week £13.90.
Class 4 (self-employed)	9% on profits between £7,956 - £41,865 2% on profits above £41,865.

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
2013/2014	£1,500,000	£50,000
2014/2015	£1,250,000	£40,000

ANNUAL ALLOWANCE CHARGE

20% - 45% 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.

CAPITAL GAINS TAX

EXEMPTIONS	2013/2014	2014/2015
Individuals, estates etc	£10,900	£11,000
Trusts generally	£5,450	£5,500
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.*

INHERITANCE TAX

RATES OF TAX ON DEATH TRANSFERS	2013/2014	2014/2015
Transfers made after 5 April 2014		
- 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 2014, a lower rate of 36% applies where at least 10% of deceased's net estate is left to charity.*

MAIN EXEMPTIONS

	2013/2014	2014/2015
Transfers to		
- UK-domiciled spouse/civil partner	No limit	No limit
- non-UK-domiciled spouse/civil partner (from UK-domiciled spouse)	£325,000	£325,000
- 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_2) emissions. There is no reduction for high business mileage users.

For 2014/2015:

- Cars that cannot emit CO_2 have a 0% charge.
- The percentage charge is 5% of the car's list price for CO_2 emissions of 75g/km or less.
- For cars with CO_2 emissions of 76g/km to 94g/km the percentage is 11%.
- For cars with CO_2 emissions of 95g/km to 99g/km the percentage is 12%.
- Cars with CO_2 emissions of 100g/km have a percentage charge of 13% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 35% (emissions of 210g/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 (£21,700 for 2014/2015) e.g. car emission 100g/km = 13% on car benefit scale. 13% of £21,700 = £2,821.

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

	2013/2014 Rates	2014/2015 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

	2013/2014	2014/2015
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£250,000	£500,000
Plant & machinery (reducing balance) per annum	18%	18%
Patent rights & know-how (reducing balance) per annum	25%	25%
Certain long-life assets, integral features of buildings (reducing balance) per annum	8%	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 April 2014 (Corporation Tax) or 06 April 2014 (Income Tax)

CO_2 emissions of g/km:	95 or less*	96-130	131 or more
Capital allowance:	100% first year	18% reducing balance	8% reducing balance

*If new

CORPORATION TAX

	2013/2014	2014/2015
Full rate	23%	21%
Small companies rate	20%	20%
Small companies limit	£300,000	£300,000
Effective marginal rate	23.75%	21.25%
Upper marginal limit	£1,500,000	£1,500,000

VALUE ADDED TAX

	2013/2014	2014/2015
Standard rate	20%	20%
Annual registration threshold	£79,000	£81,000
Deregistration threshold	£77,000	£79,000

MAIN SOCIAL SECURITY BENEFITS

		2013/2014	2014/2015
		£	£
Child Benefit	First child	20.30	20.50
	Subsequent children	13.40	13.55
	Guardian's allowance	15.90	16.35
Employment and Support Allowance	Assessment Phase		
	Age 16 – 24	Up to 56.80	Up to 57.35
	Aged 25 or over	Up to 71.70	Up to 72.40
	Main Phase		
	Work Related Activity Group	Up to 100.15	Up to 101.15
	Support Group	Up to 106.50	Up to 108.15
Attendance Allowance	Lower rate	53.00	54.45
	Higher rate	79.15	81.30
Retirement Pension	Single	110.15	113.10
	Married	176.15	180.90
Pension Credit	Single person standard minimum guarantee	145.40	148.35
	Married couple standard minimum guarantee	222.05	226.50
	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		108.30	111.20
Jobseekers Allowance	Age 16 - 24	56.80	57.35
	Age 25 or over	71.70	72.40
Statutory Maternity, Paternity and Adoption Pay		136.78	138.18

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