THE CHARTERED INSURANCE INSTITUTE

CII

AF1

Advanced Diploma in Financial Planning

Unit AF1 – Personal tax and trust planning

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

- 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

Read the following carefully, then carry out **ALL** of the tasks **(a)**, **(b)**, **(c)**, **(d)**, **(e)**, **(f)**, **(g)** and **(h)** which follow.

James, aged 72, lived alone in London, following the death of his wife Sarah in May 2009. They have three adult children and four grandchildren.

Sarah had been married before she married James, but her first husband died when he was very young and left no estate. On her death, Sarah bequeathed £325,000, which consisted of her 50% share of a holiday cottage owned on a tenants-in-common basis with James and valued on her death at £600,000, and a cash legacy of £25,000, split equally between her three children. The rest of Sarah's estate was passed directly to James in accordance with her Will.

Before her death, Sarah managed the holiday cottage as an informal holiday letting business and made it available for rental at £750 per week. As this was Sarah's business, James decided to gift his 50% share of the property directly to the children at the date of Sarah's death. He has subsequently visited, as a guest of the children, on three occasions for a total of four weeks. Whilst staying at the cottage James paid his share of the costs but did not make any rental payments.

Prior to his retirement in September 2006, James was the Chief Executive and majority shareholder of Wonder Products Ltd, a company that he formed after leaving university and owned with his fellow director, Ian, for nearly 40 years. On James's retirement, Ian paid £500,000 to buy 10% of the company from James, to reduce James's stake to 41% and allow him to release some money from the company. James has continued to receive substantial dividends from the company but no longer takes any part in its management. On his retirement, James settled £250,000 into a discretionary trust for his children. This was the first time James had made any capital transfers.

On 1 April 2013, Wonder Products Ltd was bought by an AIM listed company, Magnificent Products plc, for cash and shares in the new company. This resulted in a cash payment to James of £1,000,000 and a 15% shareholding in the new company which at the time of transfer resulted in 1,000,000 shares worth £2 each.

When James's father died in 1997, he established a life interest trust with a lump sum. James is the sole life tenant and his children are the remaindermen. The trustees invested the monies into an onshore single premium investment bond and in the 2014/2015 tax year, the trustees have not made any distributions.

James's Income Tax calculation for the 2013/2014 tax year has been completed by his accountant and he has been assessed as owing a further £140,000 on the interest and dividends from his investments. James has yet to pay this Income Tax liability, preferring to wait until the final deadline to do so. As of 1 October 2014, James has received State Pension benefits to the amount of £3,250 for the 2014/2015 tax year.

James assets are currently listed as:

Assets	**Value (£)**	**Income received to 1 October 2014 (£)**
Home	1,850,000	N/A
Current Account	14,000	Nil
NISA	220,000	4,320
Share Portfolio	750,000	25,000
Magnificent Products plc – Shares	2,800,000	84,000
Life interest in the family trust	200,000	None

As of 1 October 2014, the holiday cottage was on the market for £500,000 but has not yet been sold.

James drafted his Will in 2000, appointing Sarah and his brother, who died in 2003, as executors.

The Inheritance Tax nil rate band was:
£285,000 in 2006/2007;
£300,000 in 2007/2008;
£312,000 in 2008/2009;
£325,000 in 2009/2010 and onwards.

QUESTIONS CONTINUE OVER THE PAGE

Questions continue on pages 7 – 8

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**, James's Income Tax liability for the tax year 2014/2015, assuming he died on 1 October 2014. **(9)**

(b) Calculate, **showing all your workings**, the Inheritance Tax (IHT) liabilities that would have arisen if James died on 1 October 2014. **(19)**

(c) **(i)** Explain, in detail, the requirements that the children would need to meet in order for the holiday cottage to qualify under HM Revenue & Customs rules as a furnished holiday let. **(7)**

(ii) Detail the tax benefits that this approach would provide. **(6)**

(d) The holiday cottage was gifted by Sarah and James to the children when its value was £600,000.

State the tax consequences for the children, if any, assuming that the property is sold in October 2014 for:

(i) £500,000; **(4)**

(ii) £700,000. **(4)**

(e) State the circumstances that could result in the loss of Business Property Relief in respect of shareholdings in an unlisted company. **(5)**

(f) Explain briefly how the pre-owned asset tax rules would apply to James on his use of the holiday cottage prior to his death. **(5)**

QUESTIONS CONTINUE OVER THE PAGE

(g) **(i)** State the requirements that must be met for an estate to qualify for the reduced rate of IHT due to a charitable gift and explain briefly how the net estate is calculated. **(6)**

(ii) List the **three** components of an estate that will be used to calculate an estate's qualification for the reduced rate of IHT due to a charitable gift. **(3)**

(h) **(i)** Explain briefly what would happen in respect of his Will if James were to die on 1 October 2014. **(4)**

(ii) Describe the requirements for a Will to be valid. **(4)**

(iii) Explain briefly how an existing Will could be revoked. **(4)**

Total marks available for this question: 80

Section B questions can be found on pages 10 – 13

SECTION B

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

Question 2

Read the following carefully, then carry out **ALL** of the tasks **(a)**, **(b)**, **(c)**, **(d)** and **(e)** which follow.

Andy and Lisa have been married for 15 years. They have a daughter, Abigail, aged 13. Following a serious car accident four years ago, Abigail has been left severely physically disabled. Lisa gave up her job as a librarian to take care of Abigail full-time. Andy works as an architect in a small local business.

Abigail receives Disability Living Allowance at the highest rate and Lisa receives Carer's Allowance.

As a result of a settlement offer from the insurance company, Abigail is to be awarded a personal injury compensation lump sum of £2,000,000, which will be used to pay for all her current and future care needs.

Andy and Lisa have been advised to place the compensation monies into a Personal Injury Trust, but are unsure which type of trust would be most appropriate and the consequences of doing so.

Andy and Lisa will be the trustees and would like Lisa's sister, Emma, to be an additional trustee. They want more information as to what duties will be expected of Emma before they approach her.

Questions

(a) Explain how a Personal Injury Trust would operate during Abigail's lifetime and what would happen to it on her death if the court agreed it can be arranged as a:

(i) bare trust; **(5)**

(ii) discretionary trust. **(5)**

(b) Explain how the personal injury trust could affect entitlement to State benefits either now or in the future. **(4)**

(c) If Andy and Lisa decide upon a Discretionary Trust to hold the compensation:

(i) explain briefly the conditions that must be met for the trust to qualify for the special tax regime for trusts for the vulnerable; **(2)**

(ii) explain briefly the definitions of 'disabled' according to section 89(4) of the Inheritance Act 1984. **(2)**

(d) Explain the tax treatment of the Personal Injury Trust as a qualifying trust for a vulnerable beneficiary and how the trustees should elect for such treatment, including the timescale, if the election is to apply for the tax year 2014/2015. **(11)**

(e) Explain the main duties that will be expected of Emma if she agrees to be a trustee of Abigail's trust. **(11)**

Total marks available for this question: 40

QUESTIONS CONTINUE OVER THE PAGE

Question 3

Read the following carefully, then carry out **ALL** of the tasks **(a)**, **(b)**, **(c)**, **(d)** and **(e)** which follow.

Daniel, aged 45, and Jonathan, aged 48, are brothers who both work in the recruitment industry. Daniel is currently based in Dubai and Jonathan is in the United Kingdom (UK).

In November 2010, Daniel moved to Dubai with his wife and children, with the intention to leave the UK permanently to set up an international search and selection business. Unfortunately, due to his family becoming homesick, they have decided to return to the UK in November 2014. On their return Daniel will continue as a search and selection recruitment consultant, setting up a UK business on his own.

When he starts trading, Daniel intends to purchase a computer system costing £12,500, a car with CO_2 emissions of 130g/km costing £24,000 and business stationery costing £1,600. Daniel estimates that 80% of the car usage will be business related.

As Daniel will be using his own funds to start up his business, he is very concerned about potential costs, especially taxes. On the advice of his accountant, he has been advised to set up his business initially on a self-employed basis. Daniel is concerned about when he will have to pay taxes and National Insurance. He would also like some guidance regarding the tax issues on the sale of some of his share portfolio, which he acquired in September 2002, and then subsequently sold in December 2011 for a large gain whilst in Dubai.

Jonathan is an employee of a national recruitment firm. For the tax year 2014/2015, his salary and bonuses will total £90,000. Jonathan would like to receive some advice concerning the sale of 30,000 ABC plc shares in May 2014, which provided him with proceeds after costs of £180,000. He had acquired these shares over the following time periods.

Date acquired ABC plc shares	Number of shares	Cost (£)
August 1992	10,000	27,500
December 2002	10,000	32,500
May 2012	20,000	40,000

Jonathan had made a £15,500 loss in 2010 when he sold some of his Unit Trust. Other than this, he has made no other losses or gains.

Questions

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

(a) Explain how any gains on the sale of Daniel's shares will be treated for Capital Gains Tax (CGT) purposes and what is the objective of these rules. **(8)**

(b) Calculate, **showing all your workings**, how much CGT Jonathan will have to pay following the sale of his shares in May 2014. **(11)**

(c) Explain briefly the differences between capital allowances and allowable expenses. **(6)**

(d) Calculate, **showing all your workings**, how much Daniel will be able to claim in capital allowances in his first year of trading. **(6)**

(e) Explain briefly to Daniel, how his National Insurance contributions might be collected when he returns to the UK and sets up his new business, and when these would need to be paid. **(9)**

Total marks available for this question: 40

The tax tables can be found on pages 15 – 21

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

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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