

AF2

Advanced Diploma in Financial Planning

Unit AF2 – Business financial planning

April 2015 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.

Candidates should answer based on the legislative position immediately BEFORE the 2015 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 AF2 – Business financial 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.

Robert, aged 55, owns and runs Rockman Manufacturing Ltd which started in 1994. Robert is the sole director and owns 90% of the shares and takes a salary of £45,000 from the business. Robert originally invested £50,000 in the business in return for 50,000, £1.00 nominal shares.

Subsequently, Robert gave 10% of his shares to two friends who helped him initially with the business: one friend having 7%; and the other friend having 3%. Neither of these shareholders is involved with the business.

Rockman Manufacturing Ltd has been profitable and Robert has recently purchased some new machinery. This will reduce operating costs, increase productivity and hence increase profits.

Robert currently has 10 employees and is now looking for an investor for his business. After some enquiries, Robert has found Tim, who is in a similar business sector. Tim may wish to invest in Rockman Manufacturing Ltd. However, Tim is also interested in looking at the possibility of buying Robert's business as he wishes to move into a slightly different market sector.

The business is currently valued for sale as a going concern at £1,100,000 and Robert's current estate (not including his business) is £700,000.

The Profit and Loss Accounts and the Balance Sheets for Rockman Manufacturing Ltd are shown below.

Profit and Loss Accounts for the years ending 31 March

	2015	2014
	£'000	£'000
Sales	675	619
Cost of sales	(504)	(459)
Gross profit	171	160
Expenses*	(130)	(128)
Operating profit	41	32
Taxation	(8)	(6)
Profit after tax	33	26

*Depreciation of £41,000 is included in expenses for each year.

Balance Sheets as at 31 March

	2015		2014	
	£'000	£'000	£'000	£'000
Fixed assets		614		467
Current assets				
Stock	91		82	
Debtors	18		11	
Cash at bank	–		14	
	<u>109</u>		<u>107</u>	
Current liabilities				
Creditors	79		60	
Taxation	8		6	
Bank overdraft	19		–	
	<u>106</u>		<u>66</u>	
Net current assets		3		41
Long-term liabilities				
Asset finance loans		(253)		(165)
		<u>364</u>		<u>343</u>
Ordinary share capital		50		50
Reserves		314		293
		<u>364</u>		<u>343</u>

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) (i) Calculate, **showing all your workings**, the following ratios for the years 2014 and 2015, in respect of the accounts provided:
- operating profit margin (operating profit/sales %)
 - current ratio (current assets/current liabilities)
 - quick ratio (current assets - stock/current liabilities)
 - gross profit margin (gross profit/sales %)
 - creditor ratio (creditors/cost of sales x 365) (10)
- (ii) Explain the implications of the change in each of these ratios from 2014 to 2015. (5)
- (b) Explain the difference between a cashflow statement and cashflow forecast. (5)
- (c) Rockman Manufacturing Ltd's gearing ratio has risen from 48.1% in 2014 to 69.5% by March 2015.
- (i) Describe the implications of this change for the company. (4)
- (ii) Describe the actions that the company may take to address the situation. (6)
- (d) Tim is considering how to structure his investment in Rockman Manufacturing Ltd.
- (i) State **five** advantages to Tim of investing via a secured loan rather than an equity investment. (5)
- (ii) State why investing via a secured loan is unlikely to help the company. (2)

QUESTIONS CONTINUE OVER THE PAGE

- (e) Tim is now considering making an outright purchase of Rockman Manufacturing Ltd.
- (i) State **four** advantages to Robert of selling the shares of the company to Tim, rather than the business and assets. (4)
- (ii) Calculate, **showing all your workings**, the potential Capital Gains Tax (CGT) Robert could pay on the sale of the business. *Assume that Robert has no other gains or losses.* (5)
- (iii) Calculate, **showing all your workings**, the value of the 7% shareholding at the current company valuation and without any discount for a minority shareholder, the number of shares held, and the CGT to be paid by the holder of these shares if the business is sold. *Assume that the shareholder is a nil rate tax payer and has no other gains or losses.* (8)
- (iv) State the **three** advantages to Tim of buying the business and assets rather than buying the shares of the company. (3)
- (v) Tim has proposed purchasing the business and assets through a brand new company. He has offered Robert cash and shares in the new company in exchange for Rockman Manufacturing Ltd.
- Explain to Robert the disadvantages of receiving shares in part payment for the purchase of his business. (7)
- (f) State **four** specific risks associated with the acquisition of an existing business by a new owner. (4)
- (g) (i) Explain the effect on Robert's Inheritance Tax (IHT) position if he accepts all cash for the sale of his company to Tim. (3)
- (ii) State **five** steps that Robert could take to mitigate his IHT liability either before or after the sale. (5)
- (h) State **four** items of information that Robert must supply to Tim regarding employees transferring to the new business under Transfer of Undertakings (Protection of Employment) Regulations 2006. (4)

Total marks available for this question: 80

Section B 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)** and **(d)** which follow.

James, Mollie and Phillip are the three directors of Anything but Magnolia which is a household goods company. The company employs 15 staff, each of whom earns £20,000 per annum.

James and Mollie each hold 40% of the shares of the company, with Phillip having a 20% shareholding. The Directors contribute equally to the success of the business, and all three of them receive a salary of £50,000 per annum. The company has 120,000 fully paid shares of £1 each.

Anything but Magnolia has been growing significantly and is on track for pre-tax profits of £420,000 for the current year. The profit is after the company has paid the £50,000 per annum salary to each director.

The Directors have decided that they should use £120,000 of the profit to provide additional remuneration. They are currently considering the options available to them to fulfil this requirement.

James is keen to pay a dividend as he believes that it is more tax efficient than paying a bonus.

Mollie has suggested making contributions to a personal pension arrangement as none of the Directors has contributed to a pension scheme in the current tax year.

Phillip wishes to provide each of them with a bonus.

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 net receipt to each director and the net cost to the company of making the following payments:
- (i) A pension contribution of £40,000 for Mollie. (5)
 - (ii) A dividend of £40,000 to James. (6)
 - (iii) A bonus of £40,000 to Phillip. (7)
- (b) State the latest date for accounting purposes that the payment can be made for each of the three options outlined in your answer to part (a) above. *Assume the company's year end will be 30 June 2015.* (3)
- (c) Explain the difficulty of only James being awarded a dividend using the current share entitlements and describe how you might recommend this difficulty be overcome. (9)
- (d) The Directors wish to know about their potential obligations under pension auto-enrolment for the staff, and have asked you to clarify the rules:
- (i) for employees to be considered 'eligible workers'; (3)
 - (ii) for a default investment offering. (5)

Total marks available for this question: 38

QUESTIONS CONTINUE OVER THE PAGE

Question 3

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

Sean, Max and David are partners in Revolution Architects, a firm which they formed in 2000. Max, aged 64, is responsible for the residential side of the business. Sean and David, both in their late 40s, look after the commercial side of the business. The business has six employees.

The last three years' financials are:

	31 March 2015 £	31 March 2014 £	31 March 2013 £
Turnover	1,000,000	950,000	850,000
Total salary bill	475,000	400,000	350,000
Profit	500,000	450,000	400,000

Max intends to retire at age 65. Revolution Architects, have recently recruited Andrew on a salary of £85,000. It has taken over three years for them to find Andrew. Currently, Andrew is an employee of the partnership and will replace Max as partner when he retires.

When the partnership was started in 2000, Sean, Max and David each took out whole of life policies for partnership protection written under a partnership trust. The trust used at the time was a flexible interest-in-possession trust and no changes have been made to this trust since its inception. The trust permits the settlor to be a beneficiary. Despite having life cover in place, no formal Partnership Agreement exists to determine what would happen to the firm in the event of the death of one or more of the partners.

Sean and David have asked for advice on how they can protect their business against the financial effects of a partner's premature death, as well as how they could deal with Max's retirement.

Questions

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

- (a) Sean and David are concerned that if anything were to happen to Andrew the business would suffer.
- (i) State **three** financial implications for the firm arising from Andrew's death. (3)
 - (ii) Calculate, **showing all your workings**, using the proportion of profits formula, the level of key person cover the firm should take out on Andrew's life. (5)
 - (iii) Explain why the proportion of profits formula may not be the most appropriate to calculate the level of cover required. (5)
- (b) (i) Explain to Sean and David the implications of not having a formal Partnership Agreement and why they should have one drafted as soon as possible. (4)
- (ii) Provide **eight** features that would be included in a formal Partnership Agreement. (8)
- (c) When Andrew replaces Max as partner, Sean and David intend to update the partnership protection arrangement to add Andrew as a beneficiary to replace Max.
- (i) Explain to Max the tax implications he will face if his whole of life policy is assigned to him by the trustees upon his retirement and exit from the partnership. (5)
 - (ii) Explain to Sean and David the tax implications of altering the partnership trust created in 2000 by bringing Andrew into the existing arrangement. (6)
- (d) State **three** benefits and **three** drawbacks to the partners of converting the partnership into a limited liability partnership. (6)

Total marks available for this question: 42

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
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**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 (CO₂) emissions. There is no reduction for high business mileage users.

For 2014/2015:

- 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 94g/km the percentage is 11%.
- For cars with CO₂ emissions of 95g/km to 99g/km the percentage is 12%.
- Cars with CO₂ 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 CO₂ 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%	18%	8%
	first year	reducing balance	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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