THE CHARTERED INSURANCE INSTITUTE

AF1

Advanced Diploma in Financial Planning

Unit AF1 – Personal tax and trust planning

October 2015 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2015/2016, 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)** and **(g)** which follow.

Elizabeth's husband James died in January 2009 leaving the entire value of his estate of £234,000, to their daughters Sarah, aged 30 and Lucy, aged 28. Elizabeth had a 25% life interest in an Interest In Possession trust established in August 2005 by her father's Will. Under the terms of the trust, she is entitled to the income but not the capital. As of 1 October 2015, the trust fund was valued at £630,000.

In December 2012, Elizabeth gave Lucy £4,000 to help towards the cost of her wedding that took place in January 2013. In February 2013, Elizabeth invested £30,000, purchasing a 10% stake in Sarah's business, Drops Pharmacy Ltd, to provide herself with a regular income in retirement.

In September 2015, Elizabeth's daughter Sarah, established a discretionary trust for her daughter Gemma, aged 10, and any future grandchildren, investing £400,000 in a rental property, equity unit trusts and a range of corporate bonds. Sarah has made no previous lifetime gifts. Sarah and Lucy are joint trustees.

Elizabeth died on 1 October 2015. Apart from a £15,000 bequest to a registered charity, her estate was left to Sarah and Lucy in equal shares, with Lucy as the executor of Elizabeth's Will. Both Sarah and Lucy have significant assets in their own right and they are concerned that the increase in their own personal wealth will have a major impact on their own respective Inheritance Tax liabilities.

At her death, Elizabeth also held the following assets:

Assets	**Value (£)**	**Notes**
Main residence	280,000	Outstanding mortgage of £16,000
Current account	18,750	
Cash ISA	73,000	
Premium bonds	15,000	Invested in July 2009
Investment bond	50,000	Single premium onshore bond, purchased for £30,000 in May 2005
AIM shares	27,000	Purchased for £15,000 in April 2012
Drops Pharmacy Ltd shares	34,000	

Inheritance Tax nil rate band:

Tax years	**Nil rate band (£)**
2007/2008	300,000
2008/2009	312,000
2009/2010 onwards	325,000

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**, any Inheritance Tax (IHT) payable on Elizabeth's estate. **(12)**

(ii) State the date by which any tax due must be paid. **(1)**

(b) **(i)** In respect of Elizabeth's Will, outline Lucy's responsibilities as executor. **(7)**

(ii) State the conditions that must be satisfied for a deed of variation to be effective for IHT purposes. **(7)**

(c) Explain, in detail, the initial and ongoing IHT treatment of the discretionary trust established by Sarah in September 2015. *No calculation is required.* **(10)**

(d) Explain how any income from the discretionary trust would be taxed:

(i) on the trustees; **(8)**

(ii) if paid out to Gemma. **(7)**

(e) State the responsibilities Sarah and Lucy must satisfy as trustees of the discretionary trust. **(12)**

QUESTIONS CONTINUE OVER THE PAGE

(f) In respect of the discretionary trust established by Sarah in September 2015.

(i) State when it may be necessary for either Sarah or Lucy to be replaced as a trustee. **(6)**

(ii) Explain why Gemma may be unable to bring the trust to an end and force distribution of all the trust assets. **(4)**

(g) Sarah's Will leaves her entire estate to Gemma. Explain how Sarah could use life assurance to limit the impact of any potential IHT on her estate. **(6)**

Total marks available for this question: 80

Section B questions can be found on pages 8 – 11

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)** and **(c)** which follow.

George, aged 50, is single, and an electrician by trade. George has run his own business as a sole trader since January 2010. Immediately prior to that he was employed by a multi-national company. For the tax year 2015/2016 his net earnings after deductions and allowances will be £95,000.

Although business has been very good for the last few years, two of George's long-standing corporate clients have made allegations of negligence against him and are about to instigate legal proceedings. If the claims succeed, George thinks that he will be made bankrupt because his insurance provides a minimal level of cover in relation to claims for negligence.

George has a £44,300 ISA portfolio which consists mainly of equity and fixed interest open-ended investment companies. George also has £12,000 in bank and building society cash savings. His main residence in Watford is worth £645,000 with a £150,000 repayment mortgage due to redeem in 12 years' time. George has a self-invested personal pension plan, currently valued at £785,000. He has recently increased his contributions from £1,000 to £2,500 per month.

In addition to his main residence, George owns a small flat in Solihull, which he purchased for £105,000, net of costs, on 1 June 2000 and used as his main residence until 1 October 2009. Since moving into his current home, he has only used the flat for storage. During the time he lived in the flat, there were two periods of non-occupancy: eighteen months when he lived with his father William, who was unwell at the time, and one year when he worked abroad. He returned to the flat immediately after living with his father but after working abroad he returned to the house in Watford and made this his main residence because his employer required him to be nearer to London. He has now agreed to sell the flat for £312,000 net of sale costs. He has not made any other disposals in the tax year 2015/2016.

George and his sister Charlotte are becomingly increasingly involved in the care of their father William, who is concerned that he may not be able to look after his own financial affairs in the future. William's solicitor has suggested that William discusses setting up a Power of Attorney with George and Charlotte.

Questions

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

(a) **(i)** Explain to George, the effect bankruptcy would have on his pension, cash and investments. **(6)**

(ii) If George is declared bankrupt, state the priority order in which his creditors will be paid. **(7)**

(iii) In respect of his assets, state the restrictions that will apply to George while he is bankrupt. **(6)**

(b) Calculate, **showing all your workings**, George's liability to Capital Gains Tax if he had completed the sale of his flat on 30 September 2015. **(10)**

(c) William would like Charlotte to be able to make decisions on his behalf should he no longer want to do so, or should he lose the capacity to do so.

(i) List the general duties that would apply to Charlotte if she becomes an attorney under a Lasting Power of Attorney set up by her father. **(6)**

(ii) State the circumstances under which William's Lasting Power of Attorney could be revoked. **(5)**

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

Nathan, aged 32, works for a large veterinary practice in Cheltenham. Nathan's salary is £44,750 per annum with an annual bonus of £3,800 in the tax year 2015/2016.

Nathan pays £150 per month into his company's defined contribution pension scheme. In addition, he also contributes £100 per month by direct debit into a stakeholder personal pension that he set up some years ago whilst in his first job. He also makes gift aid payments of £50 each month.

Nathan's current savings and investments are:

Assets	**Value (£)**	**Income received in tax year 2015/2016 (£)**
Building Society account	16,000	120
National Savings and Investments account	12,000	90
Stocks & shares ISA	30,000	1,080
Enterprise Investment Scheme	12,000	n/a
Oil company shares	10,000	153

Nathan has just inherited £150,000 from a great aunt. After paying off his mortgage, Nathan is considering investing £50,000 of his inheritance into a single premium offshore investment bond.

Nathan's work colleague David is going to lodge with him when he transfers to the same practice in May 2016. David has agreed to pay Nathan rent of £500 per month.

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**, Nathan's Income Tax liability for the tax year 2015/2016. **(17)**

(b) Calculate, **showing all your workings**, the total National Insurance contributions paid on Nathan's earnings for the tax year 2015/2016 by:

(i) Nathan; **(3)**

(ii) Nathan's employer. **(3)**

(c) **(i)** State the conditions that must be met for Nathan to successfully claim rent-a-room relief. **(4)**

(ii) Explain how Nathan may be taxed on the income he receives from David. **(5)**

(d) State the tax considerations Nathan should be aware of when investing his £50,000 into an offshore investment bond. **(8)**

Total marks available for this question: 40

The tax tables can be found on pages 13 – 19

INCOME TAX

RATES OF TAX	2014/2015	2015/2016
Starting rate for savings*	10%	0%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	45%	45%
Starting-rate limit	£2,880*	£5,000*
Threshold of taxable income above which higher rate applies	£31,865	£31,785
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) *§*	£10,000	£10,600
Personal Allowance (if born between 6 April 1938 and 5 April 1948) *§*	£10,500	£10,600
Personal Allowance (if born before 6 April 1938) *§*	£10,660	£10,660
Married/civil partners (minimum) at 10% *†*	£3,140	£3,220
Married/civil partners at 10% *†*	£8,165	£8,355
Transferable tax allowance for married couples/civil partners	N/A	£1,060
Income limit for age-related allowances *§*	£27,000	£27,700
Blind Person's Allowance	£2,230	£2,290
Enterprise Investment Scheme relief limit on £1,000,000 max	30%	30%
Seed Enterprise Investment relief limit on £100,000 max	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)	£2,750	£2,780
- family element	£545	£545
Threshold for tapered withdrawal of CTC	£16,010	£16,105

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	Weekly	Monthly	Yearly
Lower Earnings Limit (LEL)	£112	£486	£5,824
Primary threshold	£155	£672	£8,060
Upper Accrual Point	£770	£3,337	£40,040
Upper Earnings Limit (UEL)	£815	£3,532	£42,385

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS	
	Contracted-in rate	Contracted-out rate (final salary)
Up to 155.00*	Nil	Nil
155.01 – 770.00	12%	10.6%
770.01 – 815.00	12%	12%
Above 815.00	2%	2%

**This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £112 per week. This £112 to £155 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 156.00**	Nil	Nil	Nil
156.01 – 770.00	13.8%	10.4%	13.8%
770.01 – 815.00	13.8%	13.8%	13.8%
Excess over 815.00	13.8%	13.8%	13.8%

*** Secondary earnings threshold.*

Class 2 (self-employed)	Flat rate per week £2.80 where profits exceed £5,965 per annum.
Class 3 (voluntary)	Flat rate per week £14.10.
Class 4 (self-employed)	9% on profits between £8,060 - £42,385. 2% on profits above £42,385.

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
2015/2016	£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.

MONEY PURCHASE ANNUAL ALLOWANCE	2014/2015	2015/2016
	N/A	£10,000*

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.

§ increased to £80,000 from 6 April - 8 July 2015. If not used, can be carried forward to 9 July 2015 - 5 April 2016, subject to a maximum of £40,000.
** transitional rules apply to the calculation for pre/post 8 July 2015 position.*

CAPITAL GAINS TAX

EXEMPTIONS	2014/2015	2015/2016
Individuals, estates etc	£11,000	£11,100
Trusts generally	£5,500	£5,550
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 TRANSFERS	2014/2015	2015/2016
Transfers made on death after 5 April 2015		
- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
Transfers made after 5 April 2015		
- Lifetime transfers to and from certain trusts	20%	20%

For deaths after 5 April 2015, 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 2015/2016:

- The percentage charge is 5% of the car's list price for CO_2 emissions of 50g/km or less.
- For cars with CO_2 emissions of 51g/km to 75g/km the percentage is 9%.
- For cars with CO_2 emissions of 76g/km to 94g/km the percentage is 13%.
- Cars with CO_2 emissions of 95g/km have a percentage charge of 14% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 37% (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 37% 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 (£22,100 for 2015/2016) e.g. car emission 100g/km = 15% on car benefit scale. 15% of £22,100 = £3,315.

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 contribution's (Class 1A) of 13.8%.

PRIVATE VEHICLES USED FOR WORK

	2014/2015 Rates	**2015/2016 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

	2014/2015	2015/2016
Plant & machinery (excluding cars) 100% annual investment allowance (first year) §	£500,000	£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 2015 (Corporation Tax) or 06 April 2015 (Income Tax)

CO_2 emissions of g/km:	75 or less*	76-130	131 or more
Capital allowance:	100% first year	18% reducing balance	8% reducing balance

**If new*

§ From 01 January 2016 allowance will decrease to £200,000.

CORPORATION TAX

	2014/2015	2015/2016
Full rate	21%	20%
Small companies rate	20%	20%
Small companies limit	£300,000	£300,000
Effective marginal rate	21.25%	20%
Upper marginal limit	£1,500,000	£1,500,000

VALUE ADDED TAX

	2014/2015	2015/2016
Standard rate	20%	20%
Annual registration threshold	£81,000	£82,000
Deregistration threshold	£79,000	£80,000

MAIN SOCIAL SECURITY BENEFITS

		2014/2015	2015/2016
		£	£
Child Benefit	First child	20.50	20.70
	Subsequent children	13.55	13.70
	Guardian's allowance	16.35	16.55
Employment and Support Allowance	Assessment Phase		
	Age 16 – 24	Up to 57.35	Up to 57.90
	Aged 25 or over	Up to 72.40	Up to 73.10
	Main Phase		
	Work Related Activity Group	Up to 101.15	Up to 102.15
	Support Group	Up to 108.15	Up to 109.30
Attendance Allowance	Lower rate	54.45	55.10
	Higher rate	81.30	82.30
Retirement Pension	Single	113.10	115.95
	Married	180.90	185.45
Pension Credit	Single person standard minimum guarantee	148.35	151.20
	Married couple standard minimum guarantee	226.50	230.85
	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		111.20	112.55
Jobseekers Allowance	Age 18 - 24	57.35	57.90
	Age 25 or over	72.40	73.10
Statutory Maternity, Paternity and Adoption Pay		138.18	139.58

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