

## AF2

# Advanced Diploma in Financial Planning

## Unit AF2 – Business financial 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 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)** and **(f)** which follow.

Liam, aged 52, and Harry, aged 54, are brothers and director shareholders of Quarry Mining Ltd. Liam and Harry have both worked for the business for around 30 years. They each own 50% of the shares and both take a salary of £55,000. In the last few years they have also taken dividends of £40,000 each.

The accounts show that the business is cash rich with retained profits of £450,000, and they expect to make profits after tax of £200,000 for year end to 31 December 2015. The business has a good credit rating with their bank which currently has fixed and floating charges on the assets of the company to underwrite the credit facilities provided.

The company sold land for £450,000 in June 2015, which they bought in 1995 for £105,000. The total costs of the sale were £22,250. The land was purchased with the intention of extending the quarry, however the planning permission they applied for was refused. They have subsequently applied for and been granted planning permission to develop the site for residential use. In May 2011 they spent £35,000 improving the site to increase the chances of planning being granted.

The brothers jointly own a commercial property personally, currently valued at £600,000, which is mortgage free. The rent received is £52,000 per annum which they split equally.

Quarry Mining Ltd is the sponsoring employer of a self-administered pension scheme (SSAS) currently valued at £520,000 of which £270,000 is in liquid assets. The brothers are the only members and benefit in equal shares. The company had been paying contributions of £6,000 per annum each for Liam and Harry since March 2011, the last contribution paid was March 2015. They have not made any personal contributions themselves and have no other pension arrangements. The input period for the scheme is aligned to the tax year.

The main business activity is running a large quarry, and a significant overhead is electricity. Liam and Harry have been investigating options to generate their own power. They have decided to install a commercial grade wind turbine purchased outside of Quarry Mining Ltd and they have set up a new trading company LH Energy Ltd with the same shareholdings and directorships. They have not yet registered the company for VAT. LH Energy Ltd is ready to commit to the purchase of the turbine for a cost of £405,000.

Quarry Mining Ltd has 27 employees including the two directors, and their staging date is 1 August 2016. In addition to the SSAS for the directors, there is a group personal pension scheme in place for key staff into which they match employee contributions up to 5% of basic salary. The scheme is available for management, has a six month waiting period and currently has a membership of five key staff. There is nothing in place for the remaining 20 employees.

**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 maximum pension contribution Quarry Mining Ltd could make to the SSAS for Liam and Harry without incurring an annual allowance charge. (6)
- (ii) Explain how HM Revenue & Customs would determine Corporation Tax Relief allowable on the proposed pension contribution in part (a)(i) above. (4)
- (iii) Calculate, **showing all your workings**, the total Income Tax due for Liam for the 2015/2016 tax year. (8)
- (b) Explain to Liam and Harry the potential implications for each of the following funding options, with regard to purchasing the wind turbine. *Assume this wind turbine is deemed tangible moveable property.*
- (i) A loan from a bank to LH Energy Ltd. (6)
- (ii) The SSAS purchasing the wind turbine. (4)
- (c) (i) Outline the qualifying criteria for a SSAS authorised employer loan. (7)
- (ii) Explain the steps that would need to be taken in order for an authorised employer loan to be made to LH Energy Ltd. *Ignore the impact of VAT and other expenses in your answer.* (7)
- (iii) Assuming the wind turbine is purchased through LH Energy Ltd, explain any tax reliefs and allowances the company could utilise to mitigate the overall costs of purchase. (4)

**QUESTIONS CONTINUE OVER THE PAGE**

- (d) (i) Calculate, **showing all your workings**, the capital gain to Quarry Mining Ltd on the sale of the land in June 2015. Indexation allowance for June 1995 is 0.728, and for May 2011 is 0.101. (8)
- (ii) Explain briefly how Quarry Mining Ltd will be taxed on the gain. (3)
- (iii) Expectations are that LH Energy Ltd will make a trading loss in the first year.  
Explain briefly the options for claiming any loss relief, and any qualifying conditions that must be met. (6)
- (e) Quarry Mining Ltd was established some time ago and is currently operating with a Memorandum and Articles based on Table A.
- (i) Explain to Liam and Harry, giving your reasons, why the formation documents for LH Energy Ltd are significantly different to that of Quarry Mining Ltd. (5)
- (ii) State **four** amendments Liam and Harry could make to the model articles for LH Energy Ltd. (4)
- (f) Explain to Liam and Harry the steps they need to take in order for Quarry Mining Ltd to comply with auto-enrolment rules:
- (i) prior to their staging date; (4)
- (ii) on and after their staging date. (4)

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

Dan Biggins is the managing director of DM Beauty Ltd which supplies cosmetics and tanning products to the retail market. The business was recently valued at £2 million and has retained profits of £100,000. The company is 34% owned by Dan, 33% by his wife Mary, who also works in the business, and 33% by their daughter Kylie.

Dan and Mary currently have Wills in place that leave all assets to each other and then to Kylie. They are concerned about what would happen to the business if Kylie were to predecease them.

Kylie is married to Chris, they have no children and do not have Wills in place. Kylie has been employed by the company for the last 10 years as sales director and has taken a lot of the burden of running the business from her parents. Over the last two years Kylie has re-invigorated sales with new initiatives which have significantly increased profits.

Dan and Mary want certainty that full control of the business will remain with the surviving shareholders in the event of death should one of them die. They also wish to minimise the tax consequences of the transfer of shares on death. They want to ensure that there is a clear process in place for all the shareholders and no nasty surprises. Kylie wants to ensure that Chris receives fair compensation for her shares in the event of her death.

There are no formal shareholder agreements in place, Dan and Mary have always believed that the company would buy back any shares on death where these were inherited outside of the existing shareholder group. Since Kylie married, Dan and Mary have been considering the reality of the company having to buy back shares and the financial strain this might place on the business.

They have contacted you to discuss putting a shareholder protection plan in place for Kylie.



**Questions**

- (a) (i)** Explain how a shareholder protection arrangement, based upon a company buy back of shares in the event of Kylie's death, would operate for DM Beauty Ltd. **(8)**
- (ii)** Explain why the arrangement described in part **(a)(i)** above, would not best meet Dan and Mary's requirements. **(4)**
- (b)** Explain to Dan and Mary what would happen in the event of Kylie's death based on her current arrangements, and how this would impact on their objectives. **(8)**
- (c) (i)** Outline an alternative arrangement that would meet the objectives of all the shareholders. **(5)**
- (ii)** Explain how this arrangement in part **(c)(i)** above, addresses the concerns of all of the shareholders. **(5)**
- (d)** The directors wish to establish key person cover for Kylie.
- Explain the key features of these products, and how they would be taxed in respect of:
- (i)** Key person life assurance. **(5)**
- (ii)** Executive income protection. **(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), (d)** and **(e)** which follow.

ACE Consulting Engineers (ACE) is a limited liability partnership (LLP) owned and managed by three designated members, Aaron, Celia and Eric.

Aaron is the managing partner and holds a 75% stake in the business and is entitled to 75% of profits after an initial fixed profit share of £40,000. His capital account stands at £15,000 and has undrawn profits of £20,000.

Celia is entitled to a fixed profit share of £30,000 plus 25% of residual profits. Her capital account stands at £5,000 and has taken drawings that have exceeded her profit entitlement by £10,000.

Eric was admitted as a member on 1 April 2014 having previously been an employee of the business. His salary of £25,000 has been replaced with a fixed profit share of the same amount. Eric has no entitlement to a further residual profit share nor does he participate in the day-to-day management of the firm. On admission as a member Eric was credited with capital of £100.

Aaron owns Nogara Ltd a private limited company that provides secretarial services to ACE, equivalent to the cost of employing a single clerical assistant at a cost of £20,000 per annum. In April 2014, Nogara Ltd was also admitted as a fourth member of the LLP and Aaron intends re-allocating his 75% residual profit share to Nogara Ltd.

**Questions**

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

- (a) The total profits for distribution for the year to 31 March 2015 were £210,000.  
Calculate, **showing all your workings**, the profit attributable to each member. (7)
- (b) Explain to Aaron the tax treatment of the profits he intends re-allocating to Nogara Ltd. (8)
- (c) Unbeknown to Aaron and Eric, Celia has suffered serious financial difficulties and has just been declared bankrupt. In an attempt to stave off bankruptcy Celia sold the car she was provided with by ACE for £10,000.  
Explain:  
(i) the legal position of the purchaser of the car with regard to Celia's actions; (3)  
(ii) Celia's position with regard to the sale of the car in her capacity as a member of ACE; (4)  
(iii) the consequences for ACE of Celia's bankruptcy. (7)
- (d) Aaron feels it would be inappropriate for Celia to continue to hold the position of member given her bankruptcy.  
Explain to Aaron his options to remove Celia as a member of ACE. (5)
- (e) Describe the **three** statutory tests that will determine whether Eric will be taxed as a self-employed person or as an employee, and state which basis will apply. (6)

**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.*

<b>Class 2 (self-employed)</b>	Flat rate per week £2.80 where profits exceed £5,965 per annum.
<b>Class 3 (voluntary)</b>	Flat rate per week £14.10.
<b>Class 4 (self-employed)</b>	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%
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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:

	0-3	3-4	4-5	5-6	6-7
- Years before death					
- 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<sub>2</sub>) 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<sub>2</sub> emissions of 50g/km or less.
- For cars with CO<sub>2</sub> emissions of 51g/km to 75g/km the percentage is 9%.
- For cars with CO<sub>2</sub> emissions of 76g/km to 94g/km the percentage is 13%.
- Cars with CO<sub>2</sub> 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<sub>2</sub> 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
<b>Cars</b>		
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
<b>Motor Cycles</b>	24p per mile	24p per mile
<b>Bicycles</b>	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%
<b>Motor cars:</b> Expenditure on or after 01 April 2015 (Corporation Tax) or 06 April 2015 (Income Tax)		
CO <sub>2</sub> emissions of g/km:	75 or less*	76-130
Capital allowance:	100%	18%
	first year	reducing balance
		131 or more
		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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