THE CHARTERED INSURANCE INSTITUTE

CII

AF3

Advanced Diploma in Financial Planning

Unit AF3 – Pension 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 AF3 – Pension 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.

Eric and Megan are married. Eric will reach his State Pension age (SPA) of 65 on 1 November 2017. Megan will reach her SPA of 63 years and 10 months on 6 January 2016. They have two adult, non-dependant children and three grandchildren.

Eric was a member of his previous employer's non-contributory contracted-out defined benefit (DB) pension scheme for 15 years. The scheme provides a 50% dependant's pension and includes a 10-year guarantee. Eric left employment in 2013 and is now a self-employed consultant. He intends taking the DB pension when he reaches the scheme's pension age of 65.

At the current time, Eric has 37 qualifying years for the purposes of calculating his entitlement to a State Pension.

Eric has an adventurous attitude to risk. In addition to the DB scheme, Eric's only other pension is a self-invested personal pension (SIPP) that is currently valued at £390,000. For lifetime allowance purposes Eric's total pension benefits are currently valued at £870,000.

Eric intends to pay a contribution into his SIPP before the end of the current tax year. His relevant earnings are expected to be £85,000 and these will be his only taxable earnings for 2015/2016. The gross input into his pensions in the three preceding pension input periods are:

Pension input period	Gross pension input
2012/2013	£45,000
2013/2014	£42,000
2014/2015	£33,000

Eric's SIPP was set up with a pension input period in line with the tax year. So far he has not made any contribution to the SIPP in the 2015/2016 tax year.

Megan, who has always been self-employed, ceased working at the end of March 2015 having made her last contribution to her SIPP in January 2015. At the time she ceased working she had accrued 32 qualifying years for the purposes of calculating her entitlement to a State Pension.

Megan has a moderate attitude to risk and, as at 5 April 2014, she had uncrystallised funds within her SIPP valued at £1,450,000. This is her only pension fund and Megan has not registered for any form of transitional protection.

On 1 May 2014 Megan crystallised £200,000 from her SIPP and after taking £50,000 as a pension commencement lump sum (PCLS) she placed the remaining £150,000 into a capped drawdown fund. The maximum income is set at £12,150, although Megan has not yet drawn any income from the fund. The drawdown fund is now valued at £166,000 and allows additional funds to be designated to the existing arrangement.

Megan used the PCLS to help fund the purchase of an investment property. She used a mortgage to fund the balance of the costs. This property has now been renovated and sold for a profit. Eric and Megan now wish to use the equity from this sale plus further funds from their pensions to purchase a larger property. The intention is to renovate the property and then let it out to provide additional income in retirement.

The couple have calculated that, in addition to the profit made on the previous property, they will need £25,000 to cover refurbishment costs plus a buy-to-let mortgage of £200,000. Eric is interested in accessing some funds from his SIPP instead of taking out a mortgage whilst Megan will use her pension funds to provide the refurbishment costs.

Eric and Megan are keen to ensure the children inherit any remaining pension funds on second death.

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) Eric would like to pay the maximum possible personal contribution into his SIPP in the 2015/2016 tax year without incurring an annual allowance tax charge.

Calculate, **showing all your workings**, the maximum net contribution that Eric can make. **(5)**

(b) Eric would like to investigate the option of taking an uncrystallised funds pension lump sum (UFPLS) that, after all Income Tax has been paid, will leave him with the £200,000 needed to fund the buy-to-let property purchase.

(i) Calculate, **showing all your workings**, the minimum amount of Eric's SIPP that will need to be crystallised in order to provide the £200,000 needed.

*In arriving at your answer you should assume that the contribution calculated in part (**a**) above is not paid in the 2015/2016 tax year.* **(9)**

(ii) If Eric does decide to take an UFPLS before the end of the 2015/2016 tax year, explain why the contribution calculated in part **(a)** above should be paid before the UFPLS is taken, rather than after. **(6)**

(iii) Outline the potential **drawbacks** to Eric of using an UFPLS rather than a buy-to-let mortgage to help purchase the property. **(9)**

(c) Megan wishes to crystallise an additional £100,000 from her SIPP in order to receive a further £25,000 pension commencement lump sum. Megan intends designating the crystallised funds into her existing capped drawdown arrangement.

(i) Calculate, **showing all your workings**, the revised maximum income available from Megan's capped drawdown arrangement. *You should assume that the GAD rate applicable is £49 per £1,000.* **(5)**

(ii) Assuming the additional funds are designated into Megan's capped drawdown arrangement on 1 November 2015.

State the date of the next triennial review and explain briefly why this is the case. **(3)**

QUESTIONS CONTINUE OVER THE PAGE

(d) Megan has heard she may be able to limit the amount of lifetime allowance tax charge she pays in the future by applying for transitional protection.

(i) Recommend, giving your reasons, the type of transitional protection Megan should apply for and state the latest date this application must be received by HM Revenue & Customs (HMRC). **(7)**

(ii) Assuming Megan receives a certificate from HMRC confirming that she holds the protection recommended in part **(d)(i)** above, outline the actions Megan should take with regard to the benefit crystallisation event that occurred on 1 May 2014. **(2)**

(iii) Assuming the actions in part **(d)(i)** and **(ii)** above are undertaken, calculate, **showing all your workings**, the percentage of Megan's lifetime allowance that will remain after she crystallises the additional £100,000 from her SIPP. **(4)**

(e) Eric and Megan are aware that changes are being introduced to the State Pension.

(i) Explain in detail how Eric's State Pension entitlement will be calculated. **(6)**

(ii) Explain how Megan's State Pension entitlement will be determined. **(3)**

(iii) Outline the factors you would take into account in order to advise Megan on the suitability of purchasing additional State Pension using Class 3A National Insurance contributions. **(7)**

(f) Eric and Megan would like to understand more about the death benefits payable in respect of their various pensions.

Assuming Megan predeceases Eric, and Eric dies before reaching age 75, outline the possible options available to their children and the tax treatment of each option.

You should assume that following Megan's death her remaining pension funds will pass to Eric and be designated to a dependant's flexi-access drawdown fund. **(14)**

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.

Basil, aged 61 is married to Audrey, aged 67. The couple are both in good health and have two adult non-dependant daughters.

Basil, who has a moderate attitude to risk, is a higher-rate taxpayer and intends to retire when he reaches his State Pension age of 65 in December 2018. Audrey has already retired and is in receipt of a full basic State Pension plus a pension of £20,000 per annum from the Teachers' Pension Scheme.

Basil has deferred benefits in two defined benefit pension schemes, both of which have a scheme pension age of 65. His entitlement under these schemes is summarised below:

Name of scheme	**Devonport Engineering Scheme**	**Mayfield Pension Scheme**
Scheme service	1 October 1992 to 6 September 1996	16 September 1996 to 9 April 2009 (plus transferred in service of 6 years and 8 months)
Contracted in/out	Contracted-in	Contracted-out
Pension as at date of cash equivalent transfer value (CETV) calculation (30 September 2015)	£1,976.78 per annum	£14,828.99 per annum (including pre-1988 guaranteed minimum pension (GMP) of £989.56 per annum and post-1988 GMP of £713.96 per annum)
Spouse's pension	50% of the preserved pension (before and after retirement)	50% of the preserved pension (before and after retirement)
GMP revaluation	N/A	Fixed rate
Excess above GMP	Statutory minimum revaluation	Statutory minimum revaluation
Escalation in payment	In line with statutory requirements	In line with statutory requirements
CETV as at 30 September 2015	£140,940	£275,185
Critical yield to age 65	8.4% per annum	13.5% per annum

Basil does not wish to transfer his benefits in the Mayfield Pension Scheme. This is in part due to the high critical yield but also because the pension from this scheme plus his State Pension will provide him with a secure income of around £20,000 per annum. The couple feel that this, plus Audrey's pension, will provide them with an adequate income in retirement.

Basil is aware of the changes in the pension legislation introduced in April 2015. He is interested in transferring his benefits in the Devonport Engineering Scheme into a personal pension plan (PPP) in order to be able to immediately benefit from these changes.

Questions

(a) In respect of Basil's benefits in the Mayfield Pension Scheme, outline:

(i) how the guaranteed minimum pension (GMP) benefits will escalate in payment; **(3)**

(ii) how the non-GMP benefits will escalate in payment; **(5)**

(iii) why the State will no longer have to pay any increases in respect of Basil's GMP. **(2)**

(b) Basil last reviewed his benefits in the Devonport Engineering Scheme in 2010 and at that time the critical yield was 7.5%.

Explain in detail the factors that could have contributed to the increase in the critical yield to 8.4%. **(11)**

(c) Explain why Basil must obtain independent advice before any transfer of his benefits out of the Devonport Engineering Scheme will be possible. **(3)**

(d) Outline the factors that you would take into account when advising Basil on whether he should transfer his benefits in the Devonport Engineering Scheme into a personal pension plan. **(12)**

(e) Outline the actions the trustees of the Devonport Engineering Scheme must take in processing any application Basil may make to transfer his benefits. **(7)**

Total marks available for this question: 43

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.

Cucinotta Ice Creams Ltd is a family owned company that employs 48 permanent workers. The company's busiest time is during the summer months when they usually employ a further 15 to 20 workers on temporary contracts.

Temporary workers are typically employed for between 6 and 12 weeks and their earnings fluctuate depending on the number of hours worked but typically average around £200 per week.

The company's staging date is 1 March 2016 and the company's operations manager, Claudia, is responsible for ensuring the company meets its obligations under the workplace pension's rules.

Claudia has done some initial research and would like to know more about postponement. Claudia would also like to ensure she understands the company's obligations and options where workers that are not already members of a pension scheme offered by the company can request to become members.

The company has an existing group personal pension plan (GPP) in place but Claudia has been informed that, whilst this is a qualifying scheme, it is not a suitable scheme for automatic enrolment purposes. Claudia is considering maintaining the GPP for the existing members and introducing a suitable automatic enrolment scheme to run alongside it.

Questions

(a) In considering a suitable workplace pension scheme for the workers of Cucinotta Ice Creams Ltd:

(i) State the additional information you would require from Claudia in order to recommend a suitable solution for the company. **(8)**

(ii) Outline the main features the Pensions Regulator recommends an employer should look for when selecting a good quality scheme. **(4)**

(b) Explain the potential **advantages** to Cucinotta Ice Creams Ltd of utilising postponement for employees who join the company after 1 March 2016. **(6)**

(c) Outline the requirements placed on the company in respect of:

(i) eligible jobholders who elect to opt-in during the postponement period; **(3)**

(ii) non-eligible jobholders who elect to opt-in during the postponement period; **(3)**

(iii) entitled workers who elect to join during the postponement period. **(4)**

(d) Claudia is interested in offering the option of salary sacrifice to the employees.

(i) Outline the **benefits** to Cucinotta Ice Creams Ltd of utilising salary sacrifice. **(4)**

(ii) Explain the requirements placed on Cucinotta Ice Creams Ltd if they wish to use salary sacrifice in respect of the automatic enrolment scheme. **(5)**

Total marks available for this question: 37

The tax tables can be found on pages 15 – 21

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

BLANK PAGE