THE CHARTERED INSURANCE INSTITUTE

AF1

Advanced Diploma in Financial Planning

Unit AF1 – Personal tax and trust planning

April 2016 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.

Candidates should answer based on the legislative position immediately BEFORE the 2016 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 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.

Andy, aged 57, is married to Kim, aged 45. They have three children, Jamie, aged 21, Judy, aged 18, and Tim, aged 14. Judy and Tim are still in full-time education.

Andy is employed as a manager on a basic salary of £50,000 gross per annum and earned bonuses of £13,000 in the tax year 2015/2016. Andy pays 6% of his basic salary into a personal pension. He has made regular gifts of £150 per month to a registered charity by direct debit for the last three years.

As part of his remuneration package, Andy receives a petrol run company car. The list price of the car is £36,000 and additional options were added to the vehicle totalling £1,750. Andy contributed £6,000 towards the cost of the car. The CO_2 emissions are 135g/km, and it was first registered in April 2014. Andy is reimbursed for his business mileage.

Kim is a regional branch manager for a small local building society. She earns £41,000 gross income per annum. She is currently a member of a contracted-out defined benefit non-contributory pension scheme. Kim does not receive any further income having registered to no longer receive Child Benefit.

Kim invested £100,000 which was part of an inheritance from her late father, into an onshore single premium investment bond in February 2003 in her own name. She has made no withdrawals. In May 2015, she fully encashed the bond for £119,200.

Kim also invested £20,000 of the inheritance into a new issue of Venture Capital Trust (VCT) shares. No dividends have been paid on these holdings in the tax year 2015/2016. However, the capital value is now calculated as £100,000.

Andy and Kim have lived in their current home, now valued at £950,000, since 2002. It is owned on a joint tenancy basis. They have a joint deposit account with a balance of £38,000 and received interest of £304 in the tax year 2015/2016. Andy has some shares, which he inherited some years ago, now worth £47,000. He received dividends of £1,170 in the 2015/2016 tax year.

Andy has a pension fund from a previous employer's defined contribution scheme with a current fund value of £153,000. Andy and Kim have read about the reforms to pensions and are considering using Andy's pension fund to repay their outstanding mortgage of £55,000.

After leaving school at age 16, Jamie started a small online business. After initial success he has recently found himself in financial difficulties and owes money to HM Revenue & Customs and other creditors.

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**, Andy's Income Tax liability for the tax year 2015/2016. *Assume he does not access any of his pension fund.* **(20)**

(ii) Calculate, **showing all your workings**, the lump sum Andy would need to access from his pension fund to provide him with sufficient money after tax to fully repay his mortgage. This will need to be completed in the tax year 2015/2016. **(6)**

(b) Explain the tax treatment of the Child Benefit if Kim and Andy had continued to receive it. **(4)**

(c) Describe, in detail, how Kim's National Insurance contributions will be calculated for the tax year 2015/2016. *No calculations are required.* **(7)**

(d) State the ongoing requirements that the Venture Capital Trust must satisfy in order to continue to receive favourable tax treatment. **(11)**

(e) Calculate, **showing all your workings**, the extra Income Tax Kim has to pay as a result of encashing the single premium investment bond in May 2015. **(11)**

(f) **(i)** State the circumstances under which one of Jamie's creditors can have him declared bankrupt. **(4)**

(ii) Describe the role of the Official Receiver. *Assume a bankruptcy order is made.* **(5)**

(iii) Explain briefly what would happen to Jamie's assets if he is made bankrupt. **(4)**

(g) Judy is about to start work as a self-employed sports coach.

(i) Explain how Judy would register as a self-employed person for Income Tax and National Insurance (NI). **(3)**

(ii) Explain how her Income Tax and NI will be collected initially and in subsequent tax years. **(5)**

Total marks available for this question: 80

QUESTIONS CONTINUE OVER THE PAGE

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.

Peter is a widower with two children, Joshua, aged 10 and Samantha, aged 7.

In June 2015, Joshua suffered severe brain damage in a car crash in which his mother was killed. His condition will significantly impair his ability to act independently both now and in the future.

Peter is concerned that Joshua will need financial assistance throughout his life. He is considering his options with regards to trust planning. In May 2014, Peter's mother, Jill, having made no previous lifetime gifts, settled £650,000 into a discretionary trust, with Joshua and Samantha as potential beneficiaries with a professional trustee and Peter as the trustees. Peter understands that the trustees can make specific provision for Joshua within the trust.

Following the car accident the insurance company settled £2,000,000 compensation into a discretionary trust with Joshua as a beneficiary, and the funds being used to invest in a mixture of cash, shares and gilts. As the trust is to be primarily for Joshua’s benefit, Peter understands it could be classed as a vulnerable persons or disabled persons trust.

Questions

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

(a) With regard to the discretionary trust established by the insurance company for Joshua.

Explain the conditions that will need to be satisfied for the trust to qualify as a disabled persons trust. **(9)**

(b) Assuming the discretionary trust established by the insurance company for Joshua qualifies as a disabled persons trust, explain for the tax year 2015/2016 the:

(i) Income Tax treatment; **(14)**

(ii) Capital Gains Tax treatment. **(7)**

(c) Explain to Peter how the discretionary trust set up by Jill could be amended to recognise Joshua as a vulnerable beneficiary. **(5)**

(d) Calculate, **showing all your workings**, the initial Inheritance Tax liability on the transfer of the gift into trust by Jill. *Assume Jill pays any tax due.* **(4)**

(e) State the powers provided to the Court of Protection in relation to the protection of a vulnerable individual. **(5)**

Total marks available for this question: 44

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.

Michael, aged 48, is a management consultant for a large UK based company. Michael has one brother, Luke, aged 44.

Michael and Luke's parents, having lived in the UK all their lives, moved to France three years ago and whilst visiting them, Michael met his fiancée Vanessa.

Vanessa and her parents have always lived in France. Vanessa is planning on moving to the UK on 1 August 2016 to marry Michael. Vanessa works as a hairdresser and has already secured a permanent full-time position in a local salon, which will start as soon as she arrives in the UK. Michael and Vanessa will live in the house Michael owns in the UK, which is valued at £600,000.

Michael was the sole beneficiary of the estate of a close friend, David, who died in November 2013. He used this inheritance to pay off his mortgage and to establish an investment portfolio worth £250,000. Vanessa has substantial income producing investments in France which she will continue to hold once she is living in the UK.

Neither Michael nor Vanessa has a Will as they feel it more appropriate to write Wills once they are married.

Luke works full-time as a fire fighter in the fire service. Luke is single and has no other relatives. Three years ago he won £400,000 on the National Lottery which he invested in a portfolio of shares now worth £430,000.

Questions

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

(a) **(i)** Explain briefly the rules used to decide whether a person is UK domiciled. **(2)**

(ii) State Vanessa's current domicile status and explain how this could change in the future. **(3)**

(iii) Explain how Vanessa will be treated for residency purposes when she arrives in the UK, and how her income will be taxed. **(6)**

(b) When Michael's friend David died, he left an estate valued at £425,000 with an Inheritance Tax (IHT) liability of £40,000.

If Michael died in March 2016, calculate, **showing all your workings**, the IHT position on his death. **(12)**

(c) **(i)** Describe the requirements for a Will to be valid. **(5)**

(ii) Explain briefly the effect that marriage would have on an existing Will. **(2)**

(iii) Explain briefly the consequences for Vanessa if Michael had died in March 2016. **(2)**

(d) Explain how Luke's estate would be treated for IHT purposes on his death. *No calculations are required.* **(4)**

Total marks available for this question: 36

The tax tables can be found on pages 11 – 17

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

	2014/2015	2015/2016
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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