THE CHARTERED INSURANCE INSTITUTE

J05

Diploma in Financial Planning

Unit J05 – Pension income options

October 2016 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2016/2017, 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

- Two 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 J05 – Pension income options

Instructions to candidates

Read the instructions below before answering any questions

- **Two hours** are allowed for this paper which consists of 15 short answer questions and carries a total of 130 marks.
- 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.

Attempt ALL questions

Time: 2 hours

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

1. Describe the criteria that must be met for a lump sum payment from an uncrystallised personal pension plan to be treated as a small pots payment, and outline how this payment will be taxed. *No calculations are required.* **(10)**

2 Grace, aged 67, was divorced in June 2013 and received a pension credit from her ex-husband in respect of a scheme pension that came into payment in December 2012. The pension credit rights that she acquired were valued at £225,000 and she transferred them into her personal pension plan (PPP), which at that time was valued at £250,000.

Grace will be retiring in November 2016. She will receive an annual pension of £55,025 plus a pension commencement lump sum of £113,603 from a previous employer's defined benefit scheme. Grace will also fully crystallise her PPP, currently valued at £553,425. She holds fixed protection 2014.

(a) Calculate, **showing all your workings**, the enhancement factor that will be applied to Grace's lifetime allowance as a result of the pension sharing order. **(2)**

(b) Calculate, **showing all your workings**, the tax charge payable if Grace takes the excess above the lifetime allowance as a lump sum in November 2016. **(10)**

3. Julie has been a member of a defined benefit pension scheme since 1990. Prior to 6 April 2016, the scheme was contracted-out. Julie will reach the scheme's normal pension age of 63 in December 2016. The scheme rules state that pensions in payment will escalate by the statutory minimum rates.

Outline the rates of statutory escalation that will be applied to Julie's pension once it is in payment. **(9)**

4. Andrew, aged 60, is a member of a small self-administered scheme (SSAS). He wishes to draw his benefits from this scheme and has been informed by the scheme trustees that one of the options available to him is to receive an income via a scheme pension paid directly from the fund.

Explain how the level of income paid to Andrew from the SSAS will be determined. **(5)**

5. Peter, aged 57, has a personal pension plan valued at £750,000. He plans to draw £120,000 as an uncrystallised funds pension lump sum (UFPLS) to repay his mortgage. This will be the first payment from this pension.

Calculate, **showing all your workings**, the net lump sum that Peter will receive initially, assuming that the UFPLS is taxed on a 'Month 1' basis. **(10)**

6. In 2011, Ben crystallised his only pension into a capped drawdown arrangement. He died in 2013, aged 73, and his wife, Emily, was his nominated beneficiary. Emily retained Ben's pension funds in capped drawdown until her death, aged 77, in October 2016.

Emily had nominated the couple's non-dependent son, Gareth, as the beneficiary of her dependant's capped drawdown fund.

Explain, in detail, the options Gareth has for receiving these benefits and their tax treatment. *No calculations are required.* **(7)**

7. Derek, aged 61, is employed and an active member of his employer's money purchase workplace pension scheme. The pension input amount in 2016/2017 is expected to be £20,000.

He has a capped drawdown arrangement currently valued at £54,000 that commenced in 2013. The provider allows additional funds to be designated into the existing arrangement.

In addition to the above, Derek has an uncrystallised personal pension plan valued at £200,000. He intends to crystallise this, take the maximum pension commencement lump sum and designate the balance of the fund into a drawdown arrangement. Derek plans to start taking occasional withdrawals from the fund.

(a) Explain the potential **benefits** to Derek of designating the funds into his existing capped drawdown arrangement rather than a flexi-access drawdown plan. **(4)**

(b) Calculate, **showing all your workings**, the revised maximum income that would apply if the funds are designated into the capped drawdown arrangement. *Assume the GAD basis amount is £47 per £1,000.* **(5)**

QUESTIONS CONTINUE OVER THE PAGE

8. Simon, aged 55, is taking early retirement to look after his wife Suki, aged 57, who is in very poor health.

Simon has a personal pension plan valued at £750,000, from which he requires an income of £18,000 per annum. He has a balanced attitude to risk and no current need to draw his full pension commencement lump sum as he has sufficient other assets.

(a) Explain why phased flexi-access drawdown is likely to be more suitable for Simon than purchasing a lifetime annuity. **(7)**

(b) Outline the potential **drawbacks** of Simon proceeding with phased drawdown. **(7)**

9. Bob, aged 58, is a deferred member of a defined benefit pension scheme. He wishes to transfer these benefits into a personal pension plan in order to access benefits using a drawdown pension. The cash equivalent transfer value of these benefits is £290,000.

Explain, giving your reasons, the advice process that Bob must follow in order to be able to proceed with the transfer of his pension benefits. **(6)**

10. Ian reached State Pension age in December 2015 and Irene reached State Pension age in July 2016. Ian and Irene have both decided to defer their State Pension.

(a) Outline, giving your reasons, the deferral options available to Ian and Irene, including any conditions that may apply. **(7)**

(b) State the rates by which each of their State Pensions will be increased during deferment for Ian and Irene under each of the options given in part **(a)** above. **(3)**

11. The Financial Conduct Authority's Conduct of Business Sourcebook (COBS) sets out rules on how information regarding open market options (OMOs) should be given.

Outline the key pieces of information that should be included in an OMOs statement. **(8)**

12. When considering a retirement income strategy, it is important to consider risk.

(a) Outline the difference between **attitude to risk** and **capacity for loss**. **(2)**

(b) State **four** key factors that influence a person's attitude to risk in respect of their retirement income planning. **(4)**

13. Kyle, aged 59, is a member of his company's defined benefit pension scheme which has a defined contribution section. Kyle has been made redundant and has been offered a redundancy payment of £45,000. He has decided to take early retirement and is entitled to an initial pension of £14,000 per annum which he can choose to commute, to provide a pension commencement lump sum, if he wishes.

His employer has offered to pay £15,000 of his redundancy lump sum directly into the defined contribution section of the scheme.

Explain, in detail, the benefits of this course of action for Kyle. *No calculations are required.* **(6)**

14. Ranjish, aged 55, has recently repaid his mortgage using the pension commencement lump sum from his personal pension plan. The balance of the fund has been designated into a flexi-access drawdown arrangement but no withdrawals have been taken. He is not planning to take any income withdrawals for at least another 10 years. As Ranjish is no longer making mortgage repayments of £900 per month, he intends to save this amount to provide additional income in his retirement.

Outline the factors Ranjish should consider when deciding whether to place his savings into a personal pension plan or an ISA. **(12)**

15. David's next annual review of his flexi-access drawdown arrangement is scheduled for September 2017. Identify **six** events that may lead to David requesting a review **prior** to this date. **(6)**

The tax tables can be found on pages 9 – 15

INCOME TAX

RATES OF TAX	2015/2016	2016/2017
Starting rate for savings*	0%	0%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	45%	45%
Starting-rate limit	£5,000*	£5,000*
Threshold of taxable income above which higher rate applies	£31,785	£32,000
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) *§*	£10,600	£11,000
Personal Allowance (if born between 6 April 1938 and 5 April 1948) *§*	£10,600	£11,000
Personal Allowance (if born before 6 April 1938) *§*	£10,660	£11,000
Married/civil partners (minimum) at 10% *†*	£3,220	£3,220
Married/civil partners at 10% *†*	£8,355	£8,355
Transferable tax allowance for married couples/civil partners	£1,060	£1,100
Income limit for age-related allowances *§*	£27,700	£27,700
Blind Person’s Allowance	£2,290	£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)	£2,780	£2,780
- family element	£545	£545
Threshold for tapered withdrawal of CTC	£16,105	£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 Earnings Limit (UEL)	£827	£3,583	£43,000

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS
Up to 155.00*****	Nil
155.01 – 827.00	12%
Above 827.00	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
Below 156.00**	Nil
156.01 – 827.00	13.8%
Excess over 827.00	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 - £43,000. 2% on profits above £43,000.

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 *§*
2016/2017	£1,000,000	£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	2015/2016	2016/2017
	£10,000*	£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	2015/2016	2016/2017
Individuals, estates etc	£11,100	£11,100
Trusts generally	£5,550	£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%	10%
Above basic rate limit	28%	20%
Surcharge for residential property and carried interest	0%	8%
Trustees and Personal Representatives	28%	20%
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	2015/2016	2016/2017
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%

A lower rate of 36% applies where at least 10% of deceased's net estate is left to a registered 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 2016/2017:

- The percentage charge is 7% 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 11%.
- For cars with CO_2 emissions of 76g/km to 94g/km the percentage is 15%.
- Cars with CO_2 emissions of 95g/km have a percentage charge of 16% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 37% (emissions of 200g/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 (£22,200 for 2016/2017) e.g. car emission 100g/km = 17% on car benefit scale. 17% of £22,200 = £3,774.

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

	2015/2016 Rates	2016/2017 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

	2015/2016	2016/2017
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£500,000	£200,000
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 2016 (Corporation Tax) or 06 April 2016 (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*

CORPORATION TAX

	2015/2016	2016/2017
Standard rate	20%	20%
Small companies rate	20%	N/A
Small companies limit	£300,000	N/A
Effective marginal rate	20%	N/A
Upper marginal limit	£1,500,000	N/A

VALUE ADDED TAX

	2015/2016	2016/2017
Standard rate	20%	20%
Annual registration threshold	£82,000	£83,000
Deregistration threshold	£80,000	£81,000

MAIN SOCIAL SECURITY BENEFITS

		2015/2016	2016/2017
		£	£
Child Benefit	First child	20.70	20.70
	Subsequent children	13.70	13.70
	Guardian's allowance	16.55	16.55
Employment and Support Allowance	Assessment Phase		
	Age 16 – 24	Up to 57.90	Up to 57.90
	Aged 25 or over	Up to 73.10	Up to 73.10
	Main Phase		
	Work Related Activity Group	Up to 102.15	Up to 102.15
	Support Group	Up to 109.30	Up to 109.30
Attendance Allowance	Lower rate	55.10	55.10
	Higher rate	82.30	82.30
Retirement Pension	Single	115.95	119.30
	Married	185.45	190.80
Single Tier State Pension	Single	N/A	£155.65
Pension Credit	Single person standard minimum guarantee	151.20	155.60
	Married couple standard minimum guarantee	230.85	237.55
	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		112.55	112.55
Jobseekers Allowance	Age 18 - 24	57.90	57.90
	Age 25 or over	73.10	73.10
Statutory Maternity, Paternity and Adoption Pay		139.58	139.58

BLANK PAGE

BLANK PAGE

BLANK PAGE