THE CHARTERED INSURANCE INSTITUTE

AF2

Advanced Diploma in Financial Planning

Unit AF2 – Business financial planning

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

- 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 carefully all information provided in the case study before attempting the questions. Your answers should take into account the clients circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c), (d) and (e) which follow.

Jadiom Ltd is an established company with three shareholding directors. Jim, aged 35, Donna, aged 33, and Alex, aged 57.

The director's shareholdings are as follows:

Alex: 60%
Jim: 15%
Donna: 25%

Alex is married to Andrea and they have two adult children. None of them have any interest in becoming involved in the business. Alex has personal assets valued at £1,200,000.

The company employs 25 people and has a total salary bill of £660,000 a year. The company has a gross profit of £565,000 a year.

Jadiom Ltd is looking to diversify their business and the directors have appointed Simon as a key member of the management team to focus on their expansion plans. He will be paid a salary of £55,000 a year. It has taken six months to find and recruit Simon and the directors estimate that if they had to find a replacement for Simon, for any reason, this would also take six months.

The directors of Jadiom Ltd do not have any business protection plans in place.

Jim and Donna have Wills but Alex has no Will in place at the moment. The directors are concerned about what would happen to their share holdings in the event of their deaths. Alex is concerned that his family receives fair value in a timely manner for his shareholding on death. Jim and Donna want to ensure that they can control the business on Alex's death.

The directors have asked you for your advice in relation to their protection needs, and have stressed they would like to keep any solutions as straight forward and tax-efficient as possible.

Questions

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

(a) **(i)** State the corporate document that should be the starting point for providing share protection advice to a limited company and explain briefly why it is important. **(5)**

(ii) Outline the information that you, as an adviser, would require from the directors in preparation of a solution to deal with their concerns on death. **(5)**

(b) **(i)** Explain to Jim and Donna the potential problems they will face as minority shareholders if Alex dies with no shareholder protection arrangements in place. **(10)**

(ii) List the financial information that may be required by the underwriters for the shareholders of Jadiom Ltd to obtain life cover. **(5)**

(iii) Explain to the directors the options for the payment of premiums on own life policies for shareholder protection. **(6)**

(iv) Identify the main **drawbacks** for the directors if any shareholder protection arrangements were set up using life cover written on life of another basis. **(3)**

(c) The shareholders have agreed to use own life policies for shareholder protection.

(i) Explain, giving your reasons, your recommendations for an arrangement that would best suit their needs. **(11)**

(ii) Explain briefly why it is important for the policies to be written under trust. **(4)**

(iii) Explain which type of trust should be used. **(6)**

(iv) Outline how the provisions in the directors' Wills should be set up for a transfer of a business share. **(3)**

QUESTIONS CONTINUE OVER THE PAGE

(d) Jadiom Ltd's accountant has suggested that the business should be valued on a fixed value basis in the cross option agreement.

(i) Explain how the fixed value method would be set up so there are no adverse tax implications to the business owners. **(7)**

(ii) State why the fixed value method may not be appropriate for Jadiom Ltd. **(2)**

(e) Jadiom Ltd will require key person cover for Simon.

(i) Identify **three** potential problems when using the multiple of salary method to calculate the level of key person cover. **(3)**

(ii) Calculate, **showing all your workings**, using the proportion of profits formula, a sum assured for a key person policy on Simon's life. **(5)**

(iii) Identify the main problem with using the proportion of profits formula to calculate the sum assured for Simon. **(5)**

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 carefully all information provided in the case study before attempting the questions. Your answers should take into account the clients circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c) and (d) which follow.

Nigel, aged 56, and Peter, aged 57, have been in partnership for 20 years running an architect practice. Business has steadily expanded and they now have a practice with 20 staff including five qualified architects.

Six months ago they made Helen and David partners in the business. Nigel and Peter's exit strategy is based on Helen and David buying out their share of the partnership in five years time.

The partners' share is as follows:

Partner	Share %
Nigel	45
Peter	45
Helen	5
David	5

When they started the partnership Nigel and Peter invested most of their liquid assets into the business. With the continued success of the business they have both built up significant wealth outside of the business and each has personal assets valued in excess of £250,000, in addition to their main residences. Helen and David have very little in terms of personal assets.

Accounts are made up to 30 June each year and the net profit for the year to 30 June 2016 was £335,762. Their accountant has calculated that the net profit for first quarter to 30 September 2016 was £80,238. There is a small amount of overlap profits of £15,000.

The business had a small set back recently having to pay out a claim for professional negligence. They were able to claim on professional indemnity insurance, however, their premiums and excesses have now gone up considerably. The business has also taken out a large loan to fund the expansion of their current premises. Nigel and Peter are becoming concerned about the extent to which they may be personally liable for any future claims or if the business should fail. They have been considering changing the partnership to a limited company.

Both Nigel and Peter have self-invested personal pensions. In the tax year 2015/2016, they maximised their pension contributions and therefore have no unused annual allowance to carry forward. They have not made any contributions in the current tax year 2016/2017.

Questions

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

(a) Outline the potential business liability issues for Nigel and Peter as partners in the current business **compared** with them being shareholding directors of a private limited company, if they incorporated the business. **(10)**

(b) The partnership was dissolved on 30 September 2016.

Calculate, **showing all your workings**, the:

(i) Partnership profit assessable on Nigel for the tax year 2016/2017; **(4)**

(ii) Income Tax liability for Nigel in the tax year 2016/2017, in respect of partnership profits ignoring any other income arising in the year, based on the partnership profits to the current tax year. **(6)**

(c) A new limited company was set up on 1 October 2016 to which the partnership's business and assets were transferred. The shareholding of the new company is in the same proportions as the previous partnership.

Explain to Nigel the Capital Gains Tax treatment of his share of the partnership on transfer to the new limited company. Include a description of the tax relief that may be available, the eligibility criteria, and any options he may have in relation to the tax treatment of the disposal. **(10)**

(d) To mitigate some of his Income Tax liability, Nigel intends to make a pension contribution of £40,000 in the tax year 2016/2017.

(i) Explain to Nigel how his annual allowance will be calculated for the tax year 2016/2017. **(5)**

(ii) Explain to Nigel the personal tax implications and obligations that would arise if he paid this amount to his pension. **(5)**

Total marks available for this question: 40

QUESTIONS CONTINUE OVER THE PAGE

Question 3

Read carefully all information provided in the case study before attempting the questions. Your answers should take into account the clients circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c), (d) and (e) which follow.

Terry and Paula are a married couple in their fifties who have built up a family business called T&P Surveys Ltd, a survey company employing about 30 people. They are both directors and shareholders of the company.

Terry and Paula each take a salary of £10,000 per annum from the business and dividends of £80,000 every year. Terry and Paula are running out of space in their current offices which the company owns outright. Rather than moving to larger premises they are looking to open a second office in a nearby town. They do not like the thought of leasing and are therefore looking to buy a suitable property. They have heard that it is possible to buy commercial property with their pensions, and have come to you for advice on how they can do this.

They have found an ideal office building which they think they can buy for £500,000 and they have estimated that they will need a further £140,000 to cover the associated purchase costs such as Stamp Duty Land Tax, conveyancing fees etc. They have been advised that the market rent for this property would be £50,000 per annum.

Terry has a personal pension currently worth £220,000. Paula has a stakeholder pension currently worth £150,000. Contributions have been paid by the company as follows:

Pension input period	**Terry**	**Paula**
2015/2016 (pre-alignment)	£80,000	£80,000
2014/2015	£10,000	£10,000
2013/2014	£10,000	£10,000

No contributions have been paid in the current tax year 2016/2017.

Terry and Paula feel that the potential for growth in their business over the next few years is huge, although they are conscious that they may need to introduce further capital into the company in order to fund this growth.

Questions

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

(a) Explain to Terry and Paula the likely steps they will have to undertake to buy the commercial premises using their pension funds. *No calculations are required*. **(5)**

(b) **(i)** Calculate, **showing all your workings**, the maximum amount of pension contributions that could be made on Terry and Paula's behalf in the current tax year 2016/2017 without incurring tax charges. **(6)**

(ii) Calculate, **showing all your workings**, how much a small self-administered scheme (SSAS) will need to borrow to purchase the property, leaving a contingency fund of £50,000 in the SSAS. *Include the maximum contribution you calculated in part **(b)(i)** above.* **(6)**

(c) Explain to Terry and Paula the benefits of using a SSAS rather than a self-invested personal pension (SIPP) in meeting all of their objectives. **(10)**

(d) Explain briefly the benefits to Terry and Paula of the SSAS buying the property. **(4)**

(e) Explain to Terry and Paula how a SSAS could be used to provide finance to the company in the future, and the conditions that would need to be satisfied to avoid any unauthorised payment charges. **(9)**

Total marks available for this question: 40

The tax tables can be found on pages 13 – 19

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

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