

AF3

Advanced Diploma in Financial Planning

Unit AF3 – Pension 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 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 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), (e), (f), (g) and (h) which follow.

Dan and Sarah are married. Dan will stop working when he reaches his State Pension age of 65 in January 2017. At that time he will be eligible to receive a State Pension of £131.20 per week. Sarah stopped working when she started to receive her State Pension of £181.20 per week in March 2015. Sarah has not yet crystallised any benefits from her private pension plans. The couple are both in excellent health and there is a history of longevity on both sides of the family.

Dan and Sarah have two children, Robert, aged 31, and Claire, aged 29. Both children are financially independent of their parents.

Dan was an active member of his employer's contracted-out defined benefit pension scheme until 5 April 2014 when he ceased membership after electing for fixed protection 2014. The scheme includes a 50% spouse's pension and is Dan's only pension.

Scheme pension age (SPA)	Pre-commutation pension at SPA	Maximum PCLS at SPA	Scheme commutation rate	GMP escalation	Non-GMP escalation
65	£70,000	£340,541	18:1	Statutory minimum	Pre 6/4/05: RPI capped at 5%. Post 6/4/05: RPI capped at 2.5%

Dan has been offered pension increase exchange (PIE) in respect of all non-statutory escalation. This would increase Dan's starting income from the pension by 27%. The information provided by the scheme states that this PIE option provides 100% of the balanced deal on a scheme wide basis.

Dan has been informed that should his benefits exceed his available lifetime allowance, any lifetime allowance tax charge owed must be paid by a reduction in his starting income from the pension. The commutation rate used for this purpose is 20:1.

Sarah, who has not registered for any form of transitional protection, has three uncrystallised money purchase pension schemes:

- An executive pension plan, currently valued at £260,000. On 5 April 2006, the plan was valued at £120,000 with a tax-free cash entitlement of £55,000.
- A retirement annuity contract (RAC), currently valued at £135,000.
- A personal pension plan (PPP), currently valued at £480,000.

Sarah would like to consolidate her pension holdings into a self-invested personal pension plan (SIPP) so that she can access her pension benefits flexibly.

Sarah has recently received a phone call from a firm she had not previously heard of offering a free review of her pensions and an investment opportunity that will provide a guaranteed return of 7% per annum. Sarah has been told the investment offer is only available if she completes the paperwork to move her pension funds within the next two weeks.

Dan and Sarah live in a mortgage free house valued at £900,000. Between them they have ISA investments of £413,000, unit trusts and blue chip shares valued at £350,000 and, as a result of a recent inheritance, cash in the bank of £190,000.

Dan and Sarah estimate that they will need at least £4,000 per month net of tax to be able to live as they wish, once Dan stops working in January 2017. They expect this will rise in line with inflation. They also require £120,000 to cover the cost of some capital expenditure.

The couple both have a medium to high attitude to risk. Their main financial objectives are to ensure they have sufficient income to live on in retirement and that they maximise the estate payable to their children 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) Dan intends to take a pension commencement lump sum (PCLS) of £300,000. Calculate, **showing all your workings**, the pension income Dan would receive in the first year of payment if he:
- (i) does not accept the offer of PIE; (5)
 - (ii) accepts the offer of PIE. (9)
- (b) Explain in detail the factors that an adviser should take into account when advising Dan on whether or not to accept the trustees offer of PIE. (11)
- (c) Calculate, **showing all your workings**, the maximum PCLS that Sarah is entitled to from her executive pension plan. (7)
- (d) Explain the factors an adviser should take into account when advising Dan and Sarah on how much PCLS they should take from their respective pensions when Dan stops working in January 2017. (10)
- (e) Outline the reasons why Sarah should treat the offer of a free review of her pension funds with caution. (5)
- (f) Explain the factors that must be taken into consideration by an adviser before advising Sarah on her wish to consolidate her existing pensions into a SIPP. (11)

QUESTIONS CONTINUE OVER THE PAGE

(g) Explain the factors an adviser should take into account when advising Dan and Sarah on how best to achieve a tax-efficient income in retirement, both now and in the future. (10)

(h) Assuming Sarah consolidates her RAC and PPP into a SIPP, state the options available on her death, whenever that may be, and outline the tax treatment that may apply. *You should assume that she completes nomination forms in favour of her children.* (12)

Total marks available for this question: 80

QUESTIONS CONTINUE OVER THE PAGE

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 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.

Carol, aged 58, is unmarried and has no children. She has recently given up her job in local government and set up her own business. Carol expects her net profits to be £20,000 per annum, which will be sufficient to cover her day-to-day living expenses.

Carol is in excellent health and there is a history of longevity in the family.

When Carol left her job in local government, she used all of her savings to repay her mortgage. She currently has outstanding credit card debts of £4,000, which she would like to clear as soon as possible. Carol has a moderate attitude to investment risk and a low capacity for loss. Although Carol's State Pension age is 66, she intends to stop working at age 65. Her main priority in respect of her retirement is to be able to maintain her standard of living and Carol will need a minimum income of £20,000 per annum to achieve this.

Over her working life, Carol has been a member of three contracted-out defined benefit schemes. She is considering transferring the benefits from one or more of her pension schemes so that she can flexibly access some funds to repay her credit card debts. Cash equivalent transfer values (CETVs) have been received and a transfer value analysis (TVAS) carried out in respect of each scheme and the details are as follows:

Name of scheme	Millbrook Pension Scheme	JJN Pension Scheme	Local Government Pension Scheme (LGPS)
Scheme service	July 1977 to March 1991	August 2004 to April 2008	May 2008 to June 2015
Normal pension age (NPA)	60	65	65
Estimated pension at NPA	£8,000 per annum	£1,400 per annum	£5,000 per annum
GMP revaluation	Fixed rate	N/A	N/A
Non-GMP revaluation	Statutory minimum revaluation	Statutory minimum revaluation	In line with increases in the Consumer Price Index (CPI)
Escalation in payment	In line with statutory requirements	In line with statutory requirements	In line with increases in the CPI
CETV	£158,000	£28,200	£98,300
Critical yield to NPA	12.3% per annum	6.2% per annum	8.4% per annum
Late retirement factor	7% per annum	N/A	5.1% per annum

Questions

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

- (a) Explain how the guaranteed minimum pension (GMP) benefits within the Millbrook Pension Scheme will escalate in payment. (5)
- (b) In respect of the cash equivalent transfer values (CETVs) and critical yields of Carol's three pension schemes:
- (i) Explain how the assumptions used in a transfer value analysis (TVAS) differ from the assumptions used in calculating a CETV. (5)
- (ii) Explain the factors that may have led to the higher critical yield in respect of the Millbrook Pension Scheme. (5)
- (c) Carol is considering transferring the benefits from one or more of her pension schemes.
- (i) Outline why Carol has the right to transfer the benefits from all three schemes. (2)
- (ii) State, giving your reasons, the advice requirements that apply in respect of each of her schemes. (5)
- (d) Explain why you would recommend that Carol should:
- (i) leave the benefits within the LGPS and the Millbrook Pension Scheme in order to draw these benefits from the schemes when she reaches her intended retirement age; (10)
- (ii) transfer her benefits within the JJN Pension Scheme to a money purchase arrangement in order to be able to access these benefits flexibly. (4)
- (e) Explain how the amount of State Pension payable to Carol when she reaches State Pension age will be determined. *No calculations are required.* (6)

Total marks available for this question: 42

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) and (d) which follow.

Ben and Susan, both aged 39, are married and have three children aged five, three and one. Ben works for a national law firm on a basic salary of £125,000 per annum. In addition to his basic salary, Ben received a bonus payment of £20,000 in June 2016.

Ben is a member of his employer's group personal pension (GPP) plan. He and his employer each make gross contributions of 10% of his basic salary. Ben's GPP is currently valued at £328,000 and is invested predominately in equity based funds.

Following the death of his parents several years ago, Ben inherited a share portfolio. This is currently valued at £330,000 and is held in his sole name. The portfolio is expected to produce dividend income of £10,000 for the current tax year 2016/2017. Ben is considering using some of this income to fund pensions for his children.

Ben has fully utilised his annual allowance in the previous five tax years and is considering doing so in the tax year 2016/2017 by making a single contribution into his employer's GPP. Ben is pleased with the investment growth on his pension but is concerned that he may eventually exceed his lifetime allowance. Ben is therefore considering Venture Capital Trusts (VCTs) as an alternative to paying additional funds into his pension. Ben is aware that VCTs can be relatively high risk investments but feels he has an adventurous attitude to risk as well as the capacity to absorb some financial loss.

Questions

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

- (a) Calculate, **showing all of your workings**, the additional net pension contribution Ben can make during the tax year 2016/2017 without exceeding his annual allowance. (8)
- (b) State the factors that you would take into account in assessing whether Ben's pension benefits are likely to exceed the lifetime allowance. (8)
- (c) Explain the differences in tax treatment between a VCT and the GPP in respect of:
- (i) contributions; (6)
 - (ii) benefits payable. (8)
- (d) Outline **four** potential benefits and **four** potential drawbacks to **Ben** of using the dividend income to fund pensions for his children. (8)

Total marks available for this question: 38

The tax tables can be found on pages 15 – 21

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%
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

§ 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.

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 (CO₂) 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 CO₂ emissions of 50g/km or less.
- For cars with CO₂ emissions of 51g/km to 75g/km the percentage is 11%.
- For cars with CO₂ emissions of 76g/km to 94g/km the percentage is 15%.
- Cars with CO₂ 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 CO₂ 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%	18%	8%
	first year	reducing balance	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

