

AF5

Advanced Diploma in Financial Planning

Unit AF5 – Financial planning process

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 AF5 – Financial planning process

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.
- You are strongly advised to attempt **all** tasks to gain maximum possible marks. The number of marks allocated to each task is given next to the task and you should spend your time in accordance with that allocation.
- **In this examination you should use the fresh copy of the fact-find provided. You are not allowed to bring into the examination the pre-released copy of the fact-find.**
- **Client objectives are provided overleaf and you should read them carefully before attempting the tasks.**
- Read carefully all tasks and information provided before starting to answer. Your answer will be marked strictly in accordance with the task 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 task on a new page and leave six lines blank after each task.

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.

CLIENTS' FINANCIAL OBJECTIVES

You have now been able to determine from the information in the fact-find that your clients have the following financial objectives:

Immediate objectives

- To generate sufficient income in retirement from their pensions and investments.
- To establish suitable methods for Hans and Eileen to draw benefits from their existing pension arrangements.
- To repay their outstanding mortgage.
- To provide funding of £30,000 to Dominic for his business use.

Longer-term objectives

- To improve the ongoing suitability and tax-efficiency of their savings and investments.
- To ensure Hans and Eileen's affairs can be managed by their appointed attorneys in the future, should this be required.
- To mitigate their Inheritance Tax liability whilst ensuring their estates pass to their intended beneficiaries.

Attempt ALL tasks**Time: 3 hours**

1. As Hans and Eileen have not sought financial advice for a number of years, they have some questions on fees and other issues relating to the financial planning process.
 - (a) With regard to the payment of fees, explain **four** benefits and **four** drawbacks to Hans and Eileen of:
 - (i) payment of hourly fees directly; (8)
 - (ii) payment by fund based fees being deducted from the investments. (8)
 - (b) Identify the client-specific factors that would typically influence Hans and Eileen's attitude to investment risk. (8)

2. Identify the additional information you would need to discuss with Hans and Eileen in order to advise them on how to meet their financial objectives of:
 - (a) repaying their mortgage on Hans' retirement; (6)
 - (b) mitigating their Inheritance Tax liability whilst ensuring their estates pass to their intended beneficiaries. (7)

3. With regard to Hans and Eileen's longer-term financial objectives for their investments. (*Exclude any pension arrangements in your answer*).
 - (a)
 - (i) Evaluate the Income Tax efficiency of their current savings and investments. (16)
 - (ii) Comment briefly on the diversification within their current savings and investment portfolio and identify whether the portfolio meets their risk profiles. (6)
 - (b) Explain in detail the Capital Gains Tax (CGT) implications of transferring the Unit Trusts and OEICs held by Hans to Eileen and the improved CGT efficiency that this action will provide. (6)

QUESTIONS CONTINUE OVER THE PAGE

4. With regard to Hans and Eileen's pension entitlement:

- (a) Recommend and justify why Eileen should consider paying Class 3 voluntary National Insurance contributions to increase her State Pension entitlement. (6)
- (b) Explain to Eileen how the benefits under her Welsh Life Group Personal Pension policy could be taken tax-efficiently as a series of ad-hoc lump sums using uncrystallised fund pension lump sum (UFPLS). (7)
- (c) Explain to Eileen the 'small pots' rules that allow her to take her preserved personal pension policies immediately and the tax implications of this course of action. (8)
- (d) Describe how Hans' pension income under the Groots Engineering Ltd pension scheme would be affected if the pension scheme entered the Pension Protection Fund after he had retired. (*Assume Hans started drawing his benefits at his normal retirement date*). (6)

Candidates will be rewarded for supporting their recommendations with relevant evidence and demonstrating how their recommendations work holistically to meet their clients' objectives.

5. With regard to Hans and Eileen's longer-term financial objectives:

- (a) Identify **five** benefits and **five** drawbacks for Hans and Eileen of transferring their existing UK Onshore Investment Bond to a discounted gift trust under a discretionary trust. (10)
- (b)
 - (i) Recommend and justify why Hans and Eileen should set up a suitable life assurance policy to cover their current and future Inheritance Tax liability. (12)
 - (ii) Explain briefly to Hans and Eileen **five** key drawbacks of the recommendation made in (b)(i) above. (5)

Candidates will be rewarded for supporting their recommendations with relevant evidence and demonstrating how their recommendations work holistically to meet their clients' objectives.

6. (a) Recommend and justify the actions that Hans and Eileen could take to ensure that, in the event of their deaths, their estates can be paid to their intended beneficiaries. *(Assume that no new investments or life policies are set up).* (15)
- Candidates will be rewarded for supporting their recommendations with relevant evidence and demonstrating how their recommendations work holistically to meet their clients' objectives.*
- (b) Explain the financial planning considerations for Hans and Eileen if they were to **lend** £30,000 to Eileen's son, Dominic, for his business use. (8)
7. Hans and Eileen are considering arranging a Lasting Power of Attorney.
- (a) Describe the **benefits** to Hans and Eileen of each of them setting up a Lasting Power of Attorney. (8)
- (b) Identify **four** common financial transactions an Attorney could make on behalf of Hans or Eileen if property and financial affairs Lasting Powers of Attorney are set up. (4)
- Candidates will be rewarded for supporting their recommendations with relevant evidence and demonstrating how their recommendations work holistically to meet their clients' objectives.*
8. Identify **six** key benefits the clients will derive from having regular reviews and contact with their financial adviser. (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%
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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
Attendance Allowance	Support Group	Up to 109.30	Up to 109.30
	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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