# THE CHARTERED INSURANCE INSTITUTE

# J05

# Diploma in Financial Planning

## Unit J05 – Pension income options

**April 2017 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.**

**Candidates should answer based on the legislative position immediately BEFORE the 2017 budget.**

### 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.** In March 2007, John's personal pension plan (PPP) was valued at £800,000. At that time, he took a pension commencement lump sum (PCLS) of £200,000. The remaining fund, currently valued at £1,050,000, is in a capped drawdown arrangement.

John is about to reach age 75. His only other pension arrangement is an uncrystallised PPP valued at £250,000. He has not registered for any form of transitional protection.

Calculate, **showing all your workings**, the lifetime allowance tax charge payable in respect of John's pension benefits when he reaches age 75. *You should assume John does not crystallise any further benefits prior to age 75*. **(8)**

**2.** Ben, aged 59, is employed and is planning to continue working until he reaches his State Pension age. He has an outstanding personal loan of £15,000 and is considering taking an uncrystallised funds pension lump sum from his personal pension plan to repay it. Ben has no other funds available to repay the outstanding debt.

Outline the factors Ben would need to consider when deciding whether to take this course of action. **(7)**

**3.** Janice will reach her State Pension age in May 2017. Her foundation amount of State Pension was calculated on 5 April 2016.

State the factors that would have been considered when determining the level of foundation amount applicable to Janice. **(5)**

**4.** Anthony has a defined benefit pension scheme and wishes to register for Fixed Protection 2016.

**(a)** Outline the conditions that must be satisfied for Anthony to register for, and maintain, Fixed Protection 2016. **(4)**

**(b)** State the circumstances that would allow Anthony's pension benefits to be transferred whilst retaining Fixed Protection 2016. **(4)**

**5.** Lucinda's husband, David, died recently, aged 75. Lucinda, aged 72, is receiving a State Pension of £86 per week and dividend income of £6,500 per annum from her unit trust portfolio. In addition, she has a dependant's flexi-access drawdown plan valued at £560,000 and an ISA valued at £210,000.

Lucinda needs a net income of approximately £24,000 per annum in order to maintain her lifestyle. Her primary financial aims are for her income to be tax efficient and to maximise the inheritance for her two non-dependent children.

Explain in detail why Lucinda can best achieve her objectives by taking the balance of the income required from her ISA rather than from her dependant's flexi-access drawdown plan. **(10)**

**6.** Sarah, aged 60, receives a salary of £36,000 per annum, which is her only income. She has an uncrystallised personal pension fund of £45,000 and intends to take the entire fund as an uncrystallised funds pension lump sum (UFPLS).

Calculate, **showing all your workings**, the amount Sarah will receive after all taxes have been settled if she takes the UFPLS on 01 April 2017. *You should assume that the scheme administrator has Sarah's tax code and therefore Month 1 does not apply.* **(8)**

**7.** Sandra, aged 73, has an uncrystallised personal pension plan valued at £980,000. She is also drawing an income from a dependant's capped drawdown pension, which she inherited from her late husband in May 2013. Sandra has nominated her son Harry to receive the benefits from her pensions when she dies. Harry is not dependent on Sandra.

Outline the options available to Harry including the tax treatment, in the event of Sandra's death before the age of 75. **(10)**

**8.** When determining a sustainable level of income to be drawn from a flexi-access drawdown plan:

**(a)** Describe briefly how the 'safe withdrawal rate' operates. **(4)**

**(b)** Outline the limitations of the 'safe withdrawal rate'. **(4)**

**QUESTIONS CONTINUE OVER THE PAGE**

**9.** Sanjeev is married to Caitlin and has been a member of his employer's defined benefit pension scheme for 30 years. The scheme was contracted-out until 5 April 2016 and its rules state that guaranteed minimum pension in payment will increase in line with statutory requirements, whilst all other benefits will increase in line with the Retail Prices Index capped at 5% per annum.

Sanjeev, who holds no form of transitional protection, will retire when he reaches the scheme's normal pension age of 65 in April 2017 and is entitled to receive a pre-commutation pension of £40,000. Sanjeev has been offered the option of increasing his pre-commutation pension to £51,600 if he accepts the offer of pension increase exchange (PIE) and gives up his right to non-statutory increases in payment.

**(a)** Outline the statutory levels of escalation the scheme must apply to Sanjeev's pension income if he elects to accept the offer of PIE. **(6)**

**(b)** Outline **four** potential benefits and **four** potential drawbacks to Sanjeev if he elects for PIE. **(8)**

**10.** State the **ten** steps, as published by The Pension Regulator, that scheme members can take to protect their pension from a potential pension scam. **(10)**

**11.** Robert, aged 69, and his wife Susan, aged 67, are retired and are both in good health. Between them they have a secure pension income of £25,000 per annum gross and cash savings of £8,000. They have no other pensions or investments.

Robert and Susan's home is mortgage-free and has a current value of £280,000. They wish to increase their income in retirement as they would like to travel whilst they remain in good health.

Outline **five** benefits and **five** drawbacks of using equity release via a lifetime mortgage to generate additional income to fund their retirement plans. **(10)**

**12.** Ranjeep, aged 64, is married to Jane, aged 62. Ranjeep retired in April 2014 and is currently in receipt of a scheme pension from his previous employer's defined benefit pension scheme. He has no other pension benefits.

Outline the potential death benefits Jane would receive in the event of Ranjeep's death, including the tax treatment. **(8)**

**13.** On 5 April 2006, Janet had an entitlement to £50,000 tax-free cash from an executive pension plan (EPP) fund, valued at £85,000. Janet is about to crystallise her EPP with the fund currently valued at £115,000. Janet has not registered for any form of transitional protection and no partial transfers have been made.

Calculate, **showing all your workings**, the maximum pension commencement lump sum available to Janet. **(7)**

**14.** Steve, aged 61, is employed and married to Julie, who has recently retired. Steve is planning to reduce his working hours in the next few months with a view to retiring fully at age 66.

Steve is an active member of his employer's group personal pension plan, he also has a self-invested personal pension (SIPP) with a current value of £220,000. He would like to generate a tax-efficient income from his SIPP to top-up his earned income once he reduces his working hours.

Outline **six** benefits and **six** drawbacks of Steve using phased flexi-access drawdown from his SIPP to provide his additional income. **(12)**

**15.** State the information contained on a State Pension benefit statement. **(5)**

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.<br>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 | 2015/2016 | 2016/2017 |
|---|---|---|
| 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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