THE CHARTERED INSURANCE INSTITUTE

CII

AF1

Advanced Diploma in Financial Planning

Unit AF1 – Personal tax and trust planning

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

- 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 AF1 – Personal tax and trust 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.

Rachel, aged 56, was self-employed and ran an internet based business until her death in March 2017. She had been divorced from her husband Gary who died in 2010. Rachel's mother Sarah, aged 74, had been living with her since 2010, when they jointly bought their house for £600,000. Rachel's two children, Karen, aged 24, and Diane, aged 17, both still live at the family home along with Karen's four-year-old daughter Emily.

On Gary's death in 2010, his Will created trusts for both Karen and Diane, providing them with the right to an income from the trusts and an absolute entitlement to capital when they reach the age of 25. At the time of Gary's death, £350,000 net of Inheritance Tax was placed into a range of fixed term deposit accounts, gilts and corporate bonds, for each of the two trusts.

Rachel made the following gifts during her lifetime:

Date of gift	Recipient	Value of gift (£)	Value March 2017 (£)
May 2014	Discretionary trust for Emily	375,000	425,000
May 2015	Gift to Karen	40,000	
June 2016	Gift to registered charity	5,000	

Rachel had stated that she intended to gift an amount of £40,000 to Diane on her 18th birthday. Unfortunately, Rachel died before being able to make this gift. At the time of her death, Rachel had not made any other gifts.

Rachel had not written a Will at the time of her death. Rachel had debts of £180,000 and she held the following assets listed in the table below:

Assets	Purchase price/initial investment (£)	Value March 2017 (£)
Fixed rate savings accounts	47,000	50,000
Enterprise Investment Scheme shares (purchased three years ago)	50,000	60,000
Investment trusts	100,000	175,000
Trading assets from the internet business	550,000	600,000
House (owned as tenants in common with Sarah)	600,000	800,000
Self-invested personal pension	714,000	825,000

Sarah's health is now starting to deteriorate. She has a holiday property in Portugal and likes to spend the winter months there. Karen has been helping Sarah with her financial affairs and she has stated that she would like Karen to continue to make decisions on her behalf whilst she is abroad, and in the future if she was not able to do so herself. Sarah is now in need of extra income and is considering an investment of some of her available capital into a discounted gift trust arrangement.

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 your workings**, the total Inheritance Tax liability payable as a result of Rachel's death and state who would be liable to pay any Inheritance Tax due in respect of:

(i) The discretionary trust that Rachel set up for Emily. **(6)**

(ii) Rachel's residual estate, excluding the discretionary trust. **(12)**

(b) **(i)** Explain in detail how the distribution of Rachel's estate could be altered so that Karen and Diane have been treated equally. **(10)**

(ii) During the course of the administration of Rachel's estate, her investment trusts substantially increase in value.

Explain how Capital Gains Tax on the sale of these investments would be calculated and accounted for in the administration of her estate. *No calculations are required*. **(7)**

QUESTIONS CONTINUE OVER THE PAGE

Questions continue on page 7

(c) **(i)** Explain how the income received by Karen from the trustees of the trust set up by her late father Gary would be taxed if she were a higher rate taxpayer. *No calculations are required.* **(10)**

(ii) Calculate, **showing all your workings**, the Inheritance Tax exit charge payable when Karen becomes beneficially entitled to the proceeds of her trust fund on her 25th birthday. *Assume the value of the monies has increased to £370,000 at this point.* **(4)**

(d) **(i)** Explain how a discounted gift trust would be established and how it would meet Sarah's need for income. **(7)**

(ii) Explain how any potential discount is calculated. *No calculations are required.* **(5)**

(e) Should Sarah decide to move to Portugal for six months of the year:

(i) State the name of the arrangement that will satisfy Sarah's wish for Karen to continue looking after her financial affairs. **(2)**

(ii) Explain in detail the steps that would need to be taken to allow Karen the ability to make decisions on Sarah's behalf, as identified in **part (e)(i)** above. **(10)**

(iii) Describe the responsibilities placed on Karen if she is appointed under the arrangement detailed in **part (e)(i)** above. **(7)**

Total marks available for this question: 80

QUESTIONS CONTINUE OVER THE PAGE

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.

Jack, aged 62, and Rebecca, aged 55, are married. Jack retired from his role as a senior manager at his company two years ago at the normal scheme retirement age of 60. Immediately after leaving employment, he became self-employed, working as a business consultant. Since then, he has been engaged solely with a single company.

Jack receives a pension of £46,000 per annum from his former employer and in the tax year 2016/2017 had self-employed earnings of £50,000.

Rebecca earns a salary of £8,000 per annum, working part-time as an administration assistant for a local charity. Jack has asked if there are any allowances or exemptions he can utilise to reduce his Income Tax liability.

In addition to his earnings and pension, Jack receives the following income:

Assets	**Income received in tax year 2016/2017 (£)**
Deposit interest	551
Fixed interest unit trust	900
Dividends from share portfolio	5,900
Stocks & Shares ISA	2,000
Cash ISA	650

Questions

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

(a) **(i)** Calculate, **showing all your workings**, Jack's Income Tax liability for the tax year 2016/2017. **(14)**

(ii) Calculate, **showing all your workings**, Jack's liability to National Insurance for the tax year 2016/2017. **(5)**

(b) In relation to Jack's Income Tax liability:

(i) State the conditions that need to be satisfied for the transferable personal allowance to be utilised by Jack. **(4)**

(ii) Identify the other options available to Jack in order to reduce his Income Tax liability. **(5)**

(c) Outline the criteria that Jack would need to demonstrate, to prove that he is self-employed if challenged by HM Revenue & Customs. **(6)**

(d) Jack is concerned that his self-employed earnings are likely to increase above the threshold for VAT.

Explain the process Jack would need to follow to register for VAT, identifying the amount when this will start to have an impact on Jack. **(7)**

Total marks available for this question: (41)

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.

Alan and Jing, aged 68 and 52 respectively, are married and are considering their retirement options. They have a son called Ethan, aged 30. Alan retired as the finance director of a successful stationery company in 2014 and is now receiving an income of £52,000 per annum from his defined benefit pension scheme. Jing's assets are primarily held in China and all of the income generated remains in China.

Alan is also a director in Chips Ltd, a computer component import company, where he now works with his son. Alan purchased a 10% share in Chips Ltd in 2012 and started work as a director following his retirement from the stationery company.

Jing is domiciled in China, and part of their retirement aspirations are to purchase a house in China and spend six months of the year there.

Alan's current assets are as follows:

Assets	**Acquisition Value (£)**	**Current Value (£)**
Cash	110,000	110,000
Stocks & Shares ISA	30,000	85,000
Buy-to-let property	150,000	210,000
Enterprise Investment Scheme	60,000	82,000
Main residence	320,000	850,000
Unit trusts & OEICs	80,000	120,000
Chips Ltd	70,000	200,000

In September 2013, Alan sold some of his investments and realised a gain of £60,000. This was immediately reinvested into the Enterprise Investment Scheme, on which he received full tax relief. Alan also has carried forward losses of £30,000 which have been correctly registered with HM Revenue & Customs.

Questions

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

(a) In order to fund the purchase of their home in China, Alan is considering the disposal of all his investments, including his holding in Chips Ltd.

(i) Calculate, **showing all your workings**, Alan's total Capital Gains Tax liability if he was to dispose of the assets highlighted above in the tax year 2016/2017. **(9)**

(ii) Outline the criteria that must be met for Alan's shares in Chips Ltd to qualify for entrepreneurs' relief. **(5)**

(b) Explain the personal tax implications arising from the use of holdover relief, if Alan had decided to gift Ethan his share in Chips Ltd rather than selling them. **(5)**

(c) In retirement, Alan and Jing will be splitting their time between the UK and China.

(i) Explain the principles of a double taxation agreement between the UK and China and how this would impact on Jing. **(6)**

(ii) Explain how Jing's assets would be treated for Inheritance Tax purposes, in the event of Jing's death. **(4)**

(d) Detail the circumstances in which tax relief may be withdrawn from Alan's Enterprise Investment Scheme investment. **(3)**

(e) Alan and Jing are considering transferring some of their assets between them.

State the impact on Alan and Jing's Capital Gains Tax position on the transfer of assets:

(i) as a married couple; **(2)**

(ii) if they were to separate; **(3)**

(iii) if they were to divorce. **(2)**

Total marks available for this question: (39)

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

	2015/2016	2016/2017
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.

	2015/2016	2016/2017
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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