THE CHARTERED INSURANCE INSTITUTE

AF3

Advanced Diploma in Financial Planning

Unit AF3 – Pension 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 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) and (g) which follow.

Nigel, who will be 58 in a few months, was widowed in 2004. He has no children or financial dependants. In 2015 he met Valerie, aged 57, who herself was widowed in 2007 and has one adult son James, who is financially independent.

Nigel and Valerie currently live in their own homes. They plan to marry later this year and live together in Nigel's home, with Valerie's property being rented out to provide additional income.

In 2002, Nigel left a senior position with Huzberg plc, a large pharmaceutical company, to set up his own management consultancy business. Having recently reduced his working week to three days, Nigel needs to subsidise his £40,000 gross annual income by drawing £15,000 net per annum of pension benefits before retiring when he reaches age 60.

Nigel was a member of the Huzberg plc Retirement Benefit Scheme (RBS) and has accrued the following preserved benefits:

Huzberg plc RBS (contracted-in defined benefit scheme)

Date of joining / leaving the scheme	01.04.1980 / 31.10.2002
Total pension at date of leaving	£19,250 per annum
Revaluation	Fixed 5% per annum
Normal retirement age (NRA)	60
Pension payable at NRA	£42,000 per annum
Escalation	Retail Prices Index, capped at 5% per annum
Early retirement factor	0.5% per month or part thereof
Pension commencement lump sum (PCLS)	Up to HM Revenue & Customs maximum by commutation
Commutation rate	15:1 at age 58 and 14:1 at age 60
Dependant's pension	50%, payable to a legally married spouse or civil partner at date of retirement or earlier death

For comparison purposes, Nigel has obtained lifetime annuity rates on a basis that exactly matches the benefit structure of the scheme pension under the Huzberg plc RBS. These rates are 2.2% at age 58 and 2.4% at age 60.

In addition to the benefits shown above, Nigel also has a personal pension plan (PPP) currently valued at £310,000. The fund is wholly invested in a cautious managed fund in line with his attitude to risk.

Valerie is currently employed and earns a salary of £56,000 per annum. She is a member of her employer's group personal pension plan (GPP) which has a current value of £88,000. Both Valerie and her employer contribute 5% of her salary to the plan. Valerie plans to retire at the same time as Nigel. She intends to take her benefits flexibly and is keen to increase the amount of PCLS available to her.

Valerie inherited her late husband's capped drawdown plan following his death and she chose to continue in capped drawdown. In the first two years following her husband's death, Valerie did not work and took an income of £20,000 per annum from the plan. She has taken no further withdrawals since. The plan is currently valued at £543,000 and the maximum permitted annual Government Actuary's Department (GAD) withdrawal is £29,000.

In the event of her death, Valerie has nominated Nigel to receive the benefits under her GPP and her son James to receive the benefits under her dependant's capped drawdown plan.

QUESTIONS CONTINUE OVER THE PAGE

Questions

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

(a) Nigel is considering taking his benefits from the Huzberg plc RBS at age 58.

(i) Calculate, **showing all your workings**, the **additional** lifetime allowance that would be used if he takes his benefits in the form of a scheme pension as opposed to taking the maximum Pension Commencement Lump Sum (PCLS) and a reduced scheme pension. **(10)**

(ii) Explain, why the early retirement reduction and commutation rate applicable at age 58 under the scheme both represent poor value. *Use the annuity rates provided in the case study to support your answer.* **(6)**

(b) Explain to Nigel why you would recommend that he leave his benefits within the Huzberg plc RBS until he is aged 60 and utilise his PPP to provide the required £15,000 net per annum for the next two years. **(12)**

(c) Outline the transitional protections that may be available to Nigel, including any conditions that would apply. **(7)**

(d) You have recommended that Valerie converts her dependant's capped drawdown plan into a dependant's flexi-access drawdown plan with a view to withdrawing an income to recycle back into her GPP.

Explain to Valerie the tax treatment and benefits of this course of action. **(10)**

(e) Valerie has received a State Pension forecast which shows she will have a shortfall when she reaches her State Pension age in June 2026.

State **eight** factors that should be considered in determining whether or not Valerie should increase her State Pension entitlement through Class 3 National Insurance contributions. **(8)**

(f) In the event of Valerie's death, outline the options available to the nominated beneficiaries of her pension plans and describe the tax treatment of each option. *Your answer should include the position if Valerie were to die either before or after age 75.* **(11)**

(g) In respect of Nigel and Valerie's income requirements in retirement:

(i) State the additional information you would require from Nigel and Valerie in order to undertake a lifetime cash-flow forecast. **(10)**

(ii) Outline **six** scenarios that should be discussed with Nigel and Valerie when carrying out a stress test of their cash-flow forecast. **(6)**

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.

Neil, aged 56, and his new partner, Sally, have recently bought a house together. They have no plans to marry. Neil has two financially independent children from a former relationship, Lucy, aged 26, and Matthew, aged 28.

Neil is a mechanical engineer and for many years he worked for Aero Engineering plc. He left this employment in 2012 and set up his own business with Matthew. Neil and Matthew have each set up self-invested personal pensions (SIPPs), to which they make ad-hoc contributions when company profits permit. Each SIPP is currently valued at £80,000. They are in the process of looking for larger premises for the business and are considering their options to purchase the premises.

Whilst he was employed, Neil was a member of the Aero Engineering Retirement Benefit Scheme (RBS), which is a defined benefit pension scheme. Prior to 6 April 2016, the scheme was contracted-out.

Neil recently received a cash equivalent transfer value (CETV) calculated on 1 April 2017, the details of which are shown below:

Date of joining scheme	1 October 1991
Date of leaving scheme	25 May 2012
Total pension at date of leaving	£26,250 per annum
Including guaranteed minimum pension (GMP)	£1,200 per annum
GMP revaluation	Fixed rate
Excess above GMP	Statutory minimum revaluation
Increases to pensions in payment	GMP – statutory increases Excess benefits increase in line with Consumer Price Index capped at 5% per annum
Normal pension age (NPA)	65
Death benefits	Dependant's pension of 2/3rds of member's pension. Definition of dependant is legal spouse or civil partner at the date of retirement/death
CETV	£597,500 - the CETV has been reduced by 20% as a result of the scheme's funding position

Neil planned to leave his benefits preserved in the Aero Engineering RBS in order to benefit from a secure income in retirement. However, the Aero Engineering RBS is significantly underfunded, and although a recovery plan is in place, the deficit is not reducing quickly as the company is currently in financial difficulty. As a result Neil is now considering transferring the benefits out of the Aero Engineering RBS into his SIPP.

Questions

(a) Describe, in detail, how revaluation will be applied to Neil's deferred benefits up to his normal pension age (NPA) under the scheme. *Your answer should include the specific rates of revaluation as well as the process for applying any cap where relevant.* **(10)**

(b) Neil is concerned about the financial health of Aero Engineering plc and the current level of underfunding of the scheme.

(i) Outline the potential **benefits** of leaving his deferred pension within the Aero Engineering RBS, despite Neil's concerns. **(4)**

(ii) Explain how Neil's pension from the Aero Engineering RBS would be affected if the scheme was to enter the Pension Protection Fund (PPF) before he reaches his NPA under the scheme. *Your answer should not cover revaluation under the PPF.* **(7)**

(c) Outline the factors you would take into account when advising Neil on whether he should transfer his benefits from the Aero Engineering RBS into his SIPP. **(12)**

(d) If Neil does decide to transfer his benefits from the Aero Engineering RBS into his SIPP, outline the process that must be followed, including any timescales that apply. **(7)**

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.

Alan, aged 57, is single. He has a personal pension plan (PPP), currently valued at £420,000 and invested in a cautious managed lifestyle fund with a selected pension age of 60.

After a period spent working on a self-employed basis, Alan started working for his current employer in February 2016 on an initial salary of £120,000. On 6 April 2016 he agreed to exchange £20,000 of his 2016/2017 salary for an equivalent employer pension contribution. The employer's contractual pension contribution is 5% of Alan's pre-exchange salary of £120,000. This contribution, which commenced on 6 April 2016, is paid in addition to the £20,000 contribution. The employer is paying these contributions into Alan's PPP, which is Alan's only pension fund.

Prior to the rule change introduced in the July 2015 Budget, Alan's PPP had a pension input period of 1 May to 30 April each year. Alan's gross pension input in recent years is as follows:

Date of contribution	**Amount**
1 June 2012	£20,000
1 March 2014	£15,000
1 May 2015	£45,000
1 November 2015	£10,000

In addition to his salary, in the 2016/2017 tax year, Alan will receive interest from savings held in deposit accounts of £2,000 and dividend income from a portfolio of shares and equity based unit trusts of £45,000.

Alan has recently received an inheritance of £150,000 and is keen to use this to boost his pension funds. His current intention is to work until he reaches his State Pension age and then use the pension fund to provide flexible benefits. It has recently been confirmed that Alan has a moderate to adventurous attitude to risk.

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 level of Alan's:

(i) threshold income for the 2016/2017 tax year; **(3)**

(ii) annual allowance in the 2016/2017 tax year. **(6)**

(b) Calculate, **showing all your workings**, the maximum net contribution Alan can pay into his personal pension plan (PPP) in the 2016/2017 tax year without incurring an annual allowance tax charge. **(12)**

(c) Explain how the level of tax payable on Alan's dividend income would be affected if he makes the pension contribution shown in your answer to **part (b)** above. *No calculations are required.* **(6)**

(d) Outline the factors you would take into account in recommending how much Alan should contribute to his PPP in the 2016/2017 tax year. **(7)**

(e) Explain why Alan's current PPP investment strategy is unsuitable for his circumstances and objectives. **(6)**

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

BLANK PAGE

BLANK PAGE