THE CHARTERED INSURANCE INSTITUTE

AF2

Advanced Diploma in Financial Planning

Unit AF2 – Business financial planning

October 2017 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2017/2018, 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 AF2 – Business financial 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.

Gerald, aged 60, is the sole shareholder director of a small electrical engineering company that he started some years ago. The strength of the business is his order book and his loyal and skilled workforce.

The business does not own the premises from which it operates. Gerald does personally own separate commercial premises that he rents out to another business. He bought these premises some time ago and these now have a very significant capital gain.

The business has 8 employees, one of whom, Tom, is aged 44. Tom has been with the company for 13 years and earns £550 a week. All the workers will be entitled to some element of holiday pay.

The business has expanded very quickly in the last two years and Gerald has spent a substantial amount of money on new machinery. The business looked as if it was doing well with a full order book. However, because of this expansion, the business is suffering from overtrading and is having problems with financing and covering day to day costs and regular outgoings. The business made small profits of £5,000 each year for the past two years.

Gerald is now considering two options: winding up the company or finding a buyer, in which case he will sell the business for £200,000. If he were to wind up the business and pay off the creditors, he would have a small profit. He has not yet decided whether he would sell his commercial property when he sells or winds up his electrical engineering company.

Richard, a competitor of Gerald's, is looking to buy a company to complement his current business. Richard wishes to grow his business rapidly rather than organically and his business is cash rich. He knows of Gerald's current situation and is very interested in buying Gerald's company. The two businesses are located within a quarter of a mile of each other. Richard has not decided whether to purchase from Gerald or wait until the business is due to go into administration. If the business is due to go into administration, Richard could negotiate with a potential administrator to get a pre-packaged administration deal.

Gerald has a Will which states that his total assets are to be held on trust to provide a lifetime income for his partner Jennifer, to whom he is not married. After the life interest expires, the estate passes in its entirety to the Charities Aid Foundation for distribution between a number of Gerald's favourite good causes.

Questions

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

(a) **(i)** State **four** business reasons why Richard may wish to buy Gerald's existing business. **(4)**

(ii) State **five** specific business risks to Richard associated with his acquisition of Gerald's business. **(5)**

(b) **(i)** Explain why it may be preferable for Gerald to sell the shares in his company rather than the business and assets. **(6)**

(ii) Explain to Gerald why it would be beneficial for him to sell the commercial premises he rents out at the same time as he sells his company. **(3)**

(iii) Explain how the proceeds will be taxed if Gerald sells the business as a going concern for £200,000. *Assume it is apportioned: 80% for goodwill; and 20% for plant, machinery and other capital equipment. No calculation is required.* **(7)**

(c) If Richard buys the business from Gerald, they must both comply with the Transfer of Undertakings (Protection of Employment) Regulations 2006.

(i) State **four** items of information that Gerald must supply to Richard regarding employees transferring to the new business. **(4)**

(ii) Explain to Gerald the responsibilities and liabilities the regulations will place on both Gerald and Richard if the company is bought by Richard as a going concern. **(8)**

(d) **(i)** Explain to Gerald why a valuation based on business assets may be useful in calculating the sale value of the company. **(4)**

(ii) Describe how Gerald might prepare his business for sale. **(6)**

(iii) Comment on the Value Added Tax position of the company share purchase, should Richard buy the business. **(4)**

QUESTIONS CONTINUE OVER THE PAGE

(e) **(i)** Describe how a pre-packaged administration ('pre-pack') arrangement works. **(4)**

(ii) State **three** advantages to Gerald of a pre-pack sale. **(3)**

(iii) Explain why pre-pack sales may not be beneficial for creditors. **(5)**

(f) **(i)** Calculate, **showing all your workings**, the amount of statutory redundancy pay Gerald will have to pay to Tom if he winds up the business. **(8)**

(ii) Explain the tax treatment of the:

- redundancy payment; **(2)**
- holiday pay entitlement. **(2)**

(g) Assuming Gerald dies before Jennifer while still owning his business assets, comment on the:

(i) Inheritance Tax implications of Gerald's Will; **(2)**

(ii) Tax implications for the trust assuming it sells the business. **(3)**

Total marks available for this question: 80

Section B questions can be found on pages 8 – 11

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.

Steve, aged 40, is a sole trader who has been running a successful garden design business for the past 10 years. In the last 12 months, he has expanded into making bespoke garden furniture and now needs bigger premises from which to work.

Steve has found suitable premises, priced at £275,000, which he would like to buy. He has been informed there will be a VAT charge. Stamp Duty Land Tax will amount to £6,000.

His only pension provision is a personal pension plan which has a current value of £150,000 invested in various medium risk equity funds. He would like to use this pension plan to fund the purchase of the premises rather than approaching his bank for a loan. Steve has not made a pension contribution in the tax year 2017/2018, but, in each of the previous 5 years he has made a £10,000 gross contribution. Steve's main residence has recently been valued at £450,000 and he has no mortgage. He has stocks and shares ISAs valued at £35,000 and £50,000 held in a deposit account. Steve's taxable earnings for the tax year 2017/2018 are £85,000.

In July 2017, Steve took on four permanent members of staff to help him with his increased workload. He has been informed that he needs to set up an auto-enrolment pension scheme by February 2018.

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**, the total cost of buying the business premises assuming that legal costs amount to £8,000. **(3)**

(ii) Explain to Steve how he could use his personal pension to meet the purchase price of the property. **(7)**

(b) **(i)** Explain how Steve can increase the net value of the pension scheme to reduce the shortfall for the property purchase. **(3)**

(ii) Calculate, **showing all your workings**, the maximum amount that Steve can contribute to his personal pension in the tax year 2017/2018 and receive tax relief on the amount. **(6)**

(c) State **five** advantages to Steve of buying the property through a self-invested personal pension (SIPP) rather than directly using his own investments/cash. **(5)**

(d) **(i)** Outline the minimum requirements for Steve to meet his auto-enrolment responsibilities. **(8)**

(ii) Describe:

- a non-eligible jobholder; **(2)**
- an entitled worker. **(2)**

(iii) Outline Steve's responsibilities towards both workers described in part **(d)(ii)** above. **(4)**

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) and (d) which follow.

Alan, Natalie and Chan are three engineers working for an industrial engineering group who now want to set up on their own account. They intend to establish a common enterprise under which they can work collaboratively, each developing their own connections with the aim of generating profit and value for the future.

They will require working capital to buy equipment and tools, and to finance the business in the early years. They are giving up well paid jobs and are each investing £20,000. Once established, they will each be capable of generating fees sufficient to meet overheads, their income needs and leave a surplus to reinvest in the business. They intend to build up retained profits to take stakes in future projects.

All three of them have their own concerns about which legal form the business should take.

Alan wants to make sure that he will only be putting at risk the money he invests in the business.

Natalie is concerned about the growing value of the business and the money she will have tied up in it. Natalie is unmarried and lives with her partner and their two children. She would like her family to benefit from her share of the value of the enterprise on her death. She wants to be certain that if either Alan or Chan dies the business will continue.

Chan has a young family and a mortgage and she is concerned about income. Chan recognises that her earnings are likely to be reduced in the early months and years of the enterprise. She wishes to pay as little tax as possible on her income.

Questions

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

(a) Considering Alan's main concern:

(i) State the **four** legal forms of business that could be adopted, and for each, explain its ability to meet Alan's requirement to limit his capital risk. **(10)**

(ii) Identify **two** legal forms that best suit Alan's objective. **(2)**

(b) Considering Natalie's concerns and assuming that none of the three of them operates as a sole trader:

(i) Describe the appropriate arrangement you would advise Natalie to ensure that her wishes can be accommodated. **(10)**

(ii) State, giving **two** reasons, the one legal form that is best suited to such an arrangement as described in your answer to **part (b)(i)** above. **(3)**

(c) Considering Chan's concerns:

(i) Calculate, **showing all your workings,** the Income Tax Chan would pay on a profit share of £121,000 as a sole trader. *Ignore any National Insurance contributions and assume that this is her only taxable income.* **(5)**

(ii) Calculate, **showing all your workings**, the net of tax sum Chan would receive from a company profit of £121,000 in the year commencing after 31 March 2017, after payment of Corporation Tax, with the balance being distributed as a dividend. *Assume Chan is not in receipt of any salary.* **(6)**

(iii) Identify the legal form which gives the greatest net income from your answers in **parts (c)(i)** and **(c)(ii)** above. **(1)**

(d) **(i)** State the legal form of business that is best suited to meeting the concerns of Alan, Natalie and Chan. **(1)**

(ii) Explain why it is better to hold retained profit in the business structure you have identified in **part (d)(i)** above rather than in any other legal form of business. **(2)**

Total marks available for this question: 40

The tax tables can be found on pages 13 – 21

INCOME TAX

RATES OF TAX	2016/2017	2017/2018
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	£32,000	£33,500
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

**not applicable if taxable non-savings income exceeds the starting rate band.*

Dividend Allowance		£5,000
Dividend tax rates		
Basic rate		7.5%
Higher rate		32.5%
Additional rate		38.1%
Trusts		
Standard rate band		£1,000
Rate applicable to trusts		
- dividends		38.1%
- other income		45%

MAIN PERSONAL ALLOWANCES AND RELIEFS		
Income limit for Personal Allowance §	£100,000	£100,000
Personal Allowance (basic)	£11,000	£11,500
Married/civil partners (minimum) at 10% †	£3,220	£3,260
Married/civil partners at 10% †	£8,355	£8,445
Transferable tax allowance for married couples/civil partners	£1,100	£1,150
Income limit for age-related allowances†	£27,700	£28,000
Rent a Room relief	£4,250	£7,500
Blind Person's Allowance	£2,290	£2,320
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
Lower Earnings Limit (LEL)	£113
Primary threshold	£157
Upper Earnings Limit (UEL)	£866

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS
Up to 157.00*	Nil
157.01 – 866.00	12%
Above 866.00	2%

**This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £113 per week. This £113 to £157 band is a zero-rate band introduced in order to protect lower earners' rights to contributory State benefits e.g. the new State Pension.*

Total earnings £ per week	CLASS 1 EMPLOYER CONTRIBUTIONS
Below 157.00**	Nil
157.01 – 866.00	13.8%
Excess over 866.00	13.8%

*** Secondary earnings threshold.*

Class 2 (self-employed)	Flat rate per week £2.85 where profits exceed £6,025 per annum.
Class 3 (voluntary)	Flat rate per week £14.25.
Class 4 (self-employed)	9% on profits between £8,164 - £45,000. 2% on profits above £45,000.

PENSIONS

TAX YEAR	LIFETIME ALLOWANCE
2006/2007	£1,500,000
2007/2008	£1,600,000
2008/2009	£1,650,000
2009/2010	£1,750,000
2010/2011	£1,800,000
2011/2012	£1,800,000
2012/2013	£1,500,000
2013/2014	£1,500,000
2014/2015	£1,250,000
2015/2016	£1,250,000
2016/2017	£1,000,000
2017/2018	£1,000,000

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.

ANNUAL ALLOWANCE

TAX YEAR	ANNUAL ALLOWANCE
2011/2012	£50,000
2012/2013	£50,000
2013/2014	£50,000
2014/2015	£40,000
2015/2016	£40,000~
2016/2017	£40,000*
2017/2018	£40,000*

~ increased to £80,000 for pension input between April - 8 July 2015. If not used, can be carried forward to pension input period of 9 July 2015 - 6 April 2016, subject to a maximum of £40,000.

**tapered at a rate of £1 for every £2 of adjusted income in excess of £150,000 where threshold income exceeds £110,000.*

MONEY PURCHASE ANNUAL ALLOWANCE	2016/2017	2017/2018
	£10,000	£10,000

ANNUAL ALLOWANCE CHARGE

20% - 45% determined by the member’s taxable income and the amount of total pension input in excess of the annual allowance or money purchase annual allowance.

CAPITAL GAINS TAX

EXEMPTIONS	2016/2017	2017/2018
Individuals, estates etc	£11,100	£11,300
Trusts generally	£5,550	£5,650
Chattels proceeds (restricted to five thirds of proceeds exceeding limit)	£6,000	£6,000

TAX RATES		
Individuals:		
Up to basic rate limit	10%	10%
Above basic rate limit	20%	20%
Surcharge for residential property and carried interest	8%	8%
Trustees and Personal Representatives	20%	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	2016/2017	2017/2018
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
- main residence nil rate band*	£100,000	£100,000
- UK-registered charities	No limit	No limit

**Available for estates up to £2,000,000 and then tapered at the rate of £1 for every £2 in excess until fully extinguished*

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/bride and/or groom	£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%

Quick succession relief:

- Years since IHT paid	0-1	1-2	2-3	3-4	4-5
- Inheritance Tax relief	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 2017/2018:

- The percentage charge is 9% 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 13%.
- For cars with CO_2 emissions of 76g/km to 94g/km the percentage is 17%.
- Cars with CO_2 emissions of 95g/km have a percentage charge of 18% 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 (£22,600 for 2017/2018) e.g. car emission 100g/km = 17% on car benefit scale. 17% of £22,600 = £3,842.

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

	2016/2017 Rates	2017/2018 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

	2016/2017	2017/2018
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£200,000	£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*

MAIN SOCIAL SECURITY BENEFITS

		2016/2017	2017/2018
		£	£
Child Benefit	First child	20.70	20.70
	Subsequent children	13.70	13.70
	Guardian's allowance	16.55	16.70
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 109.65
Attendance Allowance	Lower rate	55.10	55.65
	Higher rate	82.30	83.10
basic State Pension	Single	119.30	122.30
	Married	190.80	195.60
new State Pension	Single	155.65	159.55
Pension Credit	Single person standard minimum guarantee	155.60	159.35
	Married couple standard minimum guarantee	237.55	243.25
	Maximum savings ignored in calculating income	10,000.00	10,000.00
Bereavement Payment Support Payment*		2,000.00	2,000.00
Higher rate - lump sum		N/A	3,500.00
Higher rate - monthly payment		N/A	350.00
Standard rate – lump sum		N/A	2,500.00
Standard rate – monthly payment		N/A	100.00
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	140.98

*Only applicable where spouse or civil partner died on or after 6 April 2007**

CORPORATION TAX

	2016/2017	2017/2018
Standard rate	20%	19%

VALUE ADDED TAX

	2016/2017	2017/2018
Standard rate	20%	20%
Annual registration threshold	£83,000	£85,000
Deregistration threshold	£81,000	£83,000

STAMP DUTY LAND TAX

	Residential
Value up to £125,000	0%
£125,001 - £250,000	2%
£250,001 and £925,000	5%
£925,001 and £1,500,000	10%
£1,500,001 and over	12%

Stamp Duty Land Tax (SDLT) is payable in England, Wales and Northern Ireland only. Land and Buildings Transaction Tax (LBTT) is payable in Scotland at different rates to the above.

Additional SDLT of 3% may apply to the purchase of additional residential properties purchased for £40,000 or greater.

SDLT is charged at 15% on interests in residential dwellings costing more than £500,000 purchased by certain corporate bodies or non-natural persons.

	Non residential
Value up to £150,000	0%
£150,001 and £250,000	2%
£250,001 and over	5%

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