AF1

Advanced Diploma in Financial Planning

Unit AF1 – Personal tax and trust planning

April 2018 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 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), (e) and (f) which follow.

James, aged 58, is a successful businessman, with total earnings in the tax year 2017/2018 of £175,000. He has been divorced from his former wife Ellen for six years. They have one child, Miles, aged 16, who lives with James. Three years ago, James met Lucy and they are planning to marry next year, although they currently live separately.

Over the years, James has built up considerable wealth. His current estate comprises an investment portfolio of £678,000 which includes £200,000 of directly held gilts, and an investment worth £200,000 in an Enterprise Investment Scheme into which he invested £160,000 at launch five years ago. His home is valued at £600,000 and he also owns a collection of nineteenth century artwork by pre-eminent British artists. The artwork has a current estimated auction value of £800,000, although it is currently insured for £650,000.

On 5 May 2010, James settled £400,000 into a discretionary trust for his family which was invested in an onshore assurance bond. He appointed his sister Julia and his accountant, David, as additional trustees. The trustees encashed the bond in January 2018 for £490,000 and invested the proceeds into a portfolio of open-ended investment companies.

James has recently spoken with Julia and David regarding using some of the trust fund to purchase a property intended for Miles' future use. James has seen a flat that is currently on the market for £180,000.

James' sister, Julia, suffered financial hardship when her husband died five years ago and in June 2013 James gifted her £350,000 which she has used in total to pay off some of her debts.

James made a Will ten years ago when he was married to Ellen. As she was already wealthy, his estate is primarily left to Miles, except for one painting left to Ellen and £100,000 to Julia. Ellen was named as sole executor. When James makes his new Will, he plans to appoint his solicitor as sole executor.

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 Inheritance Tax payable if James had died on 1 April 2018. **(15)**

(ii) State who will be liable to pay any Inheritance Tax due, as a result of James' death, and when it should be paid to avoid any penalties. **(3)**

(iii) Explain how any Inheritance Tax due, as a result of James' death, could be met if insufficient liquid assets are immediately available and what the consequences are of delayed payment. **(6)**

(b) Explain the rules in order for James' estate to qualify for the residence nil rate band. **(6)**

(c) With regard to the discretionary trust set up in May 2010 explain in detail:

(i) the tax treatment on the encashment of the onshore assurance bond; (*No calculation is required*.) **(9)**

(ii) the ongoing Income Tax treatment; **(8)**

(iii) the ongoing Capital Gains and Inheritance Tax treatment. **(7)**

(d) Explain the Stamp Duty Land Tax implications, assuming the trustees purchase the flat for Miles' future use. **(6)**

QUESTIONS CONTINUE OVER THE PAGE

(e) With regard to James' Will, explain the implications if he:

(i) dies without making a new Will; **(6)**

(ii) revokes his existing Will and dies before making a new one; **(3)**

(iii) makes a new Will now prior to marrying Lucy. **(3)**

(f) Explain the main duties of the solicitor when appointed as sole executor of James' new Will. **(8)**

Total marks 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.

Jon, aged 43, and Anna, aged 39, married in May 2005. They have two children for whom Anna receives Child Benefit. Jon is employed and has an annual salary of £52,000 gross per annum. Anna is employed in her father's business which he operates as a sole trader. Anna receives a salary of £38,000 gross per annum which is payable on the first day of each month, in addition to a pension contribution equivalent to 5% of her salary.

After they got married, Anna inherited a large sum of money which she used to repay their joint mortgage and invested the remainder. Jon has also built up some savings which are held in the joint instant access savings account. Their investments are as follows:

Owner	Investment	Current Value £	Income received in 2017/2018 £
Joint	Instant Access Savings	114,000	1,160
Anna	Cash ISA	123,000	1,150
Anna	Portfolio of Equity OEICs	130,000	2,600
Anna	Portfolio of corporate bond Unit Trusts	50,000	2,000

In addition to the above information, Anna has recently surrendered an onshore assurance bond. She invested £125,000 in June 2004 and since 1 June 2015 she has taken 5% of the original investment as an annual withdrawal.

On the 1 April 2018, Anna's father, Francis, was unable, for the first time, to pay the salaries or pension contributions for his employees. Anna has only just learned that the business is in serious financial difficulty and Francis may have to declare bankruptcy.

Anna's parents have lived in the same house for 20 years, which is currently worth £400,000, with a small mortgage of £15,000 outstanding. The property is held jointly as tenants in common. Francis has no further secured liabilities. His wife has recently lent him £30,000 to meet his short-term debts. Francis owes money to various firms for supplying him goods. He also has an outstanding Value Added Tax liability.

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 amount of Income Tax Anna will pay in the tax year 2017/2018. *Assume the assurance bond was encashed in July 2017 when the value was £169,950.* **(14)**

(b) Explain the impact of the high income Child Benefit tax charge on Jon and Anna in the tax year 2017/2018. **(5)**

(c) Explain briefly the financial actions Anna could have taken in the tax year 2017/2018 to reduce her Income Tax liability in that year. **(4)**

(d) **(i)** Outline the circumstances under which an employee could petition Francis for bankruptcy. **(7)**

(ii) List in order of priority, how the trustee in bankruptcy will settle Francis' debts, in the event of his bankruptcy. **(8)**

Total marks available for this question: 38

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.

Nelle, aged 46, is divorced and a higher-rate taxpayer. She lives in her own flat, currently worth £300,000 that she bought after her divorce.

Nelle has run her own printing business as a limited company for five years which she is intending to sell to pursue an alternative career. She has recently been offered full-time employment which would necessitate spending some time overseas.

Her business is comprised of a factory unit, machinery, stock, goodwill and the balance of her business account, which has accumulated over the past five years and currently stands at £200,000. The proposed sale of the business includes a storage unit which she used solely to house her personal belongings.

On 1 March 2018, Nelle received £500,000 from the sale of a house that she bought on the 1 April 2000, for £150,000, and lived in with her ex-husband until their separation on the 1 August 2010. As part of the divorce settlement, Nelle retained the house and from the date of separation the property has been let. The sale costs were £3,000 and she spent £1,500 on re-decorating two years ago. With the proceeds she is considering buying a smaller buy-to-let property.

Nelle, would like to know the tax implications of selling her residential rental property and her business assets and also understand how an Enterprise Investment Scheme might help with mitigating tax. She has no losses to carry forward and has a medium to high 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) **(i)** If Nelle works overseas, explain the circumstances in which she would be treated as automatically **non-resident** in the UK. **(5)**

(ii) List **four** of the factors that would be considered when determining residency using the sufficient ties test. **(4)**

(b) **(i)** Explain briefly the conditions that must be satisfied for entrepreneurs' relief to apply on the sale of Nelle's business. **(2)**

(ii) Explain briefly how entrepreneurs' relief will apply to each of the specific assets referred to as part of the sale of the business. **(3)**

(c) Calculate, **showing all your workings**, Nelle's Capital Gains Tax liability on the sale of her rental property. **(12)**

(d) Assuming that Nelle remains in the UK and has not taken up the employment offer, outline the **advantages** and **disadvantages** of Nelle investing in a smaller buy-to-let property and purchases it:

(i) directly; **(4)**

(ii) through a limited company. **(6)**

(e) Outline the relevant factors that would need to be considered when advising Nelle on whether an Enterprise Investment Scheme would be an appropriate investment for her. **(6)**

Total marks for this question: 42

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	£4,000

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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