Chartered Insurance Institute

AF2

Advanced Diploma in Financial Planning

Unit AF2 – Business Financial Planning

October 2020 Examination Guide

SPECIAL NOTICES

Candidates entered for the March 2021 examination should study this examination guide carefully in order to prepare themselves for the examination.

Practice in answering the questions is highly desirable and should be considered a critical part of a properly planned programme of examination preparation.

AF2 – Business Financial Planning

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IMPORTANT GUIDANCE FOR CANDIDATES

Introduction

The purpose of this Examination Guide is to help you understand how examiners assess candidates' knowledge and their ability to apply this to a case study scenario. You can then use this understanding to help you in your preparation for the examination.

Before the examination

Study the syllabus carefully
This is available online at www.cii.co.uk. All the questions in the examination are based directly on the syllabus. *You will be tested on the syllabus alone,* so it is vital that you are familiar with it.

There are books specifically produced to support your studies that provide coverage of all the syllabus areas, however you should be prepared to read around the subject. This is important particularly if you feel that further information is required to fully understand a topic or an alternative viewpoint is sought. The reading list which can be found with the syllabus provides valuable suggestions.

Note the assumed knowledge
For the Advanced Diploma in Financial Planning, candidates are assumed to have studied the relevant units of the Diploma in Financial Planning or the equivalent. This knowledge is set out on the relevant syllabus.

Read widely
If you do not have experience in advising clients whose financial needs are relatively sophisticated, *it is quite unrealistic to expect that the study of a single textbook will be sufficient to meet all your requirements.* While books specifically produced to support your studies will provide coverage of all the syllabus areas, you should be prepared to read around the subject. This is important, particularly if you feel that further information is required to fully understand a topic or an alternative viewpoint is sought. It is vital that your knowledge is widened beyond the scope of one book. The reading list which can be found with the syllabus provides valuable suggestions.

Make full use of the Examination Guide

This Examination Guide contains a full examination paper and model answers. The model answers show the types of responses the examiners are looking for and which would achieve maximum marks, *however, you should note that there are alternative answers to some question parts which would also gain high marks.* For the sake of clarity and brevity not all of these alternative answers are shown.

This guide and previous Examination Guides can be treated as 'mock' examination papers. Attempting them under examination conditions as far as possible, and then comparing your answers to the model ones, should be seen as an essential part of your exam preparation. The examiner's comments on candidates' actual performance in each question provide further valuable guidance. You can obtain copies of the two most recent examination guides free of charge at www.cii.co.uk.

Know the layout of the tax tables

Familiarise yourself with the information contained within the tax tables printed at the back of each Examination Guide. These tax tables will be provided to candidates as part of the examination paper. The tax tables enable you to concentrate on answering the questions without having to worry about remembering all the information. *Please note that you are not allowed to take your own tax tables into the examination.*

Know the structure of the examination
Assessment is by means of a three-hour written paper in two sections. All questions are compulsory:

Section A consists of one case study, worth 80 marks. You will be expected to carry out a variety of tasks, after analysing the information provided.

Section B consists of two shorter case studies worth a total of 80 marks. Again you will be expected to carry out a variety of tasks based upon the information provided.

Each question part will clearly show the maximum marks which can be earned.

Appreciate the standard of the examination
Candidates must demonstrate that they are capable of advising clients *whose overall levels of income and capital require a more sophisticated scheme of investment* than is normally prepared by a level 4 qualified adviser. These clients require a critical appraisal of the various financial planning options available to them.

Read the Assessment information and Exam policies for candidates
The details of administrative arrangements and the regulations which form the basis of your examination entry are available online at www.cii.co.uk/qualifications/assessment-information/introduction/. This is *essential reading* for all candidates.

In the examination

The following will help:

Spend your time in accordance with the allocation of marks:

- The marks allocated to each question part are shown on the paper
- If a question has just two marks allocated, there are likely to be only one or two points for which the examiner is looking for, so a long answer is wasting valuable time.
- Conversely, if a question has 12 marks allocated, a couple of lines will not be an adequate answer. Always remember that if the paper is not completed, your chances of passing will be reduced considerably.
- Do not spend excessive time on any one question; if the time allocation for that question has been used up, leave some space, go on to the next question and return to the incomplete question after you have completed the rest of the paper, if you have time.

Take great care to answer the question that has been set.

- Many candidates finish the examination confident that they have written a 'good' paper, only to be surprised when they receive a disappointing result. Often, the explanation for this lies in a failure to think carefully about what the examiner requires before putting pen to paper.
- Highlighting key words and phrases is a technique many candidates find useful.
- The model answers provided in this Examination Guide would gain full marks. Alternative answers that cover the same points and therefore answer the question that has been asked would also gain full marks.

Tackling questions

Tackle the three questions in whatever order feels most comfortable. Generally, it is better to leave any questions which you find challenging until you have attempted the questions you are confident about. Candidates' should avoid mixing question parts, (for example, 1(a)(i) and (ii) followed by 2(b)(ii) followed by 1(e)(i)) as this often leads to candidates unintentionally failing to fully complete the examination paper. This can make the difference between achieving a pass or a narrow fail.

It is vital to label all parts of your answer correctly as many questions have multiple parts to them (for example, question 1(a) may have parts (i), (ii) and (iii)). Failure to fully distinguish between the separate question parts may mean that full credit cannot be awarded. It is also important to note that a full answer must be given to each question part and candidates should not include notes such as 'refer to answer given in 1(b)(i)'.

Answer format

Unless the question requires you to produce an answer in a particular format, such as a letter or a report, you should use 'bullet points' or short paragraphs. The model answers indicate what is acceptable for the different types of question.

Where you are asked to perform a calculation it is important to show **all** the steps in your answer. The majority of the marks will be allocated for demonstrating the correct method of calculation.

Marks are not lost due to poor spelling or grammar.

You are able to flag questions and then go back to them.

Calculators

The calculator is in a pop-up box on the right-hand side of the interface. It is important to show all steps in a calculation, even if you have used a calculator.

EXAMINERS' COMMENTS

Candidates overall performance

This advanced paper focuses on the application of knowledge gained through previous study, not on pure knowledge recall. Many less-well prepared candidates attempted answers in terms of recall of knowledge. The case studies provided in this advanced paper are designed to make candidates think about the real-world consequences of the issues highlighted in the questions.

Candidates who spent sufficient time learning the subject material and preparing for the exam demonstrated good knowledge and application in this paper, as many topics have been examined in previous examinations. Questions one and three were adequately answered by most candidates but question two was poorly answered by the majority of candidates, despite the topics having been examined previously.

Candidates generally performed well in the calculation parts of the questions although some steps in certain calculations were performed incorrectly by the majority of candidates, in particular, the treatment of the taxation of dividends and the dividend allowance and the application of VAT and stamp duty land tax. Many candidates failed to show each step of the calculation as stated in the question and so lost marks when they did not need to.

The model answers provided in the exam guides can be particularly helpful for calculation questions, as these will set out the steps the examiners are looking for and provide a template for answering these types of question.

The case studies provided in the examination paper contain relevant information which should be used when constructing answers. Candidates must allow sufficient time in the exam to read the case study and identify the key factors which will then help them answer the questions set.

Candidates missed marks as they did not relate their answers to the case study, and instead provided generic answers and this was apparent in candidate answers to question two. Candidates could have gained additional marks where they used the information in the case study to justify their answers.

Question 1

The topic in part (a) has been examined many times previously, and in general, better prepared candidates answered this question part quite well.

Candidates knowledge on crowdfunding was generally good on this question part with prepared candidates scoring well in both parts of the question.

The less well-prepared candidates struggled to answer both parts of this question and in part (b)(ii) concentrated on qualitative aspects of company accounts rather than on the structural aspects.

The first part of question (c) was answered well by those candidates who had prepared for this type of calculation. The less well-prepared candidates made a number of common errors which included not allowing for the Corporation Tax and for not deducting the dividend allowance from the basic rate band. Although they did deduct the dividend allowance in their calculations, it was not done in the correct way. A few candidates also did not apply the correct rate of tax and used basic rate tax instead of the dividend tax rate.

Most candidates struggled with part (d)(i) of this question and could not detail the requirements for a partnership closing down. Many concentrated on the transfer of the partnership to the limited company rather than on the taxation aspects of the partnership.

Part (d)(ii) was adequately answered by the majority of candidates although many candidates did not mention that they would need to choose a year end date. Many candidates also outlined the dates for the payment of corporation tax when this was not required as the question specifically asked for the steps they should take at outset, that is, when the new company is initially set up. This question was about tax affairs, yet many candidates gave answers that related to the formation of a new company and did not answer the question asked.

Part (e)(i) was generally answered satisfactorily by most candidates. However, many candidates could state that the protection would fall under the TUPE regulations but could not then go on to state what those regulations entailed.

Part (e)(ii) has been examined multiple times before and candidates answered this part reasonably well in general. However, candidates did not make enough differentiation on the liabilities of the partnership and, in particular, on Don as a continuing partner, and included Julie as liable when she was not a partner of the previous business.

Part (f)(i) of this question was reasonably well answered by most candidates. Many candidates went into unnecessary detail regarding shareholder agreements which was not required in this part.

In part (f)(ii) many candidates missed that Don would have continuing ownership and so would still qualify for business relief. In regard to Julie, while most mentioned that if she died within two years her estate would be liable for inheritance tax, they did not go on to elaborate that this would be paid on the value in excess of the nil rate band or that it could benefit from spousal exemption if it passed to her wife.

In part (f)(iii) the part most often missed was equalisation of premiums although in other respects candidates answered this part well.

Most candidates answered question (g) well although some went into unnecessary detail in terms of classifying eligible, noneligible and entitled workers, or detailing the requirements for a qualifying workplace pension. The point most often missed by candidates was that the scheme should be able to accept transfers from the partnership's employees' pensions.

Question 2

Part (a) was answered well by candidates who knew the correct formula to use. The main error candidates made was including the interest payment in the deductions. Chapter 4 of the J03 study text states that interest, tax and dividends are excluded from operating expenses.

It is possible that candidates only saw the word pre-tax and confused this with profit before tax, which would require the deduction of the interest payments.

Surprisingly, many candidates did not comment on the trend, as asked in the question. Where candidates did comment on the trend, they tended to explain the figures in words or just stated that profitability had dropped rather than giving a simple reason for the downward trend.

In part (b) the current ratio was correctly calculated by the majority of candidates although the creditor days ratio and the gearing ratio were not so well answered. In many instances where the ratios were required, candidates gave percentages for part (b)(i). Where percentages were required, candidates gave ratios for part (b)(iii). It can be confusing to interpret the word ratio correctly so candidates need to know these ratios verbatim so they can correctly provide either a figure or a percentage as required by the ratio being calculated.

Candidates also struggled to adequately explain the meaning of the ratios for the company.

Part (c) was not well answered by candidates, who gave generic answers and did not relate the answer back to the case study. Many candidates gave an explanation of wrongful trading and the penalties rather than answering the question that was asked. Many candidates gave business management solutions, which were not required. This part was also confused with the process of administration by some candidates.

Better prepared candidates were able to answer this question part (d) quite well and gave the salient points of a member's voluntary liquidation and related back to the case study and the ratios calculated. Many candidates answered this question without any reference to the key steps of a member's voluntary liquidation and gave subjective answers or presented solutions to this part which were not required.

Part (e) was well answered by many candidates although a lot of candidates still continue to confuse administration and compulsory liquidation. Many candidates stated the steps for a compulsory liquidation or creditors voluntary liquidation rather than answering the question that was asked.

Question 3

Part (a) was poorly answered by most candidates. Candidates showed a general lack of knowledge in this area with many answering the question with SSAS rules or with HM Revenue and Customs rules for SIPP property investment. Many candidates also stated rental requirements rather than purchase requirements and answered the question generically rather than relating their answer back to the case study.

Most candidates stated the possibility of an unauthorised payment but not necessarily why this was the case as they did not mention the connection between brother and sister.

Where candidates stated there would be an unauthorised payment, they generally stated that this was because it broke the residential property rules.

Where candidates mentioned the unauthorised payment for the correct reason, they did not state that the tax would be on the difference between the market value of the investment and the amount actually paid.

Part (b) was generally well answered by most candidates. The most common error was omitting to include the VAT calculated in the Stamp Duty Land Tax calculation.

Many candidates did not show all the steps in the working out to their answer and so did not gain the marks that they could have gained. Candidates must lay out the relevant steps to the calculation, no matter how obvious, to gain full marks.

In general, part (c)(i) one was answered well. The main error made by candidates was not deducting the £60,000 loan twice, at relevant stages.

In part (c)(ii) candidates correctly stated that there was enough money in the pension funds to buy the property but forgot to factor in the costs of the property purchase. Candidates who did remember the additional costs went on to give the additional methods by which the shortfall could be addressed subject to annual allowance and available carry forward, if necessary.

The topic in part (d) has been examined several times in the past. The better prepared candidates managed to do well on this question part.

On the whole, part (e) was answered reasonably well by the majority of candidates who stated when corporation tax would be payable and any relief from Corporation Tax that could be expected. However, many candidates approached this question as a purchase and the use of capital allowances (which is rather limited) rather than referring to the Corporation Tax implications for the ownership of the premises.

Unit AF2 – Business financial planning

Instructions to candidates

Read the instructions below before answering any questions.

All questions in this examination are based on English law and practice applicable in the tax year 2020/2021, 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.

- **Please write down the following number +44 (0)80 8273 9244 this is the number to use if your system freezes or you get forced out of your exam. It is fine to phone it if you have these issues.**
- **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, **both sets of questions are compulsory.**
- 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.
- The calculator is in a pop-up box on the right-hand side of the interface. It is important to show all steps in a calculation, even if you have used a calculator.
- Tax tables are provided at the right-hand side of the interface.
- For each answer, please type in the full question number you are answering e.g. **1a**
- **Please note each answer must be typed in the correct corresponding answer box.**
- Have you shown your ID during the ID check? If not, show it to the camera now please.
  Did you show the edge of your screen with a mirror during the room scan? If not, use a mirror to show it now please.

- If you have blank paper for notes, did you show both sides to the camera? If not, show both sides to the camera now please.

Subject to providing sufficient detail you are advised to be as brief and concise as possible, using note format and short sentences.

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.

Donneil Printing is run as a partnership by Don, aged 55, and his business partner Neil. The partnership will soon be dissolved as Neil wishes to retire and realise his share of the partnership. The partnership has no long-term liabilities.

Don intends to continue the business and will be joined by Julie, aged 32, a long-standing colleague. The business has five full time employees, all over the age of 25 and all of whom have been with the firm for more than three years. They will be taking on three new employees.

Julie does not wish to enter into a partnership with Don and would prefer the business to be run as a limited company. Julie is aware of the limitations of a partnership and would like the benefits provided by a limited company. Julie will be investing £100,000 of her own money into the business to mirror the value of Don's equity in the partnership. Don's equity in the partnership will transfer to the new company in exchange for shares in the new company. They will both be equal shareholders. The formalities of transferring the business to a limited company have been agreed between all three parties.

Don and Julie have plans to expand the business which will require additional capital of £80,000. Julie owns her own house valued at £350,000, with her wife Jenny, on which they owe £95,000. Don is currently in rented accommodation and has no surplus funds.

They are projecting a gross profit for the business of £125,000 in the first trading period ending on 31 March 2021. As Julie will be investing much of her own money in the business, she wants to protect her investment in case of death or illness of either herself or Don, although Don cannot see such a need.

Julie is aware that the company must provide a pension scheme for all its staff and has asked for your advice on providing an auto-enrolment pension scheme.

Question 1

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

(a) Explain briefly to Don and Julie **five** benefits and **five** drawbacks of trading as a limited company rather than a partnership under the Partnership Act 1890. **(10)**

(b) Julie is considering crowdfunding as well as traditional lenders as a method of raising finance for the new business.

(i) State the **three** main methods of crowdfunding and provide **one** characteristic of **each** method. **(6)**

(ii) State **three** reasons why providers of finance might prefer to deal with a limited company rather than a partnership. **(3)**

(c) Julie is considering her remuneration options. Assuming a gross profit of £125,000:

(i) calculate, **showing all your workings**, Julie's net income, if she takes her share as a dividend in the tax year 2020/2021. Julie will have no other taxable income; **(9)**

(ii) explain briefly to Julie why it is preferable for her remuneration to be taken as salary plus a dividend rather than a dividend alone. **(5)**

(d) Describe briefly to Don and Julie:

(i) the tax treatment that is applied to a partnership that has transferred its business into a limited company; **(4)**

(ii) the steps the new limited company must take at outset with regard to its tax affairs. **(4)**

(e) **(i)** Identify and outline the principal effect of the legal protection the employees will receive when the partnership business is transferred to the new limited company. **(3)**

(ii) Explain to Don and Julie the responsibilities and liabilities the regulations you have identified in **part (e)(i)** above will place on them on the transfer of the partnership business to the limited company. **(7)**

(f) Explain to Don and Julie, in relation to the new limited company:

(i) the issues that may arise if either were to die without appropriate shareholder protection planning in place; **(8)**

(ii) the Inheritance Tax position of their shares in the new limited company should either die during the first two years of trading, or at a later date; **(8)**

(iii) the options and implications for the payment of the premiums, assuming that they each effect an own life policy as part of a shareholder protection arrangement. **(5)**

(g) Explain to Don and Julie the key requirements and implications for the new limited company of pension auto-enrolment. **(8)**

Total marks available for this question: 80

SECTION B

Both questions in this section are compulsory and carry an overall total of 80 marks

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.

Dutonic Ltd is a company that produces electronic equipment and employs 20 people full time. Steven and Keir are shareholding directors of the company. It expanded very quickly and moved into larger premises two years ago borrowing £295,000 on a secured basis from Allco Bank to fund the purchase. Since the company took out the loan for the purchase of the property, the business has not met profit expectations. Over recent months the company has increased its overdraft with the bank and the directors have had to give personal guarantees.

Keir has become increasingly concerned about the company's financial position. He is also concerned that the company has missed nine months' worth of employer pension contributions to the group personal pension plan set up for employees. He previously worked in a legal firm dealing with bankruptcy and has some knowledge of the legal position and wishes to avoid a compulsory liquidation.

Dutonic Ltd

Profit and loss account

	Year end 31 October 2019 (£)	Year end 31 October 2020 (£)
Sales revenue	690,000	395,000
Cost of goods sold	280,000	212,000
Promotion expenses	28,000	38,000
Salaries	245,000	260,000
Administration costs	20,000	25,000
Interest on loans	19,500	28,300

Dutonic Ltd

Balance sheet

	as at 31 October 2019 (£)	as at 31 October 2020 (£)
Fixed assets		
Buildings	390,000	390,000
Machinery	30,000	19,000
	420,000	**409,000**
Current assets		
Cash	25,000	6,000
Stock	25,000	9,000
Debtors	56,000	36,000
	106,000	**51,000**
Current liabilities		
Bank overdraft	19,000	52,000
Creditors	38,000	76,000
	57,000	**128,000**
Long term liabilities		
Commercial mortgage	295,000	270,000
Net assets	184,000	72,000
Financed by:		
Share capital	10,000	10,000
Shareholder retained profit	174,000	62,000
	184,000	**72,000**

Question 2

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 pre-tax operating profit or loss for the financial years ending October 2019 and 2020 and comment on the trend. **(5)**

(b) Calculate, **showing all your workings**, the following ratios, for the financial years ending October 2019 and 2020:

(i) the current ratio; **(3)**

(ii) creditor days ratio; **(3)**

(iii) the gearing ratio. **(3)**

(iv) Explain briefly the significance for the company of **each** of the ratios that you have calculated in **part (b)** above. **(9)**

(c) With full knowledge of the company's financial position, Steven and Keir wish to continue trading.

Explain briefly how Steven and Keir can prevent charges of wrongful trading if they continue trading. **(5)**

(d) Steven and Keir are considering a members' voluntary liquidation.

Explain why this may not be an option for them. **(6)**

(e) Describe how the process of administration could help the company to avoid compulsory liquidation. **(6)**

Total marks available for this question: 40

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.

Bridget and Hans are directors of a floristry business called Flowers for all Ltd. They set up the business in 2014. They currently have one shop but now wish to expand and buy a second shop in a nearby town. They have found suitable commercial premises with a purchase price of £290,000. They will also have to pay VAT and Stamp Duty Land Tax. This shop currently belongs to Bridget's brother Ciaran.

Both Bridget and Hans have Self-Invested Personal Pensions (SIPPs). Bridget used her SIPP to buy the first shop and this is rented to the business for £18,000 a year. The new premises are much bigger than they need, and they will initially sub-let part of it. Bridget's SIPP is made up of the first shop that has a value of £250,000 and £150,000 held in cash and other assets. She has borrowings within her SIPP of £60,000. Hans' SIPP is invested in cash and various collective investments and has a current value of £205,000.

Question 3

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

(a) Explain the HM Revenue and Customs requirements for the purchase of the new shop premises, via their SIPPs, and the consequences if the requirements are not met. **(6)**

(b) **(i)** Calculate, **showing all your workings**, from the information provided, the costs Bridget and Hans will incur in the purchase of the new property. **(6)**

(ii) State the additional fees they may incur with the property purchase via their SIPPs. **(3)**

(c) **(i)** Calculate, **showing all your workings**, the total amount Bridget and Hans can borrow using their SIPPs. **(7)**

(ii) Calculate, **showing all your workings**, the shortfall in their SIPP funds to purchase the property, and describe briefly how the shortfall can be made up to finance the property purchase. **(7)**

(d) State **seven** advantages of buying the new shop through Bridget and Hans SIPPs. **(7)**

(e) Explain briefly the impact on Corporation Tax if the new shop is purchased through the limited company. **(4)**

Total marks available for this question: 40

NOTE ON MODEL ANSWERS
The model answers given are those which would achieve maximum marks. However, there are alternative answers to some question parts which would also gain high marks. For the sake of clarity and brevity not all of these alternative answers are shown. An oblique (/) indicates an equally acceptable alternative answer.

Model Answer for Question 1

(a) *Candidates would have gained full marks for any five of the following:*

Benefits:
- It is generally easier to raise capital.
- Don and Julie will both benefit from limited liability;
- debts of the company can only be claimed against the company.
- Limited company has perpetual succession and is not dissolved on death of the shareholder.
- More flexible remuneration options such as retaining profits to delay personal tax.
- Payment of dividends can reduce personal Income Tax/National Insurance.
- Better state social security entitlement.

Candidates would have gained full marks for any five of the following:

Drawbacks:
- National Insurance payable by both employer and employee.
- There are more formalities and more expense involved in establishing and running a limited company.
- Dividend payments require a profit.
- Lack of confidentiality/memorandum and articles are public documents.
- Don and Julie have legal obligations as directors.
- Public disclosure of accounts is required.

(b) (i) *Candidates would have gained two marks for any two of the following:*
- Donation/reward crowdfunding.
- Donors have a social or personal motivation forgiving money;
- generally will not receive any monetary reward;
- may receive free gifts or regular news updates.

Candidates would have gained two marks for any two of the following:
- Loan-based crowdfunding/peer-to-peer (P2P) lending.
- Investors receive their money back plus interest.
- No restrictions on the type of project or the amount of money that can be raised.

- Investment-based crowdfunding.
- People invest in an opportunity, business or project in return for shares or a small stake in the business or project.

(b) (ii)
- Continuity of management.
- Company can be sued as a separate entity.
- Can give security for borrowings by fixed/floating charges over company assets.

(c) **(i)**
- Net Profit £125,000 less (£125,000@ CT 19% = 23,750) = £101,250
- Julie's Gross dividend £101,250/2 = £50,625
- Taxable Dividend £50,625 less PA £12,500
- = £38,125
- First £2,000 @ 0%
- Next £35,500 x 7.5% = £2,662.50
- Next £625 x 32.5% = £203.13
- Total tax = £2,865.63
- Total after tax dividend = £50,625 - £2,865.63 = £47,759.38

(ii) *Candidates would have gained full marks for any five of the following:*
- A salary is an allowable business expense for Corporation Tax purposes/a dividend is not an allowable expense.
- A salary can be used for pension purposes/dividend not pensionable.
- A salary may be needed for income related private benefits e.g., mortgage, PHI etc;
- and for National Insurance contributions to count towards State Pension and other State Benefits.
- Salary is not dependent on profits.
- Salary + dividend may lead to an overall lower tax liability.

(d) **(i)** *Candidates would have gained full marks for any four of the following:*
- Don will need to complete a set of accounts to the date of cessation of the partnership;
- In order to calculate his assessable profit using closing year rules;
- from which he can deduct any overlap profit from his opening years;
- for his final partnership return.
- Any realised gains can be brought into account or elected to be held over/may benefit from Incorporation Relief.

(ii)
- Don and Julie have to register the new company for Corporation Tax and select a year end date.
- A new PAYE scheme will need to be set up for the limited company.
- Register/re-register in company's name for VAT.

(e) **(i)**
- Transfer of Undertakings (Protection of Employment) regulations 2006/TUPE Regulations will guarantee an employee's right to continued employment on the existing terms and conditions with the new employer.

(ii) *Candidates would have gained full marks for any seven of the following:*
- Don must inform each employee of the proposed transfer;
- and consult with them regarding details of the transfer.
- Don is obliged to provide the new company with full details of each employee and relevant details of their service/terms and conditions/disputes.
- If Don follows the correct procedures, he will be absolved of any responsibilities which are assumed in full by the new business.
- If procedures are not followed, employees can claim compensation from the tribunal.
- The awards of which are made jointly against both Don as the previous owner;
- and the limited company (Don and Julie) as the new employer.

- Any employee who refuses to be transferred will be deemed to have resigned;
- and consequently, there is no liability on the company for dismissal or redundancy.

(f) **(i)**

- If either one died, their shares would go to their spouse/family/ beneficiaries;
- ownership by a beneficiary or third party could lead to business problems;
- As there may not be a ready market for selling the shares, either the company or other shareholder will need to purchase them
- There is no agreement in place for the surviving shareholder to buy the shares from the estate/beneficiaries or for beneficiaries to sell to the surviving shareholder.
- The company may not have sufficient cash and retained profit to make the purchase and the other shareholder may not have sufficient resources to buy the shares.
- Therefore, beneficiaries could lose out financially;
- unless beneficiaries could sell the shares to a third party (if one could be found).

(ii)

- If Julie should die within the next two years her estate would be liable for Inheritance Tax on her business assets in excess of the nil rate band or exempt through spouse exemption as she would have no Business Relief in the 1st two years;
- Don may qualify for Business Relief as he transferred the assets of an existing business to the limited company.

- When they have held the shares for two years or more.
- As they will have shareholdings in a trading unquoted company
- They will benefit from 100% Business Relief;
- providing there is no binding contract for sale in place at time of death.

(iii) *Candidates would have gained full marks for any five of the following:*

- The company can pay the premiums.
- Which will be treated as remuneration/P11D benefit.
- They can each pay their own premium out of non-increased salary;
- or increase Directors salary to cover the costs of the life policy;
- and the extra tax and National Insurance they will suffer.
- Directors could agree equalisation of premiums (because of age difference);
- so each pays an amount related to benefit received and does not fall foul of HM Revenue and Customs rules.

(g) *Candidates would have gained full marks for any eight of the following:*

- The new company must communicate with all staff about the scheme.
- They must assess their workforce to determine who is eligible.
- The new company must automatically enrol eligible staff/no action required by staff.
- Into a qualifying workplace pension scheme;
- and both employer and employee must meet minimum funding criteria.
- Which means that employers will have to budget for the increased costs.
- If employees opt out the employer has to re-auto-enrol the employee at the three-year anniversary.
- The employer must have a back-office administration system/outsource to cope

with auto-enrolment rules and tests.
- The new company pension scheme may need to accept transfers from the partnership's employees' pension entitlements.
- Must register the scheme with the Pension regulator.

Model Answer for Question 2

(a) **2019**

- Sales 690,000
- Less (280,000 + 28,000 +245,000 + 20,000)
- = profit of 117,000 (ft)

2020
- Sales 395,000
- Less (212,000 + 38,000 + 260,000 + 25,000) = loss of 140,000.
- Trend from an operating profit to a loss of 140,000 and shows the business's trading activities have worsened over the year.

(b) **(i)** **The current ratio**
2019
- (Current Assets 106,000/current Liabilities 57,000)
- = 1.86

2020
- 51,000/128,000 = 0.40

(ii) **The creditor days ratio**
2019
- (Creditors £38,000/cost of goods sold £280,000) x 365
- = 49.5 days

2020
- (£76,000/£212,100) x 365 = 130.8 days

(iii) **The gearing ratio**
2019
- (loans 295,000/shares + reserves 184,000)
- = 1.6 x 100% = 160%

2020
- 270,000/72,000 = 3.75 x 100% = 375%

(b) (iv) The current ratio

- The result shows whether the company has enough stock and cash to meet its immediate liabilities;
- In 2020 it has dropped below 1.
- Which shows the company has insufficient working capital to finance operations.

The creditor days ratio

- The ratio measures the average time it takes to pay suppliers for goods.
- The company has doubled this period;
- and is effectively using its suppliers to finance working capital deficit.

The gearing ratio

- The company is highly geared in 2020, more than doubling from 2019.
- This indicates that it has significant problems and could be approaching insolvency;
- and is likely to lose the support of its creditors.

(c)

- As they know current assets are low;
- and there is a chance that the company could become insolvent and may not meet liabilities.
- They must take steps to minimise loss to creditors;
- such as seek a bigger temporary overdraft from the bank to continue trading;
- or apply for a company voluntary arrangement.

(d) *Candidates would have gained full marks for any six of the following:*

- The directors must be able to give a statutory declaration;
- within five weeks of the winding up resolution being passed;
- that the company is solvent;
- and able to pay all debts within a period not exceeding 12 months.
- as the ratios show, this is unlikely to be the case;
- so the directors cannot give this declaration right away;
- and creditors may opt for a compulsory liquidation.

(e)

- The administrator must attempt to rescue the company as a going concern.
- The administrator may sell property to pay off one creditor if the interests of other creditors were not harmed.
- There will be a moratorium staying all creditor actions for a period of time,
- this will enable the business to continue trading.
- Potentially trading their way out of financial difficulties/sell assets/redundancies.
- Facilitate orderly wind down to achieve better outcomes for creditors than compulsory liquidation.

Model Answer for Question 3

(a)

- The purchase will be a connected purchase with a connected party (Ciaran is Bridget's brother) but is allowed if conditions are met.
- The transaction must be carried out on an 'arm's length/commercial basis' i.e., bought at the market rate that would apply to an 'arm's length purchase'.
- The property will need to be independently valued to confirm that a fair market value is being paid.
- If the transaction is not on a commercial basis the schemes will have made an unauthorised payment.
- They will have to pay tax on the difference between the market value of the investment and the amount paid.

(b) (i)

- VAT - £290,000 x 20%
- = £58,000 = £348,000
- Stamp Duty Land Tax will be: Up to £150,000 x 0%,
- next £100,000 at 2% = £2,000
- and £98,000 at 5% £4,900
- = total of £6,900 Total cost so far £354,900

(ii)

- SIPP property purchase fees and annual fees.
- Advice/accountancy fees.
- Legal/valuation fees.

(c) (i)

- Bridget = £400,000 - £60,000
- = £340,000 x 50%
- = £170,000 - £60,000
- = max borrowing of £110,000
- Hans = £205,000 x 50%
- = max borrowing = £102,500
- They can borrow £102,500 + £110,000 = £212,500

Alternative method for (c)(i)

Existing fund - loan = X
loan/X ×100% = Y %
(50% - Y %) × X = amount available to borrow

400,000-60,000 = 340,000
60,000÷340,000 ×100% = 17.647%
50% -17.647% = 32.353%
32.353% ×340,000 = 110,000

(ii) *Candidates would have gained full marks for any seven of the following:*

- They have £205,000 and £150,000 = £355,000 still in their SIPP funds;
- this will be sufficient to cover the purchase price but not additional fees.
- They can borrow funds to cover the shortfall;
- or they can increase SIPP funds by;
- additional tax relievable pension contributions.
- These can be made by the company.
- Or using their personal funds;
- Subject to the annual allowance;
- and any available carry forward.

(d) *Candidates would have gained full marks for any seven of the following:*

- Cost of the property is effectively reduced by tax relief on the pension contributions.
- Rent they pay is not subject to income tax within the SIPP.
- Rent qualifies as an allowable business expense/reduces tax on profits.
- Rent increases the size of their pension funds.
- The rent does not impact their annual allowances.
- Potential for growth on the property which will be CGT free.
- Asset protected should bankruptcy occur/cannot be touched by creditors.
- The SIPP can be registered for VAT, so this can be reclaimed.
- Outside estate for IHT purposes.
- Pension fund will be tax free if death occurs before 75.

(e)

- They would not have to pay rent, so this is not available to reduce profits, which increases their Corporation Tax.
- Any borrowings would receive Corporation Tax relief.
- If they sublet part of the building the rental income will be subject to Corporation Tax.
- Any future gain on the property would be potentially taxable to corporation tax.

All questions in the March 2021 paper will be based on English law and practice applicable in the tax year 2020/2021, unless stated otherwise and should be answered accordingly.

The Tax Tables which follow are applicable to the October 2020 and March 2021 examinations.

INCOME TAX

RATES OF TAX	2019/2020	2020/2021
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	£37,500	£37,500
Threshold of taxable income above which additional rate applies	£150,000	£150,000
Child benefit charge:		
1% of benefit for every £100 of income over	£50,000	£50,000

*Only applicable to savings income that falls within the first £5,000 of income in excess of the personal allowance

Dividend Allowance		£2,000
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) *§*	£12,500	£12,500
Married/civil partners (minimum) at 10% *†*	£3,450	£3,510
Married/civil partners at 10% *†*	£8,915	£9,075
Marriage Allowance	£1,250	£1,250
Income limit for Married Couple's Allowance*†*	£29,600	£30,200
Rent a Room scheme – tax free income allowance	£7,500	£7,500
Blind Person's Allowance	£2,450	£2,500
Enterprise Investment Scheme relief limit on £2,000,000 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.
*** Investment above £1,000,000 must be in knowledge-intensive companies.*

Child Tax Credit (CTC)		
- Child element per child (maximum)	£2,780	£2,830
- family element	£545	£545
Threshold for tapered withdrawal of CTC	£16,105	£16,385

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	Weekly
Lower Earnings Limit (LEL)	£120
Primary threshold	£183
Upper Earnings Limit (UEL)	£962

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS
Up to 183.00*	Nil
183.00 – 962.00	12%
Above 962.00	2%

**This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £120 per week. This £120 to £183 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 169.00**	Nil
169.00 – 962.00	13.8%
Excess over 962.00	13.8%

*** Secondary earnings threshold.*

Class 2 (self-employed)	Flat rate per week £3.05 where profits exceed £6,475 per annum.
Class 3 (voluntary)	Flat rate per week £15.30.
Class 4 (self-employed)	9% on profits between £9,500 - £50,000. 2% on profits above £50,000.

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
2018/2019	£1,030,000
2019/2020	£1,055,000
2020/2021	£1,073,100

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.

ANNUAL ALLOWANCE

TAX YEAR	ANNUAL ALLOWANCE
2015/2016	£40,000~
2016/2017	£40,000*
2017/2018	£40,000*
2018/2019	£40,000*
2019/2020	£40,000*
2020/2021	£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 by £1 for every £2 of 'adjusted income' over £240,000 to a minimum of £4,000 if 'threshold income' is also over £200,000.*

MONEY PURCHASE ANNUAL ALLOWANCE	2019/2020	2020/2021
	£4,000	£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	2019/2020	2020/2021
Individuals, estates etc	£12,000	£12,300
Trusts generally	£6,000	£6,150
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%
	10%	10%
Business Asset Disposal Relief* – Gains taxed at:		
Lifetime limit	£10,000,000	£1,000,000

**For trading businesses and companies (minimum 5% employee or director shareholding) if held for at least two years.*

INHERITANCE TAX

RATES OF TAX ON TRANSFERS	2019/2020	2020/2021
Transfers made on death		
- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
Transfers		
- 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

	2019/2020	2020/2021
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*	£150,000	£175,000
- 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.*

	2019/2020	2020/2021
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%

PRIVATE VEHICLES USED FOR WORK

	2019/2020 Rates	2020/2021 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

	2019/2020	2020/2021
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£1,000,000	£1,000,000
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	6%	6%
Energy & water-efficient equipment	100%	100%
Zero emission goods vehicles (new)	100%	100%
Electric charging points	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:	50 or less*	51-110	111 or more
Capital allowance:	100% first year	18% reducing balance	6% reducing balance

**If new*

MAIN SOCIAL SECURITY BENEFITS

		2019/2020	2020/2021
		£	£
Child Benefit	First child	20.70	21.05
	Subsequent children	13.70	13.95
	Guardian's allowance	17.20	17.90
Employment and Support Allowance	Assessment Phase		
	Age 16 - 24	Up to 57.90	Up to £58.90
	Aged 25 or over	Up to 73.10	Up to £74.35
	Main Phase		
	Work Related Activity Group	Up to 102.15	Up to 74.35
	Support Group	Up to 111.65	Up to 113.55
Attendance Allowance	Lower rate	58.70	59.70
	Higher rate	87.65	89.15
Basic State Pension	Single	129.20	134.25
	Married	201.45	268.50
Single Tier State Pension	Single	168.60	175.20
Pension Credit	Single person standard minimum guarantee	167.25	173.75
	Married couple standard minimum guarantee	255.25	265.20
	Maximum savings ignored in calculating income	10,000.00	10,000.00
Bereavement Support Payment	Higher rate – First payment	3,500.00	3,500.00
	Higher rate – monthly payment	350.00	350.00
	Lower rate – First payment	2,500.00	2,500.00
	Lower rate – monthly payment	100.00	100.00
Jobseeker's Allowance	Age 18 - 24	57.90	58.90
	Age 25 or over	73.10	74.35
Statutory Maternity, Paternity and Adoption Pay		148.68	151.20

CORPORATION TAX

	2019/2020	2020/2021
Standard rate	19%	19%

VALUE ADDED TAX

	2019/2020	2020/2021
Standard rate	20%	20%
Annual registration threshold	£85,000	£85,000
Deregistration threshold	£83,000	£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%

Important note: For residential properties purchased between 8th July 2020 and 31st March 2021, Stamp Duty Land Tax does not apply up to £500,000. For purchases above £500,000, the band rates above apply as normal. Additional SDLT rules still apply as below.

Stamp Duty Land Tax (SDLT) is payable in England and Northern Ireland only. Land Transaction Tax (LTT) is payable in Wales and Land and Buildings Transaction Tax (LBTT) is payable in Scotland. The rates for LTT and LBTT are different to the rates shown above.

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

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

First-time buyers benefit from SDLT relief on purchases up to £500,000 when purchasing their main residence. On purchases up to £300,000, no SDLT is payable. On purchases between £300,000 and £500,000, a flat rate of 5% is charged on the balance above £300,000.

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