Chartered
Insurance
Institute

AF2

Advanced Diploma in Financial Planning

Unit AF2 – Business Financial Planning

March 2021 Examination Guide

SPECIAL NOTICES

Candidates entered for the May 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

Contents

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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.

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. Instead, they provided generic answers and this was apparent in candidate answers.

In many question parts which require a straightforward answer, candidates continue to provide solutions when these are not required. An example is Question 1 (a)(ii) in which candidates stated that shareholder agreements or some other arrangement would be preferable rather than just stating why the Model Articles themselves are not sufficient.

Some candidates are still answering questions which are not asked. An example is Question 1 (f)(i) in which some candidates discussed sole trader liabilities and some candidates discussed the process of registering and completing self-assessment.

In Question 2, many candidates demonstrated a lack of knowledge on partnerships with many candidates stating that the partnership could continue after Henning leaves, even though no partnership agreement is in place and the partnership is governed by the Partnership Act 1890.

Question 1

The calculation parts (a)(i) to (a)(iv) were generally answered well by most candidates, although some candidates still struggled with the creditor ratio.

In part (a)(v), where their calculations were correct, candidates gave good reasons for supplying Calcosis Ltd and mentioned their concerns around the length of time to pay back creditors.

In part (b)(i) many candidates gave answers to this part that were not related to the question asked, for example, candidates stating that the shares would not be bought by a third party. Considering that the purchase is either by the company or by the directors it is clear that candidates did not pay enough attention to the question asked.

In part (b)(ii) most candidates stated that the purchase must be funded from reserves, that the Articles of Association must allow the transaction and that the shares must be cancelled after purchase. The other points expected by examiners were generally missed by most of the candidates.

In part (b)(iii) most candidates answered this part well although some candidates could not give satisfactory answers to this part.

Part (b)(iv) was poorly answered by the majority of candidates. Some candidates interpreted this part as being a share purchase through the use of an insurance policy and mentioned the Anderson criteria, which is irrelevant for this answer. A considerable number of candidates stated that he should have held the shares for only two years rather than the five years as is required.

Part (c)(i) was not answered well by candidates, with many candidates going into tax consequences or mentioning hypothetical points such as owning a higher percentage of shares. Very few candidates mentioned the Inheritance Tax implications of owning the shares for more than two years. The better prepared candidates mentioned that although he was a voting shareholder and could have a say in the operation of the company, as a minority shareholder he would probably not have much influence.

In part (c)(ii) candidates missed many of the points and tended to repeat the same point in different ways, usually expanding on the security aspect of the loan. The better prepared candidates stated that the rate of interest would be based on the perceived lending risk and that interest would have to be paid, unlike dividend payments, which would be at the discretion of the company.

In part (d)(i) candidates concentrated on requesting health questionnaires and salary information. It is worrying that candidates did not realise that a supplementary or financial underwriting questionnaire would be required along with a company business plan.

Part (d)(ii) was usually answered adequately by the majority of candidates although most candidates did miss the potential loss of profits as one of the issues when using the multiple of salary approach.

In general, this calculation in part (d)(iii) was performed well by the majority of candidates.

Most candidates answered part (e)(i) very well although some candidates went into detail that was not required, such as giving reasons for various types of solutions.

Candidates struggled with part (e)(ii) demonstrating that they are not familiar with the Model Articles, and many candidates gave solutions rather than the simple explanation that was required.

While candidates got some of the basic points in part (f)(i) they generally did not state that the opening year rules would apply and that in the year of commencement profits would be assessed from the commencement date to the following 5 April.

Part (f)(ii) was generally answered well by the majority of candidates, although some candidates mentioned Capital Gains Tax and Inheritance Tax. Many candidates failed to state the rate of Corporation Tax payable and so they could not compare this with rates of Income Tax, which would lead to excess profits being sheltered within the company as retained profits, to be taken later when they may be taxed at more favourable lower personal rates.

Many candidates gave general answers, without being specific and so could not gain relevant marks. A number of candidates gave explanations relating to National Insurance Contributions and state benefits, which was not relevant.

Question 2

In part (a) many candidates set out the disadvantages of the Partnership Act 1890 but did not go on to state, or did not include a statement that said, how a written agreement would overcome these disadvantages.

In part (b) candidates did not refer to the legalities of the law of agency and express authority when attempting to answer this question. Some candidates concentrated on joint and several liability and the effect on personal assets. Many candidates gave generic answers and did not relate their answers to the situation in the case study.

Very few candidates considered what would happen if the partnership refused to pay the advertising agency or if Henning paid the advertising agency fees himself.

In answering part (c), many candidates discussed how the partnership could have avoided dissolution by having a partnership agreement in place, rather than answering the question that was asked.

This topic in part (d) has been examined before. Candidates could state the basic benefits but did not go on to state that conversion from an ordinary partnership to an LLP would not be treated as a cessation of business on conversion and so no extra tax liabilities would arise.

When mentioning drawbacks, many candidates did not state that an LLP required two designated members nor the consequences if the number of members drops below two.

In part (e) many candidates could not articulate the benefits and drawbacks very well. While most candidates stated that the partner who is ill can choose whether to sell, many candidates did not go on to state that if they decide to sell, the others must buy. Many candidates did not mention the drawback that the remaining partners do not have an option to buy and so could be left with an ill partner who may not be able to contribute to the business.

Question 3

Part (a) was generally answered very well by the majority of candidates. Most candidates realised that the SSAS, even after being topped up by the unused annual allowances, would not be sufficient to purchase the property and the only way to buy the property would be by making excess contributions to the SSAS and paying the annual allowance charge.
There is nothing wrong with this, as the annual allowance charge only recovers the tax relief that should not have been applied to the excess contribution. However, the directors must remember to mention the total contribution on their tax return to claim higher rate relief to offset the annual allowance charge.
In addition, the company can claim the excess contribution as a deduction against corporation tax.

Few candidates pointed out that after the £160,000 pension contributions there would still be £140,000 left to help with any excess contributions.

Some candidates unnecessarily calculated Stamp Duty Land Tax on the purchase even though it was not asked for and even though they were told in the question that all costs came to £60,000.

In part (b)(i), candidates did not mention the different tax treatments that would apply for Jodie and for Rick. Candidates gave an all-encompassing answer to the tax treatment of the rental income for Jodie and Rick, treating them identically for tax purposes, which is incorrect.

Jodie would have to borrow against her house to raise the capital to buy the property and so would be able to offset interest on any mortgage raised for the purpose of buying the commercial property. Rick, on the other hand, would be using his investments and so would not be able to make use of any tax reductions against his rental income.

While many candidates gave basic answers to part (b)(ii), they did not mention that the company is a trading company and that Jodie and Rick both own more than 5% of the shares and have owned the business for more than two years. Many candidates, unnecessarily, set out the process for calculating the capital gain, which was not asked for in the question.

Most candidates did not perform well in part (b)(iii) and did not realise the Inheritance Tax (IHT) implication of Jodie being a 51% shareholder and Rick being a non-controlling director. Answers given were general IHT answers and did not relate to the circumstances in the case study.

Part (c) has been previously examined on many occasions and candidates generally answered this part well. The main omissions from answers stemmed from the material directly related to the case study, such as Rick not needing to use his investments and Jodie not needing to borrow or remortgage. This indicates that candidates are answering this question using memory recall only and not referring to the material in the case study to help formulate their answers.

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.

If you are sitting via remote invigilation 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.**
- show your ID to the camera now, if you did not do so during the ID checks.
- show the edge of your screen with a mirror, if you did not do this during the room scan.
- Show any blank sheets of paper for notes, if you did not show both sides to the camera during the room scan.

  If you are sitting in a test centre and encounter a problem please alert the invigilator.

  For candidates sitting via remote invigilation or at a test centre

- **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 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 eg **1a**
- **Please note each answer must be typed in the correct corresponding answer box**
- **If you are wearing headset, earphones, smart watch please take them off.**
- Please familiarise yourself with **all** questions before starting the exam.

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) and (f) which follow.

Ivan, Stefano and Marcelo are the shareholding directors of Qualitatium Ltd, a private limited company, which they set up 10 years ago. Ivan owns 35% of the shares in the company.

Ivan wishes to leave the company and realise the value of his shares but none of the other directors wish to buy his shares from him. He is however aware the company could buy back the shares from him.

The company adopted the model articles and memorandum of association.

Ivan intends to set up a new consulting business but has not yet decided whether to set up as a sole trader or as a sole director limited company. His new business will start on the 10 March 2021.

Marcelo will be key to the continuation of Qualitatium Ltd. His salary is £70,000 a year. The business made profits of £355,000 in the last financial year. If Marcelo were to die, they think it could take up to six months to find a replacement for him. The total salary bill for directors and other employees is £410,000. The company has no protection plans in place.

Qualitatium Ltd has been approached by another company, Calcosis Ltd, who wish to buy merchandise from Qualitatium Ltd on 30-day credit terms, as Calcosis Ltd is experiencing increased demand for its products. Calcosis Ltd could buy up to 20% of Qualitatium Ltd's products each year. Marcelo and Stefano wish to know if they should supply Calcosis Ltd and have requested a copy of their accounts.

Calcosis Ltd is looking for an investor to help them fund growth and expansion. Ivan, as a regular business angel, is considering investing £25,000 into the business either as a secured loan or an equity investment which would make him a minority shareholder.

Parts of the actual and projected profit and loss account and balance sheet of Calcosis Ltd are below.

Profit and loss account for the years ended 31 March

	2021 **£'000**	**2020** **£'000**
Sales	847	693
Cost of sales	(612)	(540)
Gross profit	**235**	**153**
Expenses	(167)	(134)
Operating profit	**68**	**19**

Balance sheet as at 31 March

	2021 **£'000**	**2020** **£'000**
Fixed assets		
Current assets		
Stock	91	75
Debtors	20	9
Cash at bank	13	10
	124	**94**
Current liabilities		
Creditors	82	57
Taxation	13	4
	95	**61**
Net current assets	**29**	**33**

Question 1

*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 following ratios for Calcosis Ltd in both 2020 and 2021:

(i) Operating profit margin. **(4)**

(ii) Current ratio (also known as working capital ratio). **(4)**

(iii) Acid ratio (also known as quick ratio). **(3)**

(iv) Creditor ratio. **(3)**

(v) Explain, from the ratios calculated above, whether Qualitatium Ltd should supply Calcosis Ltd and state any concerns you may have. **(7)**

(b) **(i)** State **one** benefit and **one** drawback of Qualitatium Ltd buying its own shares when compared with a share purchase by the Directors. **(2)**

(ii) State the legal conditions, under the Companies Act 2006, that will apply to the Qualitatium Ltd share buyback. **(5)**

(iii) State the benefit to Ivan if the proceeds from the company share purchase are treated as a capital payment. **(2)**

(iv) Explain the conditions that must apply if the proceeds of the share purchase are to be treated as a capital payment in the hands of Ivan. **(6)**

(c) Explain the advantages to Ivan of him investing in Calcosis Ltd as:

(i) an equity investment; **(7)**

(ii) a secured loan. **(7)**

(d) **(i)** List **three** items of evidence an insurer's underwriter would require to justify an appropriate level of life cover on Marcelo. **(3)**

(ii) Identify **four** potential issues with using a multiple of salary approach to determine cover on Marcelo. **(4)**

(iii) Calculate, **showing all your workings**, a level of cover for Marcelo using the proportion of profits formula. **(4)**

(e) Stefano and Marcelo wish to set up a share purchase arrangement on death or critical illness to buy the other's shares in such an event.

(i) List the **three** components essential for a share purchase plan to be effective. **(3)**

(ii) State why the model articles alone are insufficient for their share purchase plans. **(2)**

(f) Explain and compare the tax and National Insurance contributions (NICs) implications for Ivan if he sets up his **new** consulting business as a:

(i) sole trader; **(5)**

(ii) limited company. **(9)**

Total marks available for this question: 80

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), (d) and (e) which follow.

Henning, Karina and Maggie set up Speedy Lettings three years ago and now have three branch offices. The business was set up under the Partnership Act 1890 as a general partnership. The majority of the capital was provided by Maggie although Henning and Karina did also provide some capital. They were advised to have a partnership agreement drawn up but failed to do so as they thought they may, in the future, convert to a Limited Liability Partnership (LLP).

Henning now wishes to leave the partnership and withdraw his capital as quickly as possible; Maggie is considering inviting a colleague to join the partnership to replace Henning.

Before Henning decided to leave, he spent £10,000 on advertising on behalf of the firm without getting approval of either of the other partners. The advertising agency has not yet been paid. Karina and Maggie think the cost was too high, although the advertising has proved beneficial to the firm. As Henning was not given authority to instruct the advertising agency, the other partners are insisting he should pay the cost personally.

Maggie and Karina are considering setting up life and critical illness policies to protect their partnership interests.

Question 2

(a) Explain why the partners should have had a written partnership agreement rather than relying on the provisions of the Partnership Act 1890. **(9)**

(b) Describe the extent to which Karina and Maggie are liable on the contract to the advertising agency. **(8)**

(c) Explain briefly how Henning can leave the partnership and obtain a repayment of his capital. **(5)**

(d) State **five** benefits and **five** drawbacks of the partnership converting to a LLP. **(10)**

(e) Describe **four** benefits and **four** drawbacks of a single option agreement linked to the critical illness cover for the partners. **(8)**

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), and (c) which follow.

Jodie and Rick are the shareholding directors of JoRick's Cakes Ltd. Jodie owns 51% of the shares and Rick owns 49%. Both directors are taking a salary of £60,000 per annum.

For the last 10 years they have run their company from rented premises. The company has been successful, and it has £300,000 held in the corporate deposit account. Jodie and Rick now feel they are ready to buy their own business premises.

Jodie owns her home outright which is valued at £500,000. Rick does not own a property but does have various investments and cash deposits with a total value of £430,000.

JoRick's Cakes Limited set up a small self-administered scheme (SSAS) for the two directors in 2010. The company has contributed £20,000 at the beginning of the tax year for each director for the past five years, including the current tax year. The fund has a current value of £290,000 and is invested mainly in open-ended investment companies.

Jodie and Rick have found a commercial property they think is suitable for their needs. They are considering two options to raise the finance for the purchase: either buying the property using their SSAS or buying it themselves. If they buy the property themselves Rick will use his investments and Jodie will re-mortgage her home. The purchase price of the premises is £650,000.

Question 3

(a) **(i)** Calculate, **showing all your workings**, whether the purchase of the commercial property could be funded with the maximum amount of borrowing via the SSAS and comment on your answer. *You should assume total purchase costs of £60,000.* **(10)**

(ii) Explain the financial implications for JoRick's Cakes Ltd should the business premises be purchased using the SSAS. **(5)**

(b) **(i)** Explain briefly, the Income Tax implications for Jodie and Rick assuming they buy the premises personally and JoRick's Cakes Ltd pays them full market rent. **(5)**

(ii) Explain the Capital Gains Tax implications if the property that they buy personally is sold at a later date. *No calculations are required.* **(7)**

(iii) Explain the Inheritance Tax consequences of them buying the business premises personally. **(5)**

(c) Identify **eight** benefits of buying the property through the SSAS rather than Jodie and Rick buying it personally. **(8)**

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) (i) Operating profit margin $\frac{\textbf{Operating profit}}{\textbf{Sales}}$ **×100%**

2020
(19/693)
x 100% = 2.74%

2021 (68/847) x 100% = 8.02%

(ii) Current ratio (working capital ratio) $\frac{\textbf{Current assets}}{\textbf{Current liabilities}}$

2020
94 /61
= 1.54
2021 124/95 = 1.31

(iii) Acid ratio $\frac{\textbf{Current assets – inventory}}{\textbf{Current liabilities}}$

2020
(94-75) /61 = 0.31
2021 (124-91)/95 = 0.35

(iv) Creditor ratio $\frac{\textbf{Creditors}}{\textbf{Purchases (cost of sales)}}$ **× 365 day**

2020
(57/540) x 365 = 38.5 days
2021 (82/612) x 365 = 48.9 days

(v)
- On balance they should supply
- as Calcosis Ltd’s position is getting better, their profit margin, current ratio and acid ratio increasing
- However , creditor days have increased from 38.5 to 48.9 days which is a concern
- showing that Calcosis Ltd is slow paying creditors and using creditors as bank/overdraft facility
- meaning that Qualitatium Ltd may not get paid in 30 days
- unless they can guarantee getting paid within 30 days
- or only deal on a cash basis for the short term.

(b) (i) *Candidates would have gained full marks for any one from each of the following:*

Benefit:

- Fewer formalities at outset for the company (e.g. no trust).
- Company will not have to use reserves if the Directors can find the cash to purchase shares.

Drawback:

- Compliance with company law conditions is necessary for purchase.
- Uses up company cash reserves.

(ii)

- Purchase must be funded from the profit & loss reserves/distributable income.
- Shares must be paid for in cash at time of purchase, payment cannot be deferred or by instalments.
- The Articles of Association must allow the transaction.
- The share purchase buy back must be reported to HM Revenue & Customs/Registrar of Companies.
- Shares must be cancelled after purchase.

(iii)

- Taxed under Capital Gains Tax (CGT) rules.
- Business Asset Disposal relief will apply.

(iv)

- Must be an unquoted trading company.
- Buyback must be wholly or mainly for the benefit of the trade.
- Ivan must be UK resident

  and must have held the shares for at least 5 years.

  His shareholding must be substantially reduced after the sale (He must sell more than 25% of his holding).

  After the sale he must not be connected with the company.

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

- An equity investment could give Ivan a high potential return on his investment/if Calcosis Ltd were sold, Ivan might receive a profit on his investment,
- providing he negotiates a good price for the shares that he will acquire.
- As a voting shareholder, he would have a say in the operation of Calcosis Ltd
- but as a minority shareholder, this would probably not be of much value.
- If the company makes profits Ivan could expect to receive dividends.
- For more secure dividend payments Ivan could invest in the form of (fixed-rate) preference shares
- since these would give him a right to dividends in priority over ordinary shareholders.
- Inheritance Tax (IHT) Business Relief after 2 years.

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

- A secured loan would be safer as secured loans generally offer more security of capital than equity investments.
- If Calcosis Ltd were to be wound-up, Ivan would be a secured creditor
- and could receive his investment back
  as Ivan could take a fixed or floating charge over some of Calcosis Ltd's fixed assets.
- The company will repay the loan over time so his money will be returned to him.
- Ivan can agree a rate of interest that the company will pay him
- based on the inherent lending risk
- so he would not be dependent on Calcosis Ltd's decisions regarding the payment of dividends.
- The rate of interest paid is likely to be stable and higher than the dividend yield.

- The interest paid would be tax deductible for Calcosis Ltd and might therefore be more affordable for the company than dividends.

(d) **(i)**

- Latest business accounts.
- Business plan.
- Supplementary business questionnaire/financial underwriting questionnaire.

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

- Salary alone may not be a true reflection of total earnings.
- Salary does not show his true value to the business.
- Multiple of salary does not take into account the time factor to replace.
- Potential loss of profits.
- Cost of a replacement.

(iii) (70,000 x 355,000 x 0.5)
/410,000
=£30,305

(e) **(i)**
- Life insurance policy.
- Business trust.
- Cross option agreement for purchase.

(ii)
- The model articles only give pre-emption rights/rights for first refusal
- and not an option to purchase. There is no requirement in the model articles that guarantees a sale to another shareholder.

(f) **(i)** *Candidates would have gained full marks for any five of the following:*
- Trading profits will be assessed to Income Tax
- at his marginal rates.
- The opening year rules will apply.

- For the year of commencement, he will be assessed on his profit from the commencement date
- to the following 5 April.
- He will be liable for class 2 and class 4 NICs, subject to the relevant earnings limits.
- Class 2 and class 4 NICs will be paid together with his Income Tax self-assessment.

(ii) *Candidates would have gained full marks for any nine of the following:*
- Flat rate of 19% Corporation Tax rate applies to profits of company.
- Can shelter excess profits from higher and additional Income Tax rates by retaining profits in the company
- as retained profits suffer only Corporation Tax
- and may be withdrawn in the future when they may be taxed at lower personal rates.
- It is also possible to avoid NICs by withdrawing profits in the form of dividends.
- Can take the first £2,000 of dividends taxed at 0%.
- Total NICs are higher.
- As both employer and employee NICs are payable.
- Although employer NICs are tax deductible.
- He could potentially pay lower tax by a combination of salary and dividends.

Model Answer for Question 2

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

- A Partnership agreement allows the partners to structure the partnership in a manner which reflects their business and personal circumstances.
- Ensures that the partnership is not dissolved on death, bankruptcy or retirement.
- Can regulate/allow for partners leaving the partnership.
- It can be specific about rights, responsibilities and liabilities of partners.
- Ensures that capital and liabilities can be distributed in determined ratios
- unlike the Partnership Act 1890 which states that capital and liabilities are shared equally.
- No interest is paid to partners on their capital, but a written/explicit partnership agreement could allow for this.
- Addition of new partners requires the agreement of all partners under Partnership Act 1890. A written agreement could allow for specified/majority of partners to make a decision on new partners joining.
- Written agreement can include a clause to expel partners
- Written agreement can ensure that a partnership cannot be dissolved by notice.
- A written agreement can limit the rights of junior partners e.g. to dissolve the partnership.

(b)

- Partnership Act 1890 provides that each partner is an agent of the partnership for the purposes of its business
- meaning that Henning had express authority to bind the firm
- as the advertising was in the normal course of business
- and the advertising agency had reason to believe that Henning had authority to bind the partnership
- so Karina and Maggie are bound by Henning's agreement. It is an enforceable contract.
- Should they refuse to pay the advertising agency it can bring a court action for payment.
- Should Henning pay the advertising agency fees he is entitled to recover the fee from the partnership
- through the courts.

(c)

- Henning must give a notice of dissolution to the other partners.
- Henning is entitled to his partnership capital sum, as shown in the financial accounts
- less his share of capital losses.
- The amount due to him becomes a debt on the partnership.
- If necessary he can apply to the courts to recover the debt.

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

Benefits:
- Separate legal entity
- so no dissolution on death of member.
- Personal liability of individual members limited and members' personal assets are safe from creditors.
- The conversion is not treated as a cessation of business on conversion to LLP.
- so no extra tax liabilities would arise.
- The LLP continues to be taxed under partnership rules.
- An LLP has the power to borrow/issue debentures/grant fixed or floating charges on assets.

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

Drawbacks:
- Increased regulatory burden and higher administrative costs.
- Accounts need to be filed at Companies House
- So there is loss of privacy.
- Requires two designated members
- who have additional responsibilities.
- Cannot pay dividends as has no share capital.
- If number of members drops below two for six months, the member and the LLP are jointly responsible for the LLP's debts incurred during sole membership.

(e) *Candidates would have gained full marks for any four of the following:*

Benefits:
- The ill partner can choose whether to sell and cannot be forced to sell
- so can continue in the partnership business if they feel up to it.
- If they decide to sell the others must buy.
- The benefit could provide them with a continuing income as a partner (while recovering or taking less par in the partnership).
- Or the partnership could spend proceeds on other projects.

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

Drawbacks:
- As they may not be working full-time, this could put a strain on the partnership business
- especially if they draw a high income.
- The partnership may spend the proceeds of the critical illness policy
- so the money would not be available if the ill partner does decide to sell later.
- No option for remaining partners to buy or force a sale
- so could be left with the ill partner who cannot contribute to the business.

Model Answer for Question 3

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

- Total purchase price is £650,000 + £60,000 = £710,000.
- Maximum borrowing is 50% of the net asset value of the SSAS.
- The fund is valued at £290,000 so the SSAS, at this point, could borrow £145,000.
- They have not maximised their annual allowance of £40,000 per year.
- So they can carry forward £20,000 each for last 3 years = £60,000 x 2 = £120,000.
- Plus £20,000 each for the current tax year = £40,000 – total of £160,000.
- £290,000 + £160,000 = £450,000 SSAS value.
- They need another £260,000 to buy the premises.
- The SSAS can now borrow £225,000
- this leaves a £35,000 shortfall for the SSAS purchase.
- A pension contribution in excess of the annual allowance can be made for each of them to cover the shortfall
- which will result in an additional tax charge for them
- although the excess contribution will increase their pension fund.

(ii)

- The company would have to pay a commercial rent to the SSAS.
- This would reduce cashflow
- but the rent would be allowable against Corporation Tax.
- The additional pension contributions should get Corporation Tax relief.
- Maximising pension contributions reduces their cash reserves.

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

- Interest paid by Jodie on a mortgage
- can be offset in full
- against the rental income she receives from the company.
- She will pay Income Tax on the balance at her highest marginal rate.
- Rick will use his investments so he will be taxable at his highest marginal rate on the rental income he receives.
- As he has not borrowed any money.

(ii)

- A sale is a disposal for CGT.
- This might qualify for Business Asset Disposal relief
- as JoRick's Cakes Ltd is a trading company;
- Jodie and Rick both own more than 5% of the shares;
- they have owned the business for more than 2 years.
- They can use their annual exempt amount of £12,300.
- Above this amount is taxed at 10%.

(iii)

- As a 51% shareholder Jodie would qualify for
- IHT Business Relief
- at 50% on the business premises.
- Rick would not qualify for IHT Business Relief
- as he is not a controlling director.

(c)

- No tax liability on the rental income received by the SSAS.
- The rental income increases the pension fund value.
- The rent paid does not count towards their annual allowance.
- No CGT on the property on sale.
- No IHT on the pension fund/ property as it is outside their estates.
- The fund/property is protected from creditors/bankruptcy.
- They can retain their cash reserves/Rick would not use his investments
- No personal borrowing necessary, especially for Jodie.

All questions in the May 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 March and May 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

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.*

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%