Chartered Insurance Institute

# AF2

# Advanced Diploma in Financial Planning

## Unit AF2 – Business Financial Planning

## May 2021 Examination Guide

**SPECIAL NOTICES**

**Candidates entered for the October 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 appear to rely on the knowledge gained only from the J03 study guide and this is not sufficient for this level of examination. Candidates must study the AF2 Case Study Workbook as well.

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 when they did not relate their answers to the case study and provided generic answers. This relates back to the reliance on the J03 study guide and not studying the AF2 Workbook. The AF2 Workbook, apart from introducing new material, explains how to answer these advanced case study questions so candidates stand a better chance of providing the responses the examiners expect.

**Question 1**

Part (a)(i) was generally poorly answered by most candidates, which is surprising as this topic is well covered the AF2 Case Study Workbook. Candidates could give a couple of basic points but could not provide detail to their answers. Many candidates gave answers involving personal taxation rather than considering the business taxation aspect. Very few candidates mentioned indexation or that as the business was started from scratch, that the goodwill, which is a business asset, would be fully liable to tax.

Part (a)(ii) was generally well done by most candidates who managed to provide relevant answers.

In part (b)(i) it is clear that the majority of candidates do not know the options for a Small Self-Administered Scheme (SSAS) if the sponsoring employer is sold or ceases trading. Many candidates suggested that the SSAS would need to be wound up, which is a valid option, but hardly any considered attachment to a new company run by the existing directors or allowing the SSAS to continue on its own without a sponsoring employer.

Candidates who stated that the SSAS could continue without a sponsoring employer did not explain why this was so.

Candidates, unnecessarily, concentrated on the property element of the SSAS and whether it should be sold rather than concentrating on the SSAS itself.

In part (b)(ii) many candidates did not discuss the implications but instead gave solutions along the lines of drawing benefits. Candidates missed stating the obvious point that the property, which makes up the majority value of the SSAS, would have to be sold on wind up. Few candidates mentioned this, and of those who did, even fewer mentioned that this would be an illiquid asset and may not get the price they want at the time they wish to sell.

Part (c) was poorly answered by most of the candidates and many candidates did not factor in the rental income received by the SSAS.

Most candidates identified that the property may need to be sold but many went on to describe the taxation consequences of sale, which was not required.

A surprising number of candidates only suggested that Stephen transfer his assets out of the SSAS to a personal arrangement to take benefits. Many candidates, unnecessarily, went into detail on the taxation consequences of drawing the pension, as this was not required by the question. Many candidates also commented on taking a lump sum, when this was not asked for in the question.

Part (d)(i) was poorly answered by the majority of candidates. Most candidates were only able to provide the basic information on the scheme such as the savings amount, the term and the discount applied. Most of the other points were regularly missed by the candidates. They gave benefits or reasons for using the scheme rather than describing the main points of the scheme. Candidates also confused SAYE schemes with share incentive schemes and gave hybrid answers and stating the tax advantages of share incentive schemes as applying to SAYE schemes.

Many candidates put the points required in part (d)(ii) into part (i) and did not repeat them in this question part.

Candidates answered part (d)(iii) with reference to Capital Gains Tax should these shares be sold, and on the ability to receive dividends. They did not consider the Income Tax position on the award of the shares. Many candidates who stated that Income Tax would be payable did not state why this was so and many also stated, incorrectly, that National Insurance contributions (NIC's) would be chargeable on the award.

In part (e)(i) most candidates identified the correct people to inform with justifiable reasons to support their answer.

Part (e)(ii) was answered well by most candidates, the points most often missed being the one related to inheritances or prize winnings and, surprisingly, that his pension funds would be protected.

Part (e)(iii) was answered satisfactorily by most candidates.

Part (e)(iv) was generally well covered by candidates although most candidates missed referencing the Bankruptcy restriction order.

The topic in part (f)(i) has been examined many times and was answered well by the majority of candidates. Weaker candidates answered with points that should have gone into (f)(ii) and, generally, did not repeat those points in (f)(ii).

The topic in part (f)(ii) has also been examined many times before but was not as well answered as part (f)(i). Many candidates still do not specify 75% of creditors by value. The question asked about the process of entering into an Individual Voluntary Arrangement (IVA). In spite of this, many candidates stated what would happen if he did not keep to the agreement, which was not required.

**Question 2**

This topic in part (a) has been examined frequently and most candidates performed well in both parts of the question, although weaker candidates did not do as well in (a)(ii) as they did in (a)(i).

Candidates attempted to answer part (b) in terms of taxation rather than identifying the benefits of a partnership as a business structure. In cases where candidates did identify the relevant circumstances, they, unnecessarily, expanded on their answer with numerous reasons. Candidates should pay attention to the marks awarded to a question and from that gauge the complexity of the answer required. The better prepared candidates generally identified the points surrounding confidentiality, flexibility and simple business structure. Few candidates identified the finite duration aspect and virtually no candidate mentioned the circumstance when those who own and run the business must be the same.

In part (c) many candidates did not state bonuses or pension contributions as a method of extracting profits from a limited company. Very many candidates stated dividends and went into detail about dividend taxation, which was not required by the question.

While candidates mentioned that partners' profits would be taxed as income, many went into the taxation and NIC issues at great length which was not required and used up candidates time.

In part (d)(i), many candidates' answers did not reflect the information in the case study. Many candidates recommended life cover for both rather than just Dominic, and many suggested business trust solutions, suggesting they were repeating past business protection answers rather than answering the question based on the information in this case study.

Candidates who did give answers based on the case study generally provided two of the three points: very few candidates gave all three relevant points.

Candidates' answers to part (d)(ii) covered two to three of the relevant points with the majority realising that future years' profits could be very different from first year profits. Few candidates mentioned the difference between using gross and net profit.

In part (d)(iii) candidates realised most of the implications of using a single unit linked product and this part was adequately answered by the majority of candidates.

In general, part (e) was poorly answered by candidates demonstrating a lack of knowledge in this area, which is well covered in the course books.

In part (e)(i) candidates appreciated that payback period did not account for inflation but did not comment on the arbitrary nature or the simplicity of the payback period calculation.

Candidates answers to part (e)(ii) indicted that they did not know or appreciate how an IRR is calculated. Some candidates could explain that Net Present Value brings the future value back to today's value but did not state that it was the expected profit that was brought back in to today's terms. Candidates did not compare one against the other as required by the question and stated points such as, calculations are simpler, without stating which method was complex and which may be simpler.

In part (e)(iii) one point that recurred with many candidates was whether there was any capital available for purchase. If no capital was available, (either in reserves or via borrowing), a purchase would not, generally, be considered by a business. Much more relevant is whether the business could afford the capital to be tied up.

**Question 3**

The topic in part (a) has been examined before on many occasions and was well answered by the majority of candidates.

However, candidates still lacked specific detail in their answers, for example, stating the 'value of the SSAS' rather than the 'net value of the SSAS'. Many also stated that the 'repayments must be paid in equal instalments' rather than the full 'equal instalments of capital and interest'.

While many candidates stated that the loan could be rolled over for a further period of 5 years, very few candidates gave a reason why this is allowed, such as the company being in financial difficulty.

Candidates were clearly divided into two groups when answering part (b): those candidates who knew the principle, the correct formula to use and how to apply it and those candidates who understood the principle but could not apply it correctly. Many candidates gave different payment amounts for each of the five years due to their incorrect calculation method, yet many of the same candidates, when answering the question above stated that the repayments must be made in equal instalments of interest and capital.

Some candidates did not go far enough and did not divide the answer they obtained from the calculation by five to arrive at five equal annual repayments.

In part (c) many candidates stated that the employer contribution was capped at the employee's annual allowance, and many candidates who stated that the employer contribution was effectively unlimited also stated that they would still be limited by the annual allowance. Candidates then went into the personal taxation of the employee if the contribution was in excess of the employee's annual allowance. While pursuing this personal taxation aspect, candidates forgot to concentrate on the employer aspect of this question and so missed many of the points the examiners expected.

This calculation in part (d)(i) was well done by the majority of candidates. The main errors in this part were the deduction of the pension contribution from the salary before calculating the income tax and not providing a figure for the total employee tax and NI. Some candidates also stop calculation for the employee tax and NI and did not allow for the tax relief on the pension contribution and did not calculate a net take-home pay figure.

The calculation in part (d)(ii) was also well done by the majority of candidates. The main omissions in this part was not providing the increased pension contribution due to the addition of half the employers NI saving (£1,603.50) and then not adding this figure to the employer contribution to give the new total pension contribution (£3,103.50).

## 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 e.g. **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. No watches are permitted.**
- 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.**

Stephen, aged 56, Robert, aged 58 and Fiona, aged 59 are the directors of a small private limited company which started in 1995. Stephen initially founded the company and is the majority shareholder with 75% of the shares. Robert owns 15% of the shares and Fiona owns the remaining 10%. The business has two loans and Stephen and Robert have both given personal guarantees for these.

There is a small self-administered pension scheme (SSAS) in place for all three directors and the majority of the SSAS value is earmarked to Stephen. The SSAS owns the business premises which accounts for 80% of the scheme value.

After briefly considering an employee share option scheme, the business put in place an employee Save As You Earn (SAYE) share saving scheme. This started some time ago when the directors thought that they may list the company on the alternative investment market.

Stephen is now considering rewarding two of the employees for exceptional service by giving them shares in the company although this will not be through any form of share scheme.

Unknown to Stephen and Fiona, Robert has a gambling addiction and is likely to face personal bankruptcy because of debts built up due to gambling. Robert would prefer to keep this from his other directors if possible. In addition to the SSAS he has another pension scheme from which he is taking an income.

Stephen is currently considering selling the business although this may take up to two years to complete.

## Question 1

***PLEASE ENSURE YOU ANSWER EACH QUESTION IN THE CORRECT ANSWER BOX***

**(a)** **(i)** Explain in detail the tax implications of selling the assets of the business. **(11)**

**(ii)** Identify **three** non-tax benefits for the purchaser of buying the business assets rather than the shares of the company. **(3)**

**(b)** **(i)** Explain the implications for the continuation of the SSAS on the sale of the sponsoring company. **(6)**

**(ii)** Explain briefly the implications for the members of the SSAS should the SSAS be wound up. **(3)**

**(c)** Explain briefly the implications if Stephen wishes to retire and take an income from the SSAS. **(4)**

**(d)** **(i)** Describe the main points of a Save As You Earn (SAYE) share option scheme. **(9)**

**(ii)** Explain briefly why the SAYE scheme may be better for the employees rather than an employee share option scheme. **(3)**

**(iii)** State the tax implications for the two employees of receiving the proposed award of the shares. **(4)**

**(e)** **(i)** With respect to the business, state, with reasons, who Robert should inform if he is made bankrupt. **(4)**

**(ii)** Explain what will happen to Robert's assets if he is made bankrupt. **(6)**

**(iii)** Explain what will happen to Robert's income if he is made bankrupt. **(7)**

**(iv)** Explain the legal implications to Robert if he is made bankrupt, including any applicable timeframes. **(5)**

**(f)** **(i)** Explain to Robert the advantages of him entering into an Individual Voluntary Arrangement (IVA) as an alternative to bankruptcy. **(6)**

**(ii)** Explain to Robert the process of entering into an IVA. **(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**

**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.**

### Question 2

Dominic is a self-employed manufacturer of bespoke furniture. For a number of years he has been outsourcing any work he cannot take on himself to Louis. Due to the success of this arrangement, they have decided to set up formally in business together.

Dominic and Louis are unsure as to whether to operate as a partnership or as a limited company. They will both contribute equal capital to the new business and will either be equal partners or equal shareholders. They both wish to expand the business and will need to borrow funds to do so.

Both Dominic and Louis are married with children. They both have a mortgage and would prefer not to be personally liable for any business debt. They are also keen to ensure that if they should die or suffer a critical illness that the business can continue and their families would not lose out from their share of the business.

Dominic is the main generator of new business due to his wide range of contacts and reputation. They therefore feel that key person insurance for Dominic should be put in place payable in the event of serious illness or death.

To expand their business and increase profitability, they are considering either buying or leasing new machinery. If they purchase new machinery it would cost £11,000.

**Question 2**

*PLEASE ENSURE YOU ANSWER EACH QUESTION IN THE CORRECT ANSWER BOX*

**(a)** Explain to Dominic and Louis **five**:

**(i)** benefits of them trading as a limited company; **(5)**

**(ii)** drawbacks of them trading as a limited company. **(5)**

**(b)** Explain briefly in what circumstances it may be beneficial to set up as a partnership rather than a limited company. **(4)**

**(c)** State how extracting profits from a limited company differs to taking profits from a partnership. **(4)**

**(d)** Dominic and Louis wish to use a critical illness policy, with the sum assured calculated using the proportion of profits formula based on the businesses' net profit. This is to protect the business in the event of Dominic's long-term serious illness.

**(i)** Explain briefly to Dominic and Louis how the policies for key person insurance should be written. **(3)**

**(ii)** State **four** drawbacks of Dominic and Louis using the proportion of profits formula based on the businesses' net profit now and in the future in order to calculate the sum assured. **(4)**

**(iii)** State **three** advantages and **three** disadvantages of combining life and critical illness cover in a single unit-linked contract. **(6)**

**(e)** **(i)** State **three** drawbacks of using the payback period method for calculating the investment return on the proposed purchase of the machinery. **(3)**

**(ii)** Explain briefly **three** benefits of using the Net Present Value method compared to the Internal Rate of Return method for calculating the return on an investment. **(3)**

**(iii)** Identify **three** factors that should be taken into account when considering whether to buy or lease the machinery. **(3)**

**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) and (d) which follow.**

Amira and Lola, both aged 34, are equal shareholders in a small successful architect business set up as a limited company. They employ four members of staff and their continuing success means they wish to expand.

When they started the business 9 years ago, they set up two pension schemes. The first pension scheme is a small self-administered scheme (SSAS) for Amira and Lola as directors on a 50/50 basis with the company as the sponsoring employer.

The second pension scheme, for the employees, is a group personal pension plan that qualifies as a workplace pension scheme. Both the company and the employee each pay a pension contribution of 5% of basic salary. Amira and Lola offer all employees the option of paying their contributions by salary sacrifice, with 50% of the employer National Insurance contributions saving, being used to increase the employer pension contribution.

Sanjay is a new employee of the company. He will be paid an annual salary of £30,000 and would like to understand the benefits of taking up the offer of salary sacrifice.

To expand the business Amira and Lola need to borrow funds. In the current economic climate they do not wish to approach their bank for a loan. They are considering taking a loan from their SSAS instead.

The SSAS is valued at £280,000 and is invested in cash and various unit trusts and open-ended invested companies (OEICs). To raise the amount of capital required to expand their business, Amira and Lola have decided to borrow the maximum loan amount from the SSAS, charged at a fixed rate of 3% compound over 5 years.

**Question 3**

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

***PLEASE ENSURE YOU ANSWER EACH QUESTION IN THE CORRECT ANSWER BOX***

**(a)** Outline the criteria that must be met to ensure that the loan from the SSAS qualifies as an authorised employer loan. **(10)**

**(b)** Calculate, **showing all your workings**, the maximum amount that Amira and Lola will have to repay at the end of each year. **(5)**

**(c)** Explain the amount of contribution an employer can make to a registered pension scheme for its employees **and** how HM Revenue & Customs will determine the tax relief available. **(6)**

**(d)** **(i)** Calculate, **showing all your workings**, the amount of Income Tax and National Insurance contributions that will be paid by Sanjay if he **does not** take up the option of salary sacrifice, and the net effect on his pension contribution and take-home pay. **(8)**

**(ii)** Calculate, **showing all your workings**, the amount of Income Tax and National Insurance contributions that will be paid by Sanjay if he **does** take up the offer of salary sacrifice, and the net effect on his pension contribution and take-home pay. *You should assume that the employer pension contributions are based on the unreduced salary.* **(11)**

**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)** *Candidates would have gained full marks for any eleven from each of the following:*
If the company sells the business,

- it will be a disposal for Corporation Tax purposes
- on chargeable gains on any chargeable assets.
- Any gain realised by the company will be liable to Corporation Tax at 19%.
- Indexation will reduce the gain/uplift the buying costs on assets acquired before 1 January 2018,
- Indexation will be applied to the base cost/original cost of such assets.
- The indexation allowance applied to determine the amount of gain is calculated to December 2017.
- Goodwill that existed before 1 April 2002 remains taxable under the chargeable gains rules, (which did not permit a Corporation Tax deduction for amortisation).
- There is no base cost to goodwill for this company as the company started with no goodwill and therefore there will be no indexation.
- This means that the whole of the proceeds will be taxable
- as Stephen built the business up rather than purchasing an existing business.

- They would have further tax to pay if they were to withdraw the sale proceeds from the company.

- To reduce tax paid they could leave the proceeds in the company
- where they could be invested in other assets or another trade.

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

- The purchaser knows exactly what they are buying
- and are unlikely to acquire unknown past liabilities.
- Less due diligence is required.
- No legal obligations to staff.

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

- The SSAS may be wound up/ended with benefits transferred to alternative individual arrangements.
- although this can be avoided by amending the scheme rules.

- It is possible to continue to run a SSAS without a sponsoring company
- provided the scheme rules allow for this
- and the aim is still to provide retirement benefits.

- If the remaining directors have another company, it may be possible to transfer the SSAS to the new company before sale.
- The scheme rules should be amended so that the existing sponsoring company has no powers over the SSAS.

**(ii)**

- Winding up the SSAS may not be beneficial to the owners
- as this would involve the sale of the business premises
- which may not be at an advantageous time or price as property is an illiquid asset.

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

- Main asset is the property
- although it is possible that rental income can provide Stephens pension income.
- If the rental income is not enough or if the other members want to draw benefits
- The property may need to be sold
- As the property is an illiquid asset it may not be able to be sold quickly

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

- Must apply to all employees
- employees acquire shares at a discount
- by the grant of share options.
- Qualifying period of employment may apply.
- They do not pay income tax or NICs on gains.
- Employees make regular savings of up to £500 per month
- under an SAYE contract.
- The money is saved into a bank, building society or other SAYE-authorised account
- and can be used to buy the shares after three or five years.
- At the end of the scheme a tax-free bonus is added to savings.
- There is no income tax liability on the grant of the share option or on its exercise.
- There should be a clause to ensure the option can be exercised on death, retirement or redundancy.

**(ii)**

- Due to the regular savings there is guaranteed to be money available to buy the shares in an SAYE scheme. In an employee share option scheme they would have to find a lump sum on exercise of the share option scheme.
- If the option to buy lapses for any reason/worthless/sale of company
- employee can withdraw savings with interest and bonuses.

**(iii)**

- Treated as a benefit in kind.
- Employee will be taxed (Income Tax)
- on the value of the shares.
- No NICs chargeable.

**(e) (i)**

- Inform co-directors.
- Due to a moral obligation and may be required by the articles of association.
- Lenders.
- As he will not be able to fulfil his personal guarantees.

**(ii)**

- The trustee in bankruptcy takes control of all his assets, if Robert is declared bankrupt,
- except for some essential items needed for his basic domestic needs/running the business.
- The trustee may sell all the assets
- and apply the proceeds for the benefit of Robert's creditors.
- The trustee may also take any property/inheritance or prize winnings Robert acquires during his period of bankruptcy.
- Pension value/SSAS excluded.

**(iii)**
- If the court makes an income payments order
- or Robert agrees to a voluntary Income Payments Agreement,
- the trustee may take any income Robert receives
- above a deemed reasonable level
- for a period of up to three years from the date of the agreement,
- regardless of whether Robert obtains a discharge from his bankruptcy in the meantime.
- But income from pension included in income payment order.

**(iv)** *Candidates would have gained full marks for any five of the following:*
- Robert may not obtain credit of more than £500
- or trade in any other name other than his own
- without disclosing the bankruptcy.
- He will be discharged after one year
- but will possibly be made subject to a bankruptcy restriction order (BRO),
- which can last from two to 15 years.
- Cannot act as a company director during the period of his bankruptcy
- unless the court gives express permission to do so.

**(f)** **(i)**
- He will be closely involved in the process.
- The restrictions of bankruptcy are avoided.
- He avoids the stigma of being made bankrupt
- and disqualifications that follow bankruptcy/Robert can carry on being a director.
- Overall costs are usually less than a formal bankruptcy.
- Robert does not have to tell anyone, not even the other directors.

**(ii)** *Candidates would have gained full marks for any nine of the following:*
- A formal proposal is made by Robert to the creditors
- to repay part or all of the debt.
- The proposal is sent to the creditors and the court
- if the creditors agree an authorised insolvency practitioner is appointed
- to oversee the repayments.
- The insolvency practitioner reports to the court giving their opinion on whether the proposal will work.
- Robert may apply to the court for the grant of an interim order
- preventing creditors from proceeding with a bankruptcy petition.
- A creditors' meeting is held and if 75% of creditors by value agree
- the proposals are accepted, and all creditors are bound by the IVA.
- The IVA usually lasts five years
- and will end when all the sums in the proposal are paid.

**Model Answer for Question 2**

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

**Limited company benefits**

- It is generally easier to raise capital.
- Dominic and Louis will both benefit from limited liability and the debts of the company can only be claimed against the company.
- Shares can be easily transferred which ensures perpetual succession/management and shareholdings can be separated.
- More flexible personal remuneration options such as flexibility with bonus/dividends/pension contributions.
- They can retain profits in the business and so delay the payment of personal tax to a more convenient time.
- Payment of dividends can reduce personal Income Tax and national insurance.
- Better State social security entitlement
- as they are likely to be salaried.

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

**Limited company drawbacks**

- National Insurance for both employer and employee.
- There are more formalities and more expense involved in establishing and running a limited company.
- Dividend payments or a flexible remuneration strategy require a profit.
- Lack of confidentiality as memorandum and articles are public documents.
- Dominic and Louis have many legal obligations as directors.
- Public disclosure of accounts is required.

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

- When there is a finite duration or specific purpose for the business.
- When those who own and run the business must be the same, that is no owners who are not involved in/not actively running the business.
- When confidentiality of members or accounts is required.
- A partnership is flexible to change to a limited company later if required.
- When a simpler business structure is required.

**(c)**

- Partnership – profit share as income, taxed as income.
- Company – via bonuses,
- dividends,
- pension contributions.

**(d)** **(i)**
- The policies would be on a life of another basis.
- The firm is the proposer and the owner.
- The life assured would be Dominic.

**(ii)**
- It does not always reflect true worth of the individual.
- When they have a first year profit, this may not be an accurate reflection of
- the business' potential profits in the future and could lead to under insurance.
- The use of gross or net profit will give very different results.

**(iii)** **Advantages**
- Lower premiums/one policy fee.
- Policy builds a value.
- Simple arrangement.

**Disadvantages**
- No tax relief on premium.
- Critical illness claim removes the life cover
- which may then be difficult to replace.

**(e)** **(i)** Payback period.
- Crude/simplified - based on length of time it takes to recoup the capital cost.
- Arbitrary way of making decision/arbitrary target set for payback length of time.
- Takes no account of inflation.

**(ii)** *Candidates would have gained full marks for any three of the following:*
- Internal Rate of Return (IRR) is a complex calculation/requires trial and error/iterative method to a find the IRR
- Net Present Value (NPV) gives a monetary amount in today's money
- of the expected profit.
- Highest IRR may not give the highest NPV.

**(iii)** *Candidates would have gained full marks for any three of the following:*
- Tax considerations.
- Capital not tied up if leased.
- Lease and service contract may be better than purchase plus service contract.
- NPV/IRR calculations may favour one over the other.

**Model Answer for Question 3**

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

- The loan must be made to a sponsoring employer
- at 50% maximum
- of the net value of the SSAS.
- The loan must be secured as a first charge
- of at least an equivalent value to the amount of the loan and interest i.e. against property.
- The interest rate charged must be at a commercial rate
- calculated at 1% above the average base lending rate of the six main high street banks.
- Repayment period of the loan must not be more than 5 years
- although it can be rolled over for a further 5 years
- if the company finds themselves in financial difficulty (but can only be done once).
- All loan repayments must be repaid in equal instalments of interest and capital at least annually.

**(b)** £280,000 x 50% = £140,000
£140,000 x $1.03^{5}$
= £162,298.36
£162,298.36/5
The repayment amount each year would be £32,459.67

**(c)**
- An employer can effectively make unlimited pension contributions for its employees
- Employer pension contributions are paid gross
- Can be claimed as a business expense
- before Corporation Tax is calculated.
- Tax relief on employer contributions is at the discretion of HM Revenue & Customs.
- Contributions must be 'wholly and exclusively' for the purposes of the business.

**(d)** **(i)** £30,000 - £12,500
= £17,500 x 20% = £3,500 (Income Tax)
£30,000 - £9,500 (PT)
= £20,500 x 12% = £2,460 (NICs)
Total **= £5,960**

Pension contribution = £30,000 x 5%
= £1,500 minus tax relief at 20% = **£1,200**
Take home pay is = £30,000 - £2,460 - £3,500 - £1,200 = **£22,840**

**(ii)**
- His salary becomes £28,500
- £28,500 - £9,500 = £19,000 x 12% = £2,280 NICs
- £28,500 - £12,500 = £16,000 x 20% Income Tax = £3,200
- Take home pay is = £28,500 - £2,280 - £3,200 = **£23,020**

- The company would have paid NICs of £30,000 - £8,788
- x 13.8%
- = £2,927.26
- The company will now pay NICs of £28,500 - £8,788 x 13.8% = £2,720.26
- A reduction of £207/half of this is paid into Sanjay's pension i.e. £103.50

- This makes the pension contribution **£1,603.50**
- \+ employer contribution of **£1,500 = £3103.50**

**All questions in the final October 2021 paper will be based on English law and practice applicable in the tax year 2021/2022, 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 | 2019/2020 | 2020/2021 |
|---|---|---|
| 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.*

| | 2019/2020 | 2020/2021 |
|---|---|---|
| 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.<br>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% |