Chartered Insurance Institute

AF1

Advanced Diploma in Financial Planning

Unit AF1 – Personal tax and trust planning

October 2018 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2018/2019, unless stated otherwise in the question, and should be answered accordingly.

It should be assumed that all individuals are domiciled and resident in the UK unless otherwise stated.

Instructions

- Three hours are allowed for this paper.
- **Do not begin writing until the invigilator instructs you to.**
- **Read the instructions on page 3 carefully before answering any questions.**
- Provide the information requested on the answer book and form B.
- You are allowed to write on the inside pages of this question paper, but you must **NOT** write your name, candidate number, PIN or any other identification anywhere on this question paper.
- The answer book and this question paper must **both be handed in personally by you** to the invigilator before you leave the examination room. **Failure to comply with this regulation will result in your paper not being marked and you may be prevented from entering this examination in the future.**

Unit AF1 – Personal tax and trust planning

Instructions to candidates

Read the instructions below before answering any questions

- **Three hours** are allowed for this paper which carries a total of 160 marks as follows:

- Section A: 80 marks
- Section B: 80 marks

- You are advised to spend approximately 90 minutes on Section A and 90 minutes on Section B.

- You are strongly advised to attempt **all** questions to gain maximum possible marks. The number of marks allocated to each question part is given next to the question and you should spend your time in accordance with that allocation.

- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.

- You may find it helpful in some places to make rough notes in the answer booklet. If you do this, you should cross through these notes before you hand in the booklet.

- It is important to show all steps in a calculation, even if you have used a calculator.

- If you bring a calculator into the examination room, it must be a silent, battery or solar-powered, non-programmable calculator. The use of electronic equipment capable of being programmed to hold alphabetic or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements.

- Tax tables are provided at the back of this question paper.

- Answer each question on a new page and leave six lines blank after each question part.

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

SECTION A

This question is compulsory and carries 80 marks

Question 1

Read carefully all information provided in the case study before attempting the questions. Your answers should take into account the clients circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c), (d) and (e) which follow.

Brian, aged 82, is married to Clare, aged 81. Clare enjoys good health, but Brian has recently been diagnosed with type 2 diabetes.

Since she retired twenty years ago, Clare has been receiving an annual pension from a previous employer's pension scheme of £9,000. She also receives a State Pension of £8,000. Her other annual income includes interest of £2,000 from £200,000 she holds in a building society account and dividend income of £2,200 from her XYZ Ltd shares.

Clare bought the shares in XYZ Ltd as follows:

Acquisition date	Number of shares purchased	Purchase price
June 1996	5,000	£12,500
August 2005	5,000	£14,000
February 2016	6,000	£18,000

In June 2018, Clare sold 9,000 XYZ Ltd shares at a price of £4.20. At the same time, she sold a small portfolio of directly held gilts which resulted in her making a loss of £5,000.

Brian's only income is a State Pension of £9,750 gross per annum, although they both hold the maximum amount in premium bonds and regularly win small prizes. In the tax year 2018/2019 they each receive £400 in premium bond prizes.

Their home is mortgage free and has recently been valued at £950,000.

Brian and Clare have two grown up children, Amanda and Michael, both in their fifties. Amanda is married with twin boys, aged 17. Michael is unmarried with no children.

Their grandchildren are due to start university in 2019 and Brian and Clare would like to be able to help them with ongoing living costs. They are wondering whether to use some of Clare's savings to invest in a product that will provide them with extra income as well as help them reduce their Inheritance Tax liability.

Amanda owns several buy-to-let properties which she rents for a total gross monthly income of £5,000. She has interest only mortgages on the properties, which total £176,000 on which she pays a standard variable rate of 2.5%. Amanda has no other earnings.

In February 2018, Michael left his previous employer to set-up his own interior design business as a sole trader. He spent six months on a specialist course and started trading on 1 August 2018. He expects his earnings for the tax year 2018/2019 to be £50,000.

Questions

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

(a) When considering the joint liability of Brian and Clares Income Tax in the tax year 2018/2019:

(i) State the criteria to qualify for the Marriage Allowance. **(4)**

(ii) Explain how the Marriage Allowance will operate for Brian and Clare including how it is claimed and received in full. **(7)**

(iii) Calculate, **showing all your workings**, Clare's Income Tax liability for the tax year 2018/2019. **(10)**

(b) **(i)** Calculate, **showing all your workings**, how much Capital Gains Tax Clare will pay as a result of her selling the shares in June 2018. *Ignoring the cost of sale.* **(10)**

(ii) State by when Clare must pay her Capital Gains Tax bill. **(1)**

(c) **(i)** State the benefits to Brian and Clare of using a joint life discounted gift trust. **(6)**

(ii) State the factors specific to Brian and Clare that an adviser would need to take into account before considering an investment in a joint life discounted gift trust. **(9)**

QUESTIONS CONTINUE OVER THE PAGE

(d) With regard to Amanda's buy-to-let properties:

(i) Explain how the rules on claiming Income Tax relief on mortgage interest affect her in the tax year 2018/2019. **(4)**

(ii) Calculate, **showing all your workings**, the impact of these rules on her Income Tax position. **(3)**

(iii) Explain the personal tax advantages of her buy-to-let properties being treated as furnished holiday lets. **(6)**

(e) With regard to Michael's new interior design business, and bearing in mind his change of employment status:

(i) Explain how Michael would register as self-employed. **(3)**

(ii) Explain, in detail, how Michael is assessed for Income Tax purposes in the first three years of trading including, where relevant, the profits he will be taxed on. **(8)**

(iii) Calculate, **showing all your workings**, Michael's Class 2 and Class 4 National Insurance contributions in the tax year 2018/2019. **(6)**

(iv) State the dates that Michael will pay his National Insurance contributions due for the tax year 2018/2019. **(3)**

Total marks for this question: 80

Section B questions can be found on pages 8 - 11

SECTION B

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

Question 2

Read carefully all information provided in the case study before attempting the questions. Your answers should take into account the client's circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c), (d) and (e) which follow.

Steve, aged 55, was employed in the engineering sector for twenty years before deciding, in 2017, to work for himself operating as a sole trader. The majority of his work comes from his previous employer where he worked for over ten years. This client trusts only Steve to do their work so does not consider it appropriate that he contracts this work to anyone else.

Steve is married to Bella, aged 52, they have two adult children who are not dependant. Bella works full-time as a teacher.

Their home is valued at £300,000 and owned as joint tenants. Steve has £30,000 invested in UK equity unit trusts. Bella has a regular savings stocks and shares ISA invested in European equities with a value of £12,000. They have joint savings of £5,000 held in a building society account.

Steve has been making pension contributions to his self-invested personal pension (SIPP) for the last five years and has recently made a one-off contribution of £30,000. The total value of the SIPP is £250,000.

Steve has recently had a serious car accident and has been told that he will not be able to work for at least twelve months. He is concerned that as a result of him not being able to work, he will face bankruptcy.

Questions

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

(a) Detail the factors that will be taken into account by HM Revenue & Customs to ascertain whether Steve is treated as;

(i) employed; **(5)**

(ii) or self-employed. **(4)**

(b) In the event that Steve was eventually declared bankrupt.

Explain the effects of a bankruptcy order on Steve's:

(i) home; **(6)**

(ii) investments; **(2)**

(iii) SIPP. **(7)**

(c) List any other property of Steve and Bella that are likely to be exempt from the bankruptcy proceedings. **(4)**

(d) State the impact of insolvency on Steve, had he originally established his business as a limited company. **(5)**

(e) Explain how Steve's entitlement to State Pension is calculated. **(7)**

Total marks available for this question: 40

QUESTIONS CONTINUE OVER THE PAGE

Question 3

Read carefully all information provided in the case study before attempting the questions. Your answers should take into account the client's circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c), (d) and (e) which follow.

Elizabeth, aged 79, has never been married. She has one son, John, aged 56, who settled in Australia in 2012. In March 2018, John married his long-term Australian partner, Reuben.

In August 2013, Elizabeth settled £250,000 into a discretionary trust for the future benefit of John. In July 2014, she made a gift to a children's charity of £50,000. In February 2018 she made a gift to John of £20,000 in anticipation of his marriage to Reuben.

John arranged a general Power of Attorney before he left the UK so his mother could look after things on his behalf while he is in Australia.

John is now considering retiring and he and Reuben are now relocating to the UK. One of John's concerns when he returns to the UK is being subjected to high levels of tax, so he has expressed an interest in considering schemes that specifically aim to reduce his tax liability.

Elizabeth has recently written a Will which leaves £40,000 to a local dog charity with the remainder to John. She has an estate of £500,000 which includes an Enterprise Investment Scheme (EIS) with a value of £75,000 which she has held for four years. Elizabeth has, since 2013, lived with her sister after selling her house and currently owns no property in her own name. With her interest in charity work, Elizabeth is considering setting up a charitable trust.

Questions

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

(a) Assuming Elizabeth dies in November 2018, calculate, **showing all your workings**, the Inheritance Tax liability due on her estate. **(12)**

(b) If Reuben was to move to the UK permanently:

(i) Describe how Reuben's domicile will be determined. **(5)**

(ii) Explain how Reuben's tax position will change once he becomes deemed domiciled in the UK. **(5)**

(c) Explain briefly the authority granted to Elizabeth in the general Power of Attorney arranged by John. **(6)**

(d) John has been informed that one of the investments that he is considering is under investigation by HM Revenue & Customs for tax avoidance.

Describe briefly, the disclosure of tax avoidance schemes rules that will apply to both John and the provider of the scheme. **(5)**

(e) Explain the steps that Elizabeth must follow in order to set up and register a charitable trust. **(7)**

Total marks for this question: 40

The tax tables can be found on pages 13 – 21

INCOME TAX

RATES OF TAX	2017/2018	2018/2019
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	£33,500	£34,500
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

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

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)	£11,500	£11,850
Married/civil partners (minimum) at 10% †	£3,260	£3,360
Married/civil partners at 10% †	£8,445	£8,695
Transferable tax allowance for married couples/civil partners	£1,150	£1,190
Income limit for Married couple's allowance†	£28,000	£28,900
Rent a Room relief	£7,500	£7,500
Blind Person's Allowance	£2,320	£2,390
Enterprise Investment Scheme relief limit on £1,000,000 max**	30%	30%
Seed Enterprise Investment relief limit on £100,000 max	50%	50%
Venture Capital Trust relief limit on £200,000 max	30%	30%

§ the Personal Allowance reduces by £1 for every £2 of income above the income limit irrespective of age (under the income threshold).
† where at least one spouse/civil partner was born before 6 April 1935.
*** maximum for 'standard' investment but for 'knowledge intensive' investment, the limit is £2,000,000.*

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

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	**Weekly**
Lower Earnings Limit (LEL)	£116
Primary threshold	£162
Upper Earnings Limit (UEL)	£892

Total earnings £ per week	**CLASS 1 EMPLOYEE CONTRIBUTIONS**
Up to 162.00*****	Nil
162.01 – 892.00	12%
Above 892.00	2%

**This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £116 per week. This £116 to £162 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 162.00**	Nil
162.01 – 892	13.8%
Excess over 892.00	13.8%

*** Secondary earnings threshold.*

Class 2 (self-employed)	Flat rate per week £2.95 where profits exceed £6,205 per annum.
Class 3 (voluntary)	Flat rate per week £14.65.
Class 4 (self-employed)	9% on profits between £8,424 - £46,350. 2% on profits above £46,350.

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

LIFETIME ALLOWANCE CHARGE

55% of excess over lifetime allowance if taken as a lump sum.
25% of excess over lifetime allowance if taken in the form of income, which is subsequently taxed under PAYE.

ANNUAL ALLOWANCE

TAX YEAR	ANNUAL ALLOWANCE
2011/2012	£50,000
2012/2013	£50,000
2013/2014	£50,000
2014/2015	£40,000
2015/2016	£40,000~
2016/2017	£40,000*
2017/2018	£40,000*
2018/2019	£40,000*

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

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

MONEY PURCHASE ANNUAL ALLOWANCE	2017/2018	2018/2019
	£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	2017/2018	2018/2019
Individuals, estates etc	£11,300	£11,700
Trusts generally	£5,650	£5,850
Chattels proceeds (restricted to five thirds of proceeds exceeding limit)	£6,000	£6,000

TAX RATES		
Individuals:		
Up to basic rate limit	10%	10%
Above basic rate limit	20%	20%
Surcharge for residential property and carried interest	8%	8%
Trustees and Personal Representatives	20%	20%
Entrepreneurs' Relief* – Gains taxed at:	10%	10%
Lifetime limit	£10,000,000	£10,000,000

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

INHERITANCE TAX

RATES OF TAX ON TRANSFERS	2017/2018	2018/2019
Transfers made on death after 5 April 2015		
- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
Transfers made after 5 April 2015		
- Lifetime transfers to and from certain trusts	20%	20%

A lower rate of 36% applies where at least 10% of deceased's net estate is left to a registered charity.

MAIN EXEMPTIONS

Transfers to		
- UK-domiciled spouse/civil partner	No limit	No limit
- non-UK-domiciled spouse/civil partner (from UK-domiciled spouse)	£325,000	£325,000
- main residence nil rate band*	£100,000	£125,000
- UK-registered charities	No limit	No limit

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

Lifetime transfers		
- Annual exemption per donor	£3,000	£3,000
- Small gifts exemption	£250	£250
Wedding/civil partnership gifts by		
- parent	£5,000	£5,000
- grandparent/bride and/or groom	£2,500	£2,500
- other person	£1,000	£1,000

100% relief: businesses, unlisted/AIM companies, certain farmland/building
50% relief: certain other business assets

Reduced tax charge on gifts within 7 years of death:

- Years before death	0-3	3-4	4-5	5-6	6-7
- Inheritance Tax payable	100%	80%	60%	40%	20%

Quick succession relief:

- Years since IHT paid	0-1	1-2	2-3	3-4	4-5
- Inheritance Tax relief	100%	80%	60%	40%	20%

CAR BENEFIT FOR EMPLOYEES

The charge for company car benefits is based on the carbon dioxide (CO_2) emissions. There is no reduction for high business mileage users.

For 2018/2019:

- The percentage charge is 13% of the car's list price for CO_2 emissions of 50g/km or less.
- For cars with CO_2 emissions of 51g/km to 75g/km the percentage is 16%.
- For cars with CO_2 emissions of 76g/km to 94g/km the percentage is 19%.
- Cars with CO_2 emissions of 95g/km have a percentage charge of 20% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 37% (emissions of 190g/km and above).

There is an additional 4% supplement for diesel cars not meeting Euro IV emission standards. However, the maximum charge remains 37% of the car's list price.

Car fuel The benefit is calculated as the CO_2 emissions % relevant to the car and that % applied to a set figure (£23,400 for 2018/2019) e.g. car emission 90g/km = 19% on car benefit scale. 19% of £23,400 = £4,446.

1. **Accessories** are, in most cases, included in the list price on which the benefit is calculated.
2. **List price** is reduced for capital contributions made by the employee up to £5,000.
3. **Car benefit** is reduced by the amount of employee's contributions towards running costs.
4. **Fuel scale** is reduced only if the employee makes good **all** the fuel used for private journeys.
5. **All car and fuel benefits** are subject to employers National Insurance contribution's (Class 1A) of 13.8%.

PRIVATE VEHICLES USED FOR WORK

	2017/2018 Rates	2018/2019 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

	2017/2018	2018/2019
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£200,000	£200,000
Plant & machinery (reducing balance) per annum	18%	18%
Patent rights & know-how (reducing balance) per annum	25%	25%
Certain long-life assets, integral features of buildings (reducing balance) per annum	8%	8%
Energy & water-efficient equipment	100%	100%
Zero emission goods vehicles (new)	100%	100%
Qualifying flat conversions, business premises & renovations	100%	100%

Motor cars: Expenditure on or after 01 April 2016 (Corporation Tax) or 06 April 2016 (Income Tax)

CO_2 emissions of g/km:	50 or less*	51-110	111 or more
Capital allowance:	100% first year	18% reducing balance	8% reducing balance

**If new*

MAIN SOCIAL SECURITY BENEFITS

		2017/2018	2018/2019
		£	£
Child Benefit	First child	20.70	20.70
	Subsequent children	13.70	13.70
	Guardian's allowance	16.70	17.20
Employment and Support Allowance	Assessment Phase		
	Age 16 – 24	Up to 57.90	Up to 57.90
	Aged 25 or over	Up to 73.10	Up to 73.10
	Main Phase		
	Work Related Activity Group	Up to 102.15	Up to 102.15
	Support Group	Up to 109.65	Up to 110.75
Attendance Allowance	Lower rate	55.65	57.30
	Higher rate	83.10	85.60
basic State Pension	Single	122.30	125.95
	Married	195.60	201.45
new State Pension	Single	159.55	164.35
Pension Credit	Single person standard minimum guarantee	159.35	163.00
	Married couple standard minimum guarantee	243.25	248.80
	Maximum savings ignored in calculating income	10,000.00	10,000.00
Bereavement Payment*		2,000.00	2,000.00
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
Jobseekers Allowance	Age 18 - 24	57.90	57.90
	Age 25 or over	73.10	73.10
Statutory Maternity, Paternity and Adoption Pay		140.98	145.18

**Only applicable where spouse or civil partner died before 6 April 2017.*

*** Only applicable where spouse or civil partner died on or after 6 April 2017.*

CORPORATION TAX

	2017/2018	2018/2019
Standard rate	19%	19%

VALUE ADDED TAX

	2017/2018	2018/2019
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%

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 is 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.

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