Chartered Insurance Institute

AF2

Advanced Diploma in Financial Planning

Unit AF2 – Business financial 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 AF2 – Business financial planning

Instructions to candidates

Read the instructions below before answering any questions

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

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

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

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

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

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

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

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

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

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

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

SECTION A

This question is compulsory and carries 80 marks

Question 1

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

John has recently left his employed role as technical manager of a car parts manufacturer to start his own business with his sister, Amelia. John and Amelia are both single with no financial dependants. The business will be the sale of car parts to garages.

John has a self-invested personal pension (SIPP) currently valued at £220,000. He has not made any personal pension contributions during the current tax year but fully utilised his pension allowances for the previous three tax years. He left employment on 31 March 2018 and has no taxable income for the current tax year.

Amelia is returning to work and has no earnings for the current tax year 2018/2019. She has a personal pension valued at £150,000 and has full pension contribution allowances to carry forward.

John and Amelia will be equal partners in the new business. Both have injected £50,000 start-up capital for the purchase of stock and to provide working capital. They have found a suitable local warehouse from which to operate the business. This is on the market to buy for £650,000 (including VAT).

They have recruited two employees to start working for the new business. They will be employed as soon as the business is legally formed.

John and Amelia are looking at the various legal structures for the business. They wish to ensure maximum protection of their personal assets from the business, that personal tax liabilities are minimised, and future funding needs could be sourced by the business in the future if required.

Their accountant has advised them to set the business up as a limited company with the trading year ending 31 March.

They anticipate the business will make a profit before tax of £200,000 in the first trading year (to 31 March 2019). Both John and Amelia will draw a gross salary of £50,000 from the business in the current tax year 2018/2019.

They have heard from their accountant how a small self-administered pension scheme (SSAS) could be used to help finance the business.

Questions

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

(a) State, giving your reasons, why their accountant's recommended legal structure for the business is suitable for John and Amelia. **(8)**

(b) **(i)** State when the Corporation Tax liability must be paid by. **(2)**

(ii) State when the Corporation Tax self-assessment return is due. **(2)**

(c) Explain **three** advantages and **three** disadvantages to John and Amelia of drawing the profits as:

(i) salary; **(6)**

(ii) dividends. **(6)**

(d) Calculate, **showing all your workings**, the net amount Amelia would receive after all taxes are applied if her share of the gross profit was paid to her as a:

(i) dividend; **(7)**

(ii) bonus. **(7)**

(e) John and Amelia have decided to set up a small self-administered pension scheme (SSAS) for the new company.

(i) Explain to John and Amelia the rules governing a SSAS loan to the business. **(8)**

(ii) Calculate, **showing all your workings**, the pension contribution required for both John and Amelia to purchase the property via the SSAS with maximum borrowing. *Apply all costs and assume total legal fees of £18,000 and an equal pension contribution is required.* **(9)**

(iii) State, giving reasons, the tax treatment of the required pension contribution. *Assume the contribution is made from the business.* **(8)**

QUESTIONS CONTINUE OVER THE PAGE

(f) **(i)** Explain to John and Amelia their obligations as employers in relation to auto-enrolment legislation. **(8)**

(ii) Explain briefly to John the implications of auto-enrolment for him personally. **(3)**

(g) Explain the advantages to John and Amelia of invoice factoring for the business. **(6)**

Total marks available for this question: 80

Section B questions can be found on pages 8 - 11

SECTION B

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

Question 2

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

Charles and David are the shareholding directors of a manufacturing private limited company called Steffit Ltd. The company is long established, and Charles owns 40% of shares whilst David owns 60%. They are both married with adult children. David's children have no interest in the business.

David's role in the company is mainly administrative. Charles provides the business and technical skills of the company. The business has recently taken out a loan of £250,000 for a period of four years for expansion purposes. The bank agreed to lend the business this amount of money based mainly on Charles' technical skills.

They employ Michelle as their major account sales person and she is responsible for generating more than 50% of the sales of the business. Michelle has a basic salary of £75,000 a year, bonuses, a company car and various benefits as part of her remuneration package.

Charles’ and Davids’ Wills currently leave their shares in Steffit Ltd to their respective children. Their solicitor has advised them to put a suitable shareholder arrangement in place. Charles and David are looking for maximum flexibility in any arrangements to protect their shareholdings.

There are no business protection policies currently in place for the Directors or Michelle.

Questions

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

(a) **(i)** Identify **four** key person protection areas relevant to Steffit Ltd. **(4)**

(ii) State the information you would need, in addition to salary, to calculate the level of key person cover required for Michelle using the proportion of profits formula. **(3)**

(iii) Explain the drawbacks to Steffit Ltd of using the proportion of profits formula for calculating key person cover for Michelle. **(6)**

(b) **(i)** Explain the tax treatment of the premiums, including the qualifying conditions, for a policy taken out by Steffit Ltd on the life of Michelle to provide cover for loss of profits. **(4)**

(ii) State the tax treatment of the premiums if the key person protection included repayment of the business loan as well as loss of profits and recommend how this problem could be solved. **(3)**

(c) Charles and David are setting up the shareholder agreement.

(i) State the **two** options they could use in the valuation clause. **(2)**

(ii) Give **one** drawback for each option identified in **part (c)(i)** above. **(2)**

(iii) Explain the Inheritance Tax treatment of David's shares in Steffit Ltd if his shares pass under his Will to his sons. **(4)**

(d) **(i)** Explain how a shareholder protection arrangement should be set up for David and Charles. **(6)**

(ii) Explain why David and Charles should only use a business trust for the protection arrangement. **(6)**

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 clients circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c) and (d) which follow.

Insole Limited is a successful sports shoe retailer. The business was set up in 1982 by Nicola who still runs the business and owns 90% of the ordinary share capital. The other shareholders are Kim, an employee who owns 3% and Mahendra, an ex-employee who left the business in 2010, who owns 7%.

The business is profitable, with profits for the current trading year expected to be £300,000. This is after Nicola's director salary of £60,000.

Nicola is considering retirement, and the business is currently on the market for £2,400,000 for the full share value. Several interested parties have approached Nicola over the sale.

Nicola's son, Oliver, has recently set up a marketing company. His company has been successful but requires additional working capital of £200,000, to fund its next stage growth. Nicola is considering an investment in Oliver's company, although she would not want to be involved in managing the business.

Questions

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

(a) Explain why Nicola would qualify for entrepreneurs' relief on the sale of her shares but Kim and Mahendra would not. **(6)**

(b) **(i)** Calculate, **showing all your workings**, the net amount after Capital Gains Tax (CGT) that Nicola would receive from the sale if the shares were sold during the current tax year. *Assume nil start-up costs for the purpose of this calculation and Nicola has made no other gains this tax year.* **(7)**

(ii) State the CGT advantages to Nicola in delaying the sale of her business until 30 April 2019 instead of selling it in the current tax year. **(4)**

(c) **(i)** Outline the main conditions that must be met in order for Oliver's business to qualify as an Enterprise Investment Scheme investment. **(6)**

(ii) Explain briefly, the Income Tax and CGT treatment of Nicola's proposed investment in Oliver's business. **(8)**

(d) A competitor has made an offer to buy the assets of the business as opposed to the shares.

(i) Explain the advantages to the purchaser. **(3)**

(ii) Explain to Nicola the tax implications for the business. **(6)**

Total marks available 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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