Chartered Insurance Institute

# J05

# Diploma in Financial Planning

## Unit J05 – Pension income options

### April 2019 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

- Two 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 J05 – Pension income options

## Instructions to candidates

## Read the instructions below before answering any questions

- **Two hours** are allowed for this paper which consists of 15 short answer questions and carries a total of 130 marks.

- 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.**

**Attempt ALL questions**

**Time: 2 hours**

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

**1.** Trudi, aged 61, was recently widowed. Her husband John died at the age of 62 and at the time of his death, he was employed by VIGHT Ltd. John had the following pension death benefits and no form of transitional protection.

| Scheme | Death benefit | Notes |
|---|---|---|
| VIGHT Ltd death in service scheme | £550,000 | Written under registered pension scheme rules |
| VIGHT Ltd Group Personal Pension Plan | £750,000 | Uncrystallised fund |
| Capped drawdown plan | £300,000 | John crystallised a personal pension plan valued at £225,000 in February 2013 |

**(a)** In respect of John's pension based death benefits, explain, giving your reasons, how they will each be treated for lifetime allowance purposes. **(6)**

**(b)** Calculate, **showing all your workings**, the lifetime allowance tax charge payable as a result of John's death. *You should assume that the remaining death benefits are paid in the tax year 2018/2019 and the excess over the lifetime allowance is taken as a lump sum.* **(7)**

**2.** Adrian retired and took benefits from his employer's defined benefit pension scheme five years ago, when he was aged 58. The scheme's normal pension age was 65 and he had been a member of the scheme for 23 years. He currently receives an annual pension of £22,500. All of Adrian's pension increases by 3% per annum and includes a 66% widow's pension. He is married and has no children.

Adrian's pension scheme has now entered the Pension Protection Fund (PPF).

Explain, giving your reasons, how Adrian's pension benefits will be impacted as a result of the scheme entering the PPF. **(6)**

**3.** Describe the criteria that must be met for a lump sum payment from an uncrystallised personal pension plan to be treated as a small pots payment, and outline how this payment will be taxed. *No calculations are required.* **(7)**

**4.** Leo, aged 64, has deferred benefits in a previous employer's defined benefit pension scheme. He has been offered the option of pension increase exchange (PIE) when he takes his benefits from the scheme at the age of 65.

**(a)** Explain to Leo what PIE is and why the scheme trustees may offer it. **(3)**

**(b)** Identify the key factors that should be considered by Leo when deciding whether to accept this offer. **(6)**

**5.** Ian, aged 65, has recently retired. He has an uncrystallised personal pension plan, currently valued at £53,000, which he has decided to fully withdraw.

Calculate, **showing all your workings**, the net lump sum that Ian will receive initially, assuming that the withdrawal is taxed on a 'Month 1' basis. *You should assume that the withdrawal takes place in the 2018/2019 tax year.* **(11)**

**6.** Nadia will retire when she reaches her State Pension age in May 2019 and will receive her State Pension of £9,450 per annum.

Nadia's husband died, aged 63, in May 2014. She receives a dependant's scheme pension of £6,000 per annum. She was also the nominated beneficiary under his personal pension plan (PPP) and designated these funds, currently valued at £367,000, into dependant's drawdown in July 2014. She has never drawn an income from this fund.

Nadia's other assets are her employer's group personal pension plan valued at £220,000, a house valued at £400,000, which is mortgage-free and savings of £30,000.

Outline the factors you would take into account when determining a sustainable level of income that can be drawn from Nadia's money purchase pension plans. **(8)**

**QUESTIONS CONTINUE OVER THE PAGE**

**7.** Vera died in March 2019, aged 68. She had nominated her husband, Edward, as the beneficiary of her pension arrangements.

At the time of her death, Vera had an uncrystallised personal pension plan (PPP) valued at £450,000. She was also in receipt of income of £14,000 per annum from a lifetime annuity. This was purchased in March 2014 and was set up on a single life basis and included annuity protection.

Explain the death benefits available to Edward, including the tax treatment, in respect of Vera's:

**(a)** Uncrystallised PPP. **(9)**

**(b)** Lifetime annuity. **(4)**

**8.** Rajiv's only pension is a personal pension plan (PPP) valued at £290,000. The PPP is wholly invested in a lifestyle fund with a selected retirement age of 65.

Rajiv has a high attitude to risk and plans to draw an income via a series of uncrystallised funds pension lump sums when he retires in May 2019 at the age of 65.

Explain why Rajiv's current investment approach is unsuitable and why he would benefit from an earmarked investment strategy in retirement. **(8)**

**9.** When considering a retirement income strategy, it is important to consider risk.

**(a)** State the definitions of attitude to risk and capacity for loss. **(4)**

**(b)** State **four** key factors that influence a person's attitude to risk in relation to their pension. **(4)**

**10.** Victor, aged 63, is planning to fully retire next month. His pension arrangements consist of a retirement annuity contract, a Section 32 buy-out bond and two personal pension plans. Victor would like to consider consolidating all his pension plans and accessing his pension benefits through a flexi-access drawdown plan.

State the additional information you would require from each pension scheme administrator before advising Victor on the suitability of consolidating his pensions. **(8)**

**11**. Odette has been employed since 1975 and has never been a member of a contracted-out pension scheme. Odette will be entitled to a State Pension of £195.00 per week when she reaches her State Pension age in June 2019.

**(a)** Explain, giving your reasons, why Odette's State Pension will be higher than the new State Pension (£168.60 per week for 2019/2020) when she reaches State Pension age. **(4)**

**(b)** Explain briefly how Odette's State Pension will escalate once in payment. **(4)**

**12.** Tricia, aged 49, is considering retiring within the next 12 months. She has the contractual right to take benefits from her company pension scheme at age 50.

Explain, in detail, the eligibility conditions that must be satisfied for Tricia to take advantage of this contractual right. **(7)**

**13.** State the **ten** steps, as published by the Pension Regulator, that scheme members can take to protect their pension from a potential pension scam. **(10)**

**14.** Caroline, aged 66, is a widow and has a financially independent son. She is retired and her State Pension covers all her essential expenditure.

Caroline has a property worth £300,000 which is mortgage free, and a small emergency fund. She has a personal pension fund of £225,000 and is considering her options for taking the benefits from it. Caroline has a cautious attitude to risk.

Outline **four** potential benefits and **four** potential drawbacks for Caroline if she utilises the phased flexi-access drawdown option, rather than purchasing a lifetime annuity. **(8)**

**15.** Owais, aged 59, is employed and planning to continue working until he reaches his State Pension age. He needs to raise a net lump sum of £15,000 and is considering taking this from his personal pension plan (PPP). His PPP is valued at £80,000 and permits flexible withdrawals. He has no other means of raising this money.

Outline the factors Owais would need to consider, when deciding whether he should take the lump sum via an uncrystallised funds pension lump sum or as a pension commencement lump sum. **(6)**

The tax tables can be found on pages 9 – 17

# 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.<br>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

| | 2017/2018 | 2018/2019 |
|---|---|---|
| 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*

| | 2017/2018 | 2018/2019 |
|---|---|---|
| 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%<br>first year | 18%<br>reducing balance | 8%<br>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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