



Chartered  
Insurance  
Institute

# AF2

## Advanced Diploma in Financial Planning

### Unit AF2 – Business financial planning

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

- 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.**

Ashland Security Ltd is a long running trading business specialising in the sale of CCTV equipment. The business was established by two friends, Lee and Paul who each own 50% of the share capital. In addition to Lee and Paul, the business has 12 employees. The business has been performing very well over the last two years, achieving a turnover of £5,000,000 and net profit before Corporation Tax of £600,000 in the last full company year. The strong recent performance has been largely due to increased sales volumes.

Chloe, who has been with the business for over ten years, is employed as the company's sales manager. With the recent increase in sales it has been agreed that Chloe will become a shareholder in the business. She will buy a 20% share of the business with Lee and Paul both reducing their shareholding to 40%.

Ashland Security Ltd has key person protection in place for Chloe. The sum insured is £120,000 which is based on her annual salary. The business has in place a relevant life insurance plan written on the life of Chloe for the sum assured of £500,000.

Lee and Paul have a buy and sell agreement in place should one of them die. The agreement values the business at 1 x turnover. They each took out 'life of another' life insurance to provide the required funds on death. The policies were taken out six years ago with the sum assured of £2,000,000 each.

Lee and Paul are members of the Ashland Security Ltd small self-administered pension scheme (SSAS). They have each made equal contributions of £20,000 per annum to the SSAS from the business over the last ten years, including the current tax year. Neither of them have any pension benefits outside of the SSAS. Chloe, Lee and Paul are not subject to tapering for the pension annual allowance for the 2018/2019 tax year. The main asset of the SSAS is a commercial building from which the business trades. The building was valued at £650,000 last year. In addition, there is £89,500 held in cash deposits within the SSAS.

Chloe has a self-invested personal pension (SIPP) which has a current fund value of £300,000. Due to the recent business growth Ashland Security Ltd wishes to purchase an additional building with a purchase price of £600,000.

Lee, Paul and Chloe have agreed that the value of the business for the purposes of the share trade will be £5,000,000, the current annual turnover. In reviewing their shareholder protection arrangements, Lee, Paul and Chloe wish to ensure that their beneficiaries receive the full value of their shareholding and the arrangement is flexible and tax efficient.

## Questions

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

- (a) Chloe is considering her options for financing the purchase of the shares.
- Explain the tax implications to Chloe if she were to take a bank loan to purchase the shares. (5)
- (b) Chloe would like to review her options to purchase the shares using her pension fund.
- Explain to her the limits, implications and restrictions of purchasing the shares using:
- (i) her existing SIPP; (6)
- (ii) the Ashland Security Ltd SSAS if she were to transfer her SIPP funds to the SSAS. (6)
- (c) Explain to Ashland Security Ltd the implications for the existing key person cover when Chloe becomes a shareholder. (9)
- (d) Explain in detail the drawbacks if the shareholders were to use the existing relevant life policy for shareholder protection purposes for:
- (i) Chloe's beneficiaries; (3)
- (ii) Ashland Security Ltd; (2)
- (iii) Lee and Paul. (3)
- (e) (i) Explain to Lee and Paul how the existing shareholder protection arrangements are affected by Chloe becoming a shareholder. (7)
- (ii) Explain how a cross option agreement could be used for Paul, Lee and Chloe. (8)

QUESTIONS CONTINUE OVER THE PAGE

- (f) (i) List **three** disadvantages for the three shareholders of using 'life of another' protection policies to provide the funds for the shareholder protection arrangement. (3)
- (ii) Recommend a suitable alternative arrangement to writing 'life of another' policies and explain how it meets their objectives. (6)
- (iii) Explain the tax treatment of the premiums payable if paid personally or via the business on the policies recommended in your answer to **part (f)(ii)** above. (5)
- (g) Lee, Paul and Chloe wish to buy the additional building using the SSAS. There is no existing borrowing and they do not wish to borrow any funds via the SSAS. Any shortfall will be made up by the company paying extra contributions to the SSAS in proportion to their shareholding. *Assume that Chloe transfers her SIPP to the SSAS.*
- (i) Calculate, **showing all your workings**, the amount required to purchase the additional building via the SSAS, including Stamp Duty. *Assume that other associated purchase costs are £20,000.* (5)
- (ii) Calculate, **showing all your workings**, the funding shortfall and the extra contributions that Lee, Paul and Chloe would need to make to allow the SSAS to purchase the building. (6)
- (iii) Explain to Lee and Paul the tax implications to them of the company making the required contribution identified in your answer to **part (g)(ii)** above to the SSAS. (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), (d), (e) and (f) which follow.**

Lizzard Design is a limited liability partnership (LLP) owned and managed by two designated members, John and Evie.

John is the managing partner and holds a 75% stake in the business and is entitled to 75% of profits after an initial fixed profit share of £30,000. His capital account stands at £20,000 and has undrawn profits of £25,000.

Evie is entitled to a fixed profit share of £20,000 plus 25% of residual profits. Her capital account stands at £5,000 and has taken drawings that have exceeded her profit entitlement by £10,000.

Ben was admitted as a member on 1 April 2019 having previously been a part-time employee of the business. His salary of £10,000 has been replaced with a fixed profit share of the same amount. Ben has no entitlement to a further residual profit share nor does he participate in the day-to-day management of the firm. On admission as a member Ben was credited with capital of £100.

John owns Typpeit Ltd a private limited company that provides administrative services to Lizzard Design, equivalent to the cost of employing a single administration assistant at a cost of £20,000 per annum.

In April 2019, Typpeit Ltd was also admitted as a fourth member of the LLP and John intends re-allocating his 75% residual profit share to Typpeit Ltd.



**Questions**

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

- (a) The total profits for distribution for the year to 31 March 2019 were £220,000.  
Calculate, **showing all your workings**, the profit attributable to each member. (7)
- (b) Explain to John the tax treatment of the profits he intends re-allocating to Typeit Ltd. (8)
- (c) Evie has had financial difficulties and is about to be declared bankrupt. She has attempted to avoid her bankruptcy by selling the car that Lizzard Design provided for her use for £12,000.  
Explain:  
(i) Evie's position with regard to selling the car in her capacity as a member of Lizzard Design; (4)  
(ii) the consequences for Lizzard Design should Evie be declared bankrupt. (7)
- (d) John feels it would be inappropriate for Evie to continue to hold the position of member given her impending bankruptcy.  
Explain to John his options to remove Evie as a member of Lizzard Design. (5)
- (e) Describe the **three** statutory tests that will determine whether Ben will be taxed as a self-employed person or as an employee, and state which basis will apply. (6)
- (f) Explain the implications for Lizzard Design if Evie resigns from the LLP. (3)

**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.**

Henry, aged 58, has been trading as a cabinet maker since 2010. He has always run his business as a sole trader.

Henry is married to Rachel and they have two children, aged 14 and 10. Rachel works as a graphic designer on a part-time basis.

Henry and Rachel own their home as joint-tenants and this has recently been valued at £425,000. Henry has no savings. Rachel has savings of £4,000 in an online savings account as well as a stocks and shares ISA with a value of £24,000. Henry has a personal pension to which he has been making regular contributions since he was twenty five. The most recent statement values the fund at £97,200. Three months ago Henry contributed a one-off lump sum of £20,000 net.

Demand for his type of bespoke furniture has lessened and his profits have dropped by 50% in the last eighteen months. Henry has been relying on credit cards to sustain him and his family's lifestyle and he currently owes three different credit card companies a total of £35,000. He also owes £40,000 in total to two of his suppliers and has an outstanding Value Added Tax bill from 2017. Rachel has recently lent Henry the sum of £10,000 so he could pay his main supplier of materials.

Henry is now concerned that one or more of his creditors will apply for him to be made bankrupt.

**Questions**

- (a)** Henry is aware that there are alternatives to being made bankrupt.  
Explain to him the main points of an Individual Voluntary Arrangement (IVA) including the process and structure. **(12)**
- (b)** Explain the advantages to Henry of an IVA rather than being made bankrupt. **(6)**
- (c)** Assuming a bankruptcy order is placed on Henry, explain the effects of this on;
- (i)** Henry and Rachel's main residence; **(7)**
  - (ii)** Henry's personal pension. **(7)**
- (d)** Explain the order of priority when it comes to paying creditors, giving examples specific to Henry's situation. **(8)**
- 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.*

<b>Class 2 (self-employed)</b>	Flat rate per week £2.95 where profits exceed £6,205 per annum.
<b>Class 3 (voluntary)</b>	Flat rate per week £14.65.
<b>Class 4 (self-employed)</b>	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:

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

Quick succession relief:

	0-1	1-2	2-3	3-4	4-5
- Years since IHT paid					
- 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<sub>2</sub>) 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<sub>2</sub> emissions of 50g/km or less.
- For cars with CO<sub>2</sub> emissions of 51g/km to 75g/km the percentage is 16%.
- For cars with CO<sub>2</sub> emissions of 76g/km to 94g/km the percentage is 19%.
- Cars with CO<sub>2</sub> 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<sub>2</sub> 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
<b>Cars</b>		
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
<b>Motor Cycles</b>	24p per mile	24p per mile
<b>Bicycles</b>	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%
<b>Motor cars:</b> Expenditure on or after 01 April 2016 (Corporation Tax) or 06 April 2016 (Income Tax)				
CO <sub>2</sub> emissions of g/km:	50 or less*	51-110	111 or more	
Capital allowance:	100%	18%	8%	
	first year	reducing balance	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.*

	Non residential
Value up to £150,000	0%
£150,001 and £250,000	2%
£250,001 and over	5%

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