Chartered Insurance Institute

AF2

Advanced Diploma in Financial Planning

Unit AF2 – Business Financial Planning

April 2019 Examination Guide

SPECIAL NOTICES

Candidates entered for the October 2019 examination should study this examination guide carefully in order to prepare themselves for the examination.

Practice in answering the questions is highly desirable and should be considered a critical part of a properly planned programme of examination preparation.

AF2 – Business Financial Planning

Contents

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IMPORTANT GUIDANCE FOR CANDIDATES

Introduction

The purpose of this Examination Guide is to help you understand how examiners assess candidates' knowledge and their ability to apply this to a case study scenario. You can then use this understanding to help you in your preparation for the examination.

Before the examination

Study the syllabus carefully
This is available online at www.cii.co.uk. All the questions in the examination are based directly on the syllabus. *You will be tested on the syllabus alone,* so it is vital that you are familiar with it.

There are books specifically produced to support your studies that provide coverage of all the syllabus areas, however you should be prepared to read around the subject. This is important particularly if you feel that further information is required to fully understand a topic or an alternative viewpoint is sought. The reading list which can be found with the syllabus provides valuable suggestions.

Note the assumed knowledge
For the Advanced Diploma in Financial Planning, candidates are assumed to have studied the relevant units of the Diploma in Financial Planning or the equivalent. This knowledge is set out on the relevant syllabus.

Read widely
If you do not have experience in advising clients whose financial needs are relatively sophisticated, *it is quite unrealistic to expect that the study of a single textbook will be sufficient to meet all your requirements.* While books specifically produced to support your studies will provide coverage of all the syllabus areas, you should be prepared to read around the subject. This is important, particularly if you feel that further information is required to fully understand a topic or an alternative viewpoint is sought. It is vital that your knowledge is widened beyond the scope of one book. The reading list which can be found with the syllabus provides valuable suggestions.

Make full use of the Examination Guide

This Examination Guide contains a full examination paper and model answers. The model answers show the types of responses the examiners are looking for and which would achieve maximum marks, *however, you should note that there are alternative answers to some question parts which would also gain high marks.* For the sake of clarity and brevity not all of these alternative answers are shown.

This guide and previous Examination Guides can be treated as 'mock' examination papers. Attempting them under examination conditions as far as possible, and then comparing your answers to the model ones, should be seen as an essential part of your exam preparation. The examiner's comments on candidates' actual performance in each question provide further valuable guidance. You can obtain copies of the two most recent examination guides free of charge at www.cii.co.uk.

Know the layout of the tax tables

Familiarise yourself with the information contained within the tax tables printed at the back of each Examination Guide. These tax tables will be provided to candidates as part of the examination paper. The tax tables enable you to concentrate on answering the questions without having to worry about remembering all the information. *Please note that you are not allowed to take your own tax tables into the examination.*

Know the structure of the examination
Assessment is by means of a three-hour written paper in two sections. All questions are compulsory:

Section A consists of one case study, worth 80 marks. You will be expected to carry out a variety of tasks, after analysing the information provided.

Section B consists of two shorter case studies worth a total of 80 marks. Again, you will be expected to carry out a variety of tasks based upon the information provided.

Each question part will clearly show the maximum marks which can be earned.

Appreciate the standard of the examination
Candidates must demonstrate that they are capable of advising clients *whose overall levels of income and capital require a more sophisticated scheme of investment* than is normally prepared by a level 4 qualified adviser. These clients require a critical appraisal of the various financial planning options available to them.

Read the Assessment information and Exam policies for candidates
The details of administrative arrangements and the regulations which form the basis of your examination entry are available online at www.cii.co.uk/qualifications/assessment-information/introduction/. This is *essential reading* for all candidates.

In the examination

The following will help:

Spend your time in accordance with the allocation of marks:

- The marks allocated to each question part are shown on the paper;
- If a question has just two marks allocated, there are likely to be only one or two points for which the examiner is looking for, so a long answer is wasting valuable time.
- Conversely, if a question has 12 marks allocated, a couple of lines will not be an adequate answer. Always remember that if the paper is not completed, your chances of passing will be reduced considerably.
- Do not spend excessive time on any one question; if the time allocation for that question has been used up, leave some space, go on to the next question and return to the incomplete question after you have completed the rest of the paper, if you have time.

Take great care to answer the question that has been set.

- Many candidates leave the examination room confident that they have written a 'good' paper, only to be surprised when they receive a disappointing result. Often, the explanation for this lies in a failure to think carefully about what the examiner requires before putting pen to paper.
- Highlighting key words and phrases is a technique many candidates find useful.
- The model answers provided in this Examination Guide would gain full marks. Alternative answers that cover the same points and therefore answer the question that has been asked would also gain full marks.

Tackling questions

Tackle the three questions in whatever order feels most comfortable. Generally, it is better to leave any questions which you find challenging until you have attempted the questions you are confident about. Candidates' should avoid mixing question parts, (for example, 1(a)(i) and (ii) followed by 2(b)(ii) followed by 1(e)(i)) as this often leads to candidates unintentionally failing to fully complete the examination paper. This can make the difference between achieving a pass or a narrow fail.

It is vital to label all parts of your answer correctly as many questions have multiple parts to them (for example, question 1(a) may have parts (i), (ii) and (iii)). Failure to fully distinguish between the separate question parts may mean that full credit cannot be awarded. It is also important to note that a full answer must be given to each question part and candidates should not include notes such as 'refer to answer given in 1(b)(i)'.

Answer format

Unless the question requires you to produce an answer in a particular format, such as a letter or a report, you should use 'bullet points' or short paragraphs. The model answers indicate what is acceptable for the different types of question.

Where you are asked to perform a calculation, it is important to show **all** the steps in your answer. Most of the marks will be allocated for demonstrating the correct method of calculation.

Provided handwriting is legible, candidates will **not** lose marks if it is 'untidy'. Similarly, marks are not lost due to poor spelling or grammar.

Calculators

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 alphabetical or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements. The majority of the marks will be allocated for demonstrating the correct method of calculation.

EXAMINERS' COMMENTS

Candidates overall performance

Candidates overall performance in this examination was disappointing with many candidates unable to apply their knowledge to the case studies presented and did not use the information in the case studies to support their answers.

Question 1 appeared to challenge all candidates with good candidates gaining no more than half the marks available. This was quite surprising as these topics have all been examined before.

In Question 2, candidates generally lacked sufficient detail in their answers or were not familiar with the topic.

Candidates made better attempts at Question 3 although in many cases in-depth knowledge of some of the areas was not demonstrated sufficiently well by candidates.

Candidates should bear in mind that this examination is a test of the application of knowledge rather than a recall of generic knowledge. Candidates should use the information provided in the case study to support their answers to ensure that they are relevant to the particular situation under scrutiny.

It is important to read the directions in the question carefully to ensure that all marks can be accessed. For example, where a candidate is asked to explain, a simple generic list will not access all the marks available for the question. Candidates should also take care to ensure they provide all the information required by the question, for example providing a total in a calculation question.

Question 1

Part (a) should have been a straightforward recall of knowledge relevant to the case study. Many candidates demonstrated a lack of knowledge in this area and did not gain most of the points required. Candidates focused on issues such as personal liability for debt, dividend taxation, and in many cases stated that no tax relief would be available.

Part (b) was not answered well by most candidates with many not stating the most obvious point, that the fund would not be large enough to fund a purchase of the shares. This question required candidates to first state what the default position would be for each of the pension vehicles, and then why they could or could not be used in this scenario.

In part (b)(i) many candidates stated the purchase would not be allowed but gave no reasons to support this. Most candidates did not provide sufficient detail in their answers.

Part (b)(ii) was answered slightly better than part (b)(i) as most candidates were able to state the general conditions for investment by a small self-administered scheme (SSAS). However, candidates still did not give reasons to support their conclusions.

Part (c) lacked detail in the answers given by candidates. Many candidates identified that Corporation Tax relief would be lost but did not state why; many did not state the implications due the change in Chloe's standing in the company. Many candidates also did not appreciate that the key person cover could continue and many advocated that shareholder cover be taken out instead, which is not what the question asked.

Part (d) was very poorly answered by most candidates with candidates not being able to work through the implications of using a relevant life policy (RLP) for shareholder protection.

In part (d)(i) candidates did not work out the total potential loss to Chloe's beneficiaries, and answered this part on a very superficial level. Many candidates stated that on Chloe's death that the beneficiaries would end up with Chloe's shares in the business, which is correct but did not go on to state what they would receive for those shares and what they would lose.

Part (d)(ii) was also not answered well by candidates. The implications here are that if an RLP is used in this way Corporation Tax relief on premiums would be lost. Most candidates missed this and could not explain why this would be so. Most candidates also missed that this question part was worth only two marks yet answered this part at a length not in keeping with a two mark question.

Part (d)(iii) required an understanding of how a personal life policy, such as an RLP, could be used for shareholder protection if the proceeds are paid to the employee. The only way to do this would be via an agreement amongst parties that would be done through the shareholder's Will, and the examiners were looking to see if candidates understood this and recognised the risks involved in this method.
This has been tested previously, although the question was asked in a different way. Candidates did not do well on this question part.

Part (e), on shareholder protection has been examined frequently.

Part (e)(i) required candidates to analyse the current provisions in the case study and how this would impact the shareholding directors. The answer was essentially in two parts, one related to the life policies and one to the buy sell agreement. Candidates generally answered the life policy part reasonably well but missed the implications inherent in the buy/sell agreement.

Part (e)(ii) has been examined many times and most candidates performed adequately in this part.

Part (f) was adequately answered by most candidates.

In part (f)(i) some candidates demonstrated a lack of knowledge in this area and most candidates did not mention the lack of flexibility of this arrangement.

In part (f)(ii), many candidates stated generic Inheritance Tax savings and did not specify business relief. Many candidates did not mention the flexibility of the arrangement.

Part (f)(iii) was answered well by most candidates, though some candidates showed a clear lack of knowledge on this area. The point most frequently missed was that the business would be liable to Class 1A National Insurance Contributions.

Part (g) was adequately answered by most candidates although there was some confusion between the existing and the new purchase.

In part (g)(i) many candidates did not know the commercial stamp duty rates, which they should know at this level of examination. In some cases, candidates calculated VAT which was not required. If the calculation was required, this would either be stated in the question or there would be a mention of the VAT status of the commercial property in the case study. This would direct the candidates as to whether they should calculate VAT or not.

Part (g)(ii) was completed well by many candidates, the main issue being that many candidates did not calculate the extra contributions that Lee, Paul and Chloe would need to make to address the total shortfall.

In part (g)(iii) some candidates made no attempt to calculate the total allowances remaining to Lee and Paul. Only when this is done does it become clear that their contributions will be in excess of their allowances. This would then lead on to the tax implications of the required contributions.

Question 2

The part (a) calculation was well answered by most candidates. The main issue was that many candidates ignored Ben's entitlements which led to incorrect answers.

Part (b) was not well answered by most candidates and there was a clear demonstration of lack of knowledge in this area. Many candidates also confused the taxation of a limited liability partnership (LLP) and a limited company. Some candidates invoked the IR35 rules, again showing a lack of knowledge and understanding in this area.

Some candidates stated that John would be assessed on all the profits in excess of the £20,000 profit of Typpeit Ltd but gave no reasons why this would be the case.

Part (c)(i) was answered well by most candidates.

In part (c)(ii) candidates demonstrated a lack of knowledge in their answers with many candidates still confusing ordinary partnerships and LLPs. Some candidates mentioned points that were more pertinent in part (f) of this question but unfortunately did not repeat them there.

Some candidates concentrated on the effects of bankruptcy to Evie personally rather than on the effects to the firm.

Many candidates did not realise that the LLP would be an unsecured creditor in Evie's bankruptcy.

Part (d) was also poorly answered by candidates with many candidates being able to mention only one point of relevance, that John could not take any action against Evie to remove her without her agreement.

In part (e) many candidates could not state the three statutory test and many candidates just stated that Ben would be treated as an employee without stating the relevant reasons.

Part (f) also showed a lack of understanding of how an LLP works. Many candidates stated that the LLP would have to be dissolved, without giving reasons for this statement; many stated that a new partner would need to join, but again did not give specific requirements; many said that Ben could be a member and allow the LLP to continue, even though they had just stated in part (e) above that Ben was an employee.

Question 3

Part (a) was most satisfactorily answered by many candidates though numerous candidates lacked sufficient detail in their answers. Many candidates included points from bankruptcy and liquidation rather than IVA. This demonstrated that many candidates are still not clear on the differences of these solutions for businesses in financial difficulty.

Part (b) has been examined many times and it was disappointing to see so many poor attempts on this question part.

Most candidates were able to state that Henry could continue to trade and avoid the stigma of bankruptcy however the majority of other points were not mentioned.

Part (c) was generally well done by most candidates and appeared to be one of the few parts in the paper in which candidates performed reasonably well.

Part (c)(i) was well attempted by most candidates although a few sometimes left out the reasons for some of the answers, such as having young/minor children living in the house.

Part (c)(ii) was also well answered in the main, although many candidates did not mention Henry being over age 55, which is relevant for some parts of the answer.

Part (d) was well attempted by most candidates although many candidates did not mention the expenses of bankruptcy or that Rachel would be last in line in order of priority for repayment of debts.

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)**

(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

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), (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 Typpeit 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

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) 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

NOTE ON MODEL ANSWERS
The model answers given are those which would achieve maximum marks. However, there are alternative answers to some question parts which would also gain high marks. For the sake of clarity and brevity not all of these alternative answers are shown. An oblique (/) indicates an equally acceptable alternative answer.

Model Answer for Question 1

(a)
- Chloe can claim tax relief at her highest marginal rate of Income Tax for the interest paid;
- as she owns at least 5% of the ordinary shares.
- Interest is restricted to £50,000 or 25% of income whichever is higher.

(b) (i)
- Normally she could invest full fund up to £300,000 of the £1,000,000 purchase price (20% of £5,000,000)
- However, Chloe will be a controlling director subject to anti avoidance rules so the purchase will not be allowed.
- The self-invested personal pension (SIPP) route is not a viable option.

(ii)
- A small self-administered pension scheme (SSAS) can invest up to 5% of fund value in the sponsoring employer;
- based on her fund value of £300,000 this would only be £15,000. Even if the others would allow her to use the full fund to calculate the 5%, she would not have enough to fund the purchase.
- It is also unlikely the trustees would allow the investment as Chloe would have a controlling interest.

- The SSAS could be used but would only be a small proportion of the £1,000,000 cost.

(c)
- Cover on Chloe can continue as key person cover;
- is not restricted to just employees as shareholders contributing to profit are also eligible.
- Would need to review the amount of cover in place possibly changing to a proportion of profits formula as profits have increased.
- As the cover no longer meets the Anderson rules as there is no longer an employee/employer relationship;
- the premiums would not qualify for Corporation Tax relief any longer;
- this is because they would fail the wholly and exclusively rule;
- as Chloe now has a significant shareholding/owns more than 5% of shares.
- The cover no longer needs to be short-term as the Anderson rules no longer apply.

(d) (i) Chloe currently has shares worth £1 million and a relevant life policy of £500,000 for a total value of £1.5 million. If the relevant life policy was used for shareholder protection then on her death her beneficiaries would just receive the £500,000 from the policy and potentially lose £1 million.

(ii)
- They will lose Corporation Tax on the premiums;
- as it will fail the wholly and exclusively test.

(iii)
- Any share transfer would be done by Chloe's Will as the proceeds of the RLP would go to Chloe's beneficiaries.
- Chloe could change her Will at any time without the others knowing. Lee and Paul are therefore at risk of receiving no shares or financial compensation for the shares as there is no agreement in place to do so.

(e) (i)
- Current cover does not match the current business value.
- Initially cover was set at £2,000,000 each, total £4,000,000.
- Current business value is £5,000,000.
- But the existing cover would match the reduced shareholdings (80% of £5,000,000).
- However, the existing buy/sell arrangement excludes Chloe and only covers Paul and Lee;
- it could be amended to include Chloe;
- but becomes more complex to administer as too many policies needed.

(ii) *Candidates would have gained full marks for any eight of the following:*
- Gives the surviving owners the option to buy the deceased persons shares and gives the beneficiaries the option to sell.
- Neither option is automatically enforced;
- but if either party exercises the option it is binding on the other party.
- The option is usually exercisable within a set period of time (3 months etc).
- The agreement normally sets out the proportions each person would need to buy on death of a shareholder.
- This is important here given the unequal shareholding after Chloe buys in;
- as a cross option agreement is not a binding contract for sale shares should qualify for Business Relief;
- which Lee and Paul would not get under the buy sell agreement.
- Chloe would qualify for Business Relief after two years.

(f) **(i)**
- Relatively cumbersome as they would need six life insurance policies being affected.
- Complex to administer and there may be premium equalisation issues.
- Not flexible for future business changes so does not meet their objective.

(ii)
- Own life;
- for a sum assured equal to their shareholding, that is, £2,000,000 for Paul and Lee and £1,000,000 for Chloe.
- The policies should be subject to a business trust which maintains business relief;
- and flexibility to add or remove shareholders in the future.
- The trust would also provide quick access to funds without waiting for probate.

(iii)
- If paid personally premiums will not benefit from tax relief as they are paid from after tax income.
- If paid by the business the directors will be liable to Income Tax as a P11D benefit.
- The business would also be liable to Class 1A National Insurance.
- The premiums will be an allowable expense for the business and gain Corporation Tax relief.

(g) **(i)** Purchase price is £600,000
Stamp Duty
- £150,000 @ 0% = £0
- £100,000 @ 2% = £2,000
- £350,000 @ 5% = £17,500
- Total = £19,500

- Total purchase price £600,000 + £19,500 + £20,000 = £639,500.

(ii)
- Available cash in SSAS of £89,500
- Chloe's transfer value £300,000
- Total available funds £389,500
- Shortfall £639,500 - £389,500 = £250,000
- £250,000 x 40% = £100,000, which is 40% each from Lee and Paul, total £200,000.
- £250,000 x 20% = £50,000, which is 20% from Chloe.

(iii)
- Available allowance of £20,000 for the current tax year;
- and £20,000 for each of the previous three years.
- Total allowance is therefore £80,000.
- Required contribution for Lee and Paul is £20,000 more;
- this extra would therefore be subject to Income Tax on the excess/annual allowance charge;
- at their highest marginal rate.

Model Answer for Question 2

(a)

John	£30,000
Evie	£20,000
Ben	£10,000
	£60,000

Residual

	£220,000 - £60,000	=	£160,000
John	75% x £160,000	=	£120,000
Evie	25% x £160,000	=	£40,000

Total Entitlements

John	£30,000 + £120,000	=	£150,000
Evie	£20,000 + £40,000	=	£60,000
Ben	£10,000		

(b)
- The mixed partnership rules will apply.
- This covers any profit of John's paid to the corporate partner (Typpeit Ltd).
- If there is an intention to reduce tax, as there is in this case, the income paid to John's company in excess of its notional profits of £20,000 from the service supply;
- will be assessed as John's personal income and not as the income of the Typpeit Ltd, the corporate partner.

(c) (i)
- As a member of the limited liability partnership (LLP) Evie is likely to have the power to sell partnership assets.
- Unless this has been restricted in a partnership deed.
- However, she is not entitled to keep the proceeds.
- And must account to the firm for the money raised.

(ii)
- The bankruptcy would not impinge upon the continuation of the LLP;
- or of Evie's position as a member.
- Evie's interests in her capital and current account;
- and any partnership property;
- would vest in her trustee in bankruptcy which could have a financial impact on the partnership.
- The LLP will be an ordinary unsecured creditor in Evie's bankruptcy;
- for the overdrawn current account and money she obtained through selling the car.

(d)
- Unless there is a written agreement between the partners that expressly permits for the expulsion of a partner;
- no partner can be expelled by a majority of partners.
- Even where there is express provision the power can only be used in good faith.
- John may not be able to take any action without Evie's agreement.

(e)
- This is an attempt to disguise Ben's remuneration.
- Is at least 80% of Ben's income dependent upon the firm's overall profits.
- Is Ben's capital injection at least 25% of his profit share?
- Does Ben play a significant role in the management of the LLP?
- Ben fails all three tests so he will be taxed as an employee on the disguised remuneration.

(f) *Candidates would have gained full marks for any three of the following:*
- The LLP would only have one designated member.
- An LLP can only exist with a minimum of two designated members.
- Ben cannot automatically be made a designated member as he fails the statutory rules.
- So John would need to bring in another risk taking partner to make a designated member for the business to survive;
- if this could not be done the LLP would need to be dissolved.

Model Answer for Question 3

(a)
- A formal proposal is made by Henry;
- to the creditors to repay part or all of the debt.
- The proposal is sent to the creditors and the court;
- if the creditors agree an authorised insolvency practitioner is appointed to oversee the repayments.
- The insolvency practitioner reports to the court including their opinion on whether the proposal will work.
- Henry may apply to the court for the grant of an interim order;
- preventing creditors from proceeding with a bankruptcy petition.
- If sufficient creditors object to the proposal, a creditors' meeting is held and if 75% of creditors by value agree;
- the proposals are accepted, and all creditors are bound by the Individual Voluntary Arrangement (IVA).
- The insolvency practitioner then makes payments in accordance with the agreed scheme for the life of the IVA.
- The IVA usually lasts five years;
- and will end when all the sums in the proposal are paid.

(b)
- Henry is closely involved in the process.
- The restrictions of bankruptcy are avoided.
- Henry avoids the stigma of being made bankrupt;
- and disqualifications that follow bankruptcy.
- Overall costs are usually less than a formal bankruptcy.
- Henry can carry on trading.

(c) **(i)**
- Their home cannot be sold without a court order.
- Henry owns the house with Rachel and she has a legal interest in the property (a charge on the property).
- The Trustee in bankruptcy can only claim Henry's share of the property. Rachel's share of the property is safe.
- Henry also has minor children.
- The court has to take into account their needs and is unlikely to order a sale immediately.
- It is likely that any sale will be postponed for one year after bankruptcy. This gives Henry time to find alternative accommodation.
- The trustee in bankruptcy has up to three years to deal with the home.

(ii)
- Assets within a pension scheme are protected from bankruptcy.
- The trustee in bankruptcy cannot ask Henry to start taking an income from his pension in order to apply this to his debts even though he is aged over 55.

- The trustee in bankruptcy can apply to the court.
- If the court thinks that payment of £20,000 was an excessive pension contribution;
- and has unfairly prejudiced/defrauded the creditors.
- The court can order a pension provider to pay the trustee in bankruptcy the excessive contribution and adjust Henry's liability accordingly.

(d)
- The expenses of bankruptcy;
- fees and costs of the trustee in bankruptcy.
- Preferential debt e.g. his mortgage.
- Any creditor holding a floating charge over an asset e.g. a debenture.
- Unsecured creditors such as his outstanding VAT bill;
- and credit card companies.
- Interest due on all debts since the bankruptcy order was made.
- Debts to the bankrupt's spouse/£10,000 borrowed from Rachel.

All questions in the October 2019 paper will be based on English law and practice applicable in the tax year 2019/2020, unless stated otherwise and should be answered accordingly.

The Tax Tables which follow are applicable to the October 2018 and April 2019 examinations.

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.

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