J05

Diploma in Financial Planning

Unit J05 – Pension income options

October 2019 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2019/2020, 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. Robert died in September 2019 aged 68. At the time of his death his private pension plans consisted of:

- A scheme pension of £32,000 per annum. The pension came into payment in March 2016 and includes a 10-year guarantee period and a 50% dependant's pension.

- A dependant's capped drawdown plan that Robert inherited in July 2013 following the death of his wife. Robert first drew an income from this plan in March 2016.

Robert nominated the death benefits under both plans to his financially independent son, aged 39.

Outline the death benefits available under both plans and their tax treatment.
You should assume that the death benefits are paid to Robert's son. **(10)**

2. Laila, aged 61, is about to retire due to some minor health issues. She is a member of her employer's defined benefit scheme and the scheme trustees have advised her that she is entitled to an immediate scheme pension of £17,000 per annum. Alternatively, the trustees have offered Laila a cash equivalent transfer value (CETV) of £544,000. The normal pension age of the scheme is age 65.

Outline the additional information you would require before advising Laila on whether she should take the scheme pension on offer, or if she should accept the CETV. **(12)**

3. Tameka, aged 67, holds Fixed Protection 2014. In 2014/2015 she crystallised her benefits in a previous employer's defined benefit scheme. At that time, she received a pension commencement lump sum (PCLS) of £230,000 and an indexed scheme pension of £34,600 per annum.

In addition to her scheme pension, Tameka has an uncrystallised personal pension plan (PPP) currently valued at £900,000. She now intends to fully crystallise her PPP and take the maximum permitted PCLS. Tameka then intends to place the balance of the fund, after deduction of the lifetime allowance tax charge, into a flexi-access drawdown plan (FAD).

Calculate, **showing all your workings**, the amount that will be invested into the FAD. **(10)**

4. Tania, aged 62, is married to Henry aged 66. Her only private pension plan is a retirement annuity contract (RAC) valued at £350,000. The contract offers a guaranteed annuity rate of 10.5% at age 65. This rate is based on a single life annuity that is level in payment and paid monthly in arrears.

(a) Outline the additional information you would require about the RAC before advising Tania on whether or not these benefits should be transferred to a personal pension plan (PPP) in order to access them flexibly. **(5)**

(b) Explain giving your reasons, the advice requirements that must be satisfied before Tania can undertake a transfer of these benefits to a PPP. **(5)**

5. Aileen, aged 58, was widowed in 2018. She is now in receipt of a dependant's scheme pension of £12,500 per annum gross. Aileen has no children and no dependants.

She has decided to retire and has calculated she will need a net income of £24,000 per annum to cover her regular outgoings. In addition to her dependant's scheme pension, she has an uncrystallised personal pension plan (PPP) valued at £700,000, which is wholly invested in fixed interest funds. Her other assets are her home, which is mortgage free and valued at £550,000, and cash on deposit of £45,000. Aileen has a cautious attitude to risk and very little investment experience.

Outline the factors that you would take into account when deciding whether you would recommend that Aileen use her PPP to purchase a lifetime annuity or if she should take her retirement income via flexi-access drawdown. **(8)**

6. Asif, aged 74, has 10% of his lifetime allowance remaining and has not registered for any form of transitional protection.

He has one pension fund that remains uncrystallised. This is a personal pension plan valued at £120,000. Asif would like to take the whole of this fund as a lump sum payment.

Assuming that Month 1 taxation does **not** apply, explain the tax payable if Asif takes the whole fund;

(a) in October 2019, before reaching the age of 75, as an uncrystallised funds pension lump sum (UFPLS) payment plus a lifetime allowance excess lump sum; **(5)**

(b) immediately after reaching the age of 75 in November 2019 as an UFPLS. **(5)**

QUESTIONS CONTINUE OVER THE PAGE

7. Tim will reach his State Pension age in December 2019. His wife, Pauline, will reach her State Pension age in June 2021.

Outline the conditions that must be met in order for Tim to be able to make a successful application to receive the Guarantee Credit element of the State Pension Credit. **(5)**

8. Jenny, aged 64, is in excellent health. She recently crystallised her personal pension plan into a flexi-access drawdown plan in order to access this fund flexibly.

Explain briefly to Jenny why:

(a) longevity risk is an important factor to consider given that she plans to access her benefits flexibly; **(5)**

(b) her life expectancy probability should be used when assessing longevity risk, rather than her average life expectancy. **(5)**

9. Hugh deferred receipt of his basic and additional State Pension when he reached State Pension age in November 2015. He has elected to receive both elements of his deferred pension from 4 November 2019.

Hugh intends to take the deferred payments as a lump sum and has been informed that this will total approximately £35,000. His State Pension income will be £171.50 per week for the remaining 22 weeks of 2019/2020.

In 2019/2020 Hugh will also receive savings income of £2,000 and dividend income of £11,000.

Explain, giving your reasons, how taking his deferred State Pension from 4 November 2019 will affect Hugh's Income Tax position for the current tax year 2019/2020. **(9)**

10. Some individuals, for example sportsmen and sportswomen, with retirement annuity contracts (RAC) and personal pension plans (PPP), have a right to take their pension benefits from these contracts before the current minimum pension age of 55.

Outline the:

(a) conditions that must be met for a member of a RAC or PPP, who is in good health, to be able to draw their pension benefits before the age of 55 without being subject to unauthorised payment tax charges; **(3)**

(b) restrictions that apply when benefits are taken before the age of 55. **(4)**

11. Oleg, aged 64, is married to Yulia aged 62. He is a member of his previous employer's defined benefit scheme and now intends to draw his scheme pension.

Oleg has been advised that he will receive a pension of £35,000 per annum which will increase each year in line with RPI capped at 5%, and that in the event of his death, Yulia will receive a 50% dependant's pension. He has also been informed that he can commute part of the income for a pension commencement lump sum (PCLS). The commutation rate is 12:1 and Oleg can take any amount of PCLS up to the HM Revenue & Customs' maximum of £150,000.

Outline the factors that you would take into account when advising Oleg on how much of his pension income he should commute for PCLS. **(8)**

12. Mohit, aged 61, is divorced with three financially independent children. He is self-employed and plans to gradually reduce his working hours over the next five years until reaching State Pension age, when he intends to retire fully.

Mohit has a self-invested personal pension (SIPP) valued at £825,000. His only other assets are a cash ISA worth £47,000 and his house valued at £550,000. His house is owned outright. As he is reducing his working hours, Mohit intends to spend more time travelling.

Outline **five** potential benefits and **five** potential drawbacks for Mohit of starting to draw an income from his SIPP via phased drawdown. **(10)**

13. Stefanos has recently retired and has set up a flexi-access drawdown (FAD) plan to provide his income in retirement. He would also like to leave a legacy on his death to his financially independent children.

Outline the factors that you will take into account when determining the amount of income Stefanos should withdraw each year from his FAD. **(6)**

14. Jade, aged 48, is in poor health. She is a member of her employer's Group Personal Pension (GPP) and her fund is valued at £350,000. Although her condition is **not** life threatening, Jade feels she can no longer continue to work.

Outline the conditions, set by HM Revenue & Customs, that must be satisfied in order that Jade can now access the benefits in her GPP on the grounds of ill-health. **(5)**

15. State the factors that should be taken into account when carrying out an annual review of a client's investments held within their flexi-access drawdown plan. **(10)**

The tax tables can be found on pages 9 – 17

INCOME TAX

RATES OF TAX	2018/2019	2019/2020
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	£34,500	£37,500
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 of £5,000.*

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)	£11,850	£12,500
Married/civil partners (minimum) at 10% †	£3,360	£3,450
Married/civil partners at 10% †	£8,695	£8,915
Marriage Allowance	£1,190	£1,250
Income limit for Married Couple's Allowance†	£28,900	£29,600
Rent a Room scheme – tax free income allowance	£7,500	£7,500
Blind Person's Allowance	£2,390	£2,450
Enterprise Investment Scheme relief limit on £2,000,000 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.
*** Investment above £1,000,000 must be in knowledge-intensive companies.*

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)	£118
Primary threshold	£166
Upper Earnings Limit (UEL)	£962

Total earnings £ per week	**CLASS 1 EMPLOYEE CONTRIBUTIONS**
Up to 166.00*****	Nil
166.01 – 962.00	12%
Above 962.00	2%

**This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £118 per week. This £118 to £166 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 166.00**	Nil
166.01 – 962	13.8%
Excess over 962.00	13.8%

*** Secondary earnings threshold.*

Class 2 (self-employed)	Flat rate per week £3.00 where profits exceed £6,365 per annum.
Class 3 (voluntary)	Flat rate per week £15.00.
Class 4 (self-employed)	9% on profits between £8,632 - £50,000. 2% on profits above £50,000.

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
2019/2020	£1,055,000

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
2015/2016	£40,000~
2016/2017	£40,000*
2017/2018	£40,000*
2018/2019	£40,000*
2019/2020	£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	2018/2019	2019/2020
	£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	2018/2019	2019/2020
Individuals, estates etc	£11,700	£12,000
Trusts generally	£5,850	£6,000
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 (2018/2019), two years (2019/2020).*

INHERITANCE TAX

RATES OF TAX ON TRANSFERS	2018/2019	2019/2020
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*	£125,000	£150,000
- 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 2019/2020:

- The percentage charge is 16% 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 19%.
- For cars with CO_2 emissions of 76g/km to 94g/km the percentage is 22%.
- Cars with CO_2 emissions of 95g/km have a percentage charge of 23% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 37% (emissions of 165g/km and above).

There is an additional 4% supplement for diesel cars not meeting Euro 6 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 (£24,100 for 2019/2020) e.g. car emission 90g/km = 22% on car benefit scale. 22% of £24,100 = £5,302.

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

	2018/2019 Rates	2019/2020 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

	2018/2019	2019/2020
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£200,000	£1,000,000
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%	6%
Energy & water-efficient equipment	100%	100%
Zero emission goods vehicles (new)	100%	100%
Electric charging points	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	6% reducing balance

**If new*

MAIN SOCIAL SECURITY BENEFITS

		2018/2019	2019/2020
		£	£
Child Benefit	First child	20.70	20.70
	Subsequent children	13.70	13.70
	Guardian's allowance	17.20	17.60
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 110.75	Up to 111.65
Attendance Allowance	Lower rate	57.30	58.70
	Higher rate	85.60	87.65
Basic State Pension	Single	125.95	129.20
	Married	201.45	201.45
Single Tier State Pension	Single	164.35	168.60
Pension Credit	Single person standard minimum guarantee	163.00	167.25
	Married couple standard minimum guarantee	248.80	255.25
	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
Jobseeker's Allowance	Age 18 - 24	57.90	57.90
	Age 25 or over	73.10	73.10
Statutory Maternity, Paternity and Adoption Pay		145.18	148.68

**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

	2018/2019	2019/2020
Standard rate	19%	19%

VALUE ADDED TAX

	2018/2019	2019/2020
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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