



Chartered
Insurance
Institute

AF2

Advanced Diploma in Financial Planning

Unit AF2 – Business financial planning

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

- 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.

Fred, aged 52, is married to Ruby. They have three teenage children. Fred is the sole income earner in the family. Fred and Ruby are trustees of a trust fund set up for their children 10 years ago by Fred's parents.

Twenty years ago, Fred set up a design and print business as a sole trader. In recent years he has seen a steady decline in profits as shown in the table below.

Year ending	31 January 2017	31 January 2018	31 January 2019
Profit	£78,000	£46,000	£32,000

Due to his falling profits, Fred and Ruby have exhausted their savings and Fred has been using personal credit cards to maintain the family's lifestyle. He now has over £60,000 in credit card debt.

Fred and Ruby own their own home as joint tenants. Their home has recently been valued at £300,000. They have a mortgage of £200,000. In the last three months, Fred has been unable to pay their monthly mortgage payment, nor has he paid his monthly credit card payments. Fred rents his business premises and has not paid the rent for six months. The value of his missed monthly rental payments is £20,000. He has overdue invoices from his suppliers to the value of £15,000. Fred has not yet been sued by any of his creditors.

Fred has a Self-Invested Personal Pension (SIPP). It has a current value of £390,000. At the beginning of 2019 he made a lump sum contribution of £40,000.

A competing business, run by two friends, Max and Alex, has agreed to buy Fred's business as a going concern for a sum of £20,000 for the goodwill, £15,000 for equipment and £2,000 for stock. The business has also agreed to take on three of the four employees that Fred employs.

Max and Alex are considering buying bigger premises to accommodate their expanding business. The property they are considering has a purchase price of £600,000 which will be subject to VAT and Stamp Duty Land Tax. The business has a small self-administered pension scheme (SSAS) for Max and Alex. The scheme was set up in 2009 and is currently valued at £590,000. The SSAS has made a loan to the sponsoring employer with £40,000 currently outstanding.

Question 1

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

- (a) Explain to Fred the process if he were to:
- (i) declare himself bankrupt; (6)
 - (ii) enter into an Individual Voluntary Arrangement (IVA). (8)
- (b) Explain to Fred how the following will be treated under a bankruptcy order:
- (i) his house; (6)
 - (ii) his pension; (5)
 - (iii) the trust property. (3)
- (c) Recommend, giving reasons, whether Fred should declare himself bankrupt or whether he should enter into an IVA. (8)
- (d) Describe to Fred, in relation to the sale of his business;
- (i) the full extent of his liabilities as a sole trader; (5)
 - (ii) his legal position with regard to his employees and the information he must provide to each of them; (6)
 - (iii) his responsibilities towards his employee who is not required by Max and Alex. (7)
- (e) Explain briefly to Fred, in relation to the sale of the business, the tax treatment of:
- (i) the goodwill in his business; (3)
 - (ii) his stock. (3)

QUESTIONS CONTINUE OVER THE PAGE

- (f) Assume Fred transfers his business to the buyer on the 30 October 2019 and profits between the 1 February 2019 and 30 October 2019 are £26,000. His overlap profit from the transition year is £5,000.

The written down tax pool value on equipment being sold is £11,000 and he makes a loss on sale of stock of £1,500.

Calculate, **showing all your workings**, the amount of taxable profits that will fall into the tax years 2018/2019 and 2019/2020 using the profits in the table on page 4 and the information above. (5)

- (g) With regards to Max and Alex buying their new business premises through their SSAS:

- (i) calculate, **showing all your workings**, the maximum amount available to the SSAS for the purchase; (5)
- (ii) calculate, **showing all your workings**, the total cost of the purchase, assuming legal fees of £15,000; (6)
- (iii) state **four** advantages of Max and Alex buying the property through the SSAS compared to buying the premises themselves. (4)

Total marks available for this question: 80

Section B questions can be found on pages 8 - 11

SECTION B

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

Question 2

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

Hayden and Erin are the shareholding directors of an electronics company which is making significant profits. The shares are owned 60% by Hayden and 40% by Erin. Hayden and Erin are not related to each other.

Their account manager, Cameron, an employee, is responsible for much of the profits and sales due to his contacts and ability. Should anything happen to Cameron, Hayden and Erin think that it could take a long time to find a replacement for him.

Erin is the main research development engineer and is responsible for their original electronic designs. It is due to her ability that the bank has made a large development loan to the company.

Should either of the main shareholders die, the survivor would like to retain control of the business in the most tax efficient way. The company has a standard Memorandum and Articles of Association.

There are no protection plans currently in place.

Question 2

- (a) (i) Explain the benefits of keyperson cover for Cameron to Hayden and Erin. (7)
- (ii) State, with reasons, the protection cover you would advise for Erin. (5)
- (b) The company has decided to take out a short term keyperson cover for Cameron and Erin. In Erin's case this will be to cover the loan and loss of profits.
- (i) State, with reasons, why the premiums for keyperson cover on Erin will not qualify for Corporation Tax relief. (4)
- (ii) Explain briefly why a multiple of salary approach for keyperson cover may not be appropriate for Cameron. (3)
- (c) State the purpose of shareholder protection. (4)
- (d) Hayden and Erin have agreed to use own life policies for their shareholder protection.
- (i) Explain, giving your reasons, your recommendations for an arrangement that would suit their needs and keep any taxation to a minimum. (12)
- (ii) Explain briefly why a business trust should be used for shareholder protection. (5)

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.

Kyriakos and Stefanos are self-employed plumbers. They have been friends for a long time. Stefanos has now obtained a large contract with a major building project and he and Kyriakos have decided to go into business together to service the contract.

Stefanos owns a house with no mortgage and has investments of £45,000. Kyriakos had made a loss in his business in the previous tax year 2018/19. He has no significant personal assets.

They now need to decide on a relevant business structure for their new enterprise. The assets from their existing businesses will be incorporated into the new structure.

They wish to reinvest future profits to help to grow their new business. They also wish to limit their personal liabilities in any new business structure that they set up.

Question 3

Explain briefly Kyriakos and Stefanos's responsibilities for paying tax, **excluding VAT**, to HM Revenue & Customs as:

- (a) (i) sole traders; (5)
- (ii) a limited company. (5)
- (b) (i) State **three** advantages for Kyriakos and Stefanos operating as a partnership. (3)
- (ii) Outline the potential business liability issues for Kyriakos and Stefanos if they set up their new business as a partnership. (6)
- (c) (i) Recommend, with reasons, the business structure that Kyriakos and Stefanos could use to transfer their sole trader businesses. (8)
- (ii) Explain briefly the benefits to Kyriakos if his sole trader business was transferred to the structure you have recommended in **part (c)(i)** above. (3)
- (d) Kyriakos and Stefanos, as sole traders, are new to the concept of budgets and budgetary control.

Explain to Kyriakos and Stefanos the:

- (i) concept and purpose of a business budget for their business; (6)
- (ii) concept of budgetary control. (4)

Total marks available for this question: 40

The tax tables can be found on pages 13 - 21

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
<i>*not applicable if taxable non-savings income exceeds the starting rate band of £5,000.</i>		
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%
<i>§ the Personal Allowance reduces by £1 for every £2 of income above the income limit irrespective of age (under the income threshold).</i>		
<i>† where at least one spouse/civil partner was born before 6 April 1935.</i>		
<i>** Investment above £1,000,000 must be in knowledge-intensive companies.</i>		
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 (CO₂) 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 CO₂ emissions of 50g/km or less.
- For cars with CO₂ emissions of 51g/km to 75g/km the percentage is 19%.
- For cars with CO₂ emissions of 76g/km to 94g/km the percentage is 22%.
- Cars with CO₂ 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 CO₂ 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%	18%	6%
	first year	reducing balance	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%

BLANK PAGE

