Chartered Insurance Institute

AF1

Advanced Diploma in Financial Planning

Unit AF1 – Personal tax and trust planning

July 2020 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.

Unit AF1 – Personal tax and trust 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, **both questions are compulsory**.

- 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.

- It is important to show all steps in a calculation, even if you have used a calculator.

- Tax tables are provided at the right-hand side of the interface.

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 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.

Fenella, aged 49, and Brad, aged 53, are both divorced from their former partners. They live together in their rented home in Nottingham and sub-let a bedroom to a friend for £500 per month. They account for this income through the Rent a Room Scheme.

Fenella is employed as a manager of a construction company. Additionally, she provides consultancy to various firms on a self-employed basis. She contributes £4,000 net each year into a self-invested personal pension (SIPP). Her income for the 2019/2020 tax year is recorded as:

Salary from the construction company	£100,000
Bonus – 7.5% of basic salary	£7,500
Dividends – from a portfolio of investment trusts	£30,000
Self-employed profits	£20,000
Bank interest	£750
Corporate Bond open-ended investment scheme (OEIC) income	£1,250
ISA equity unit trust income	£2,000
Income from the sub-let	£3,000

Brad generates his income from a range of properties that he owns and manages. In the tax year 2019/2020 Brad held the following properties:

- A furnished holiday cottage in the UK. It was commercially let to one group for three months and then to numerous members of the public via Airbnb for stays of two weeks or less. The property was unoccupied for three weeks during the 2019/2020 tax year.
- A furnished apartment in Spain. Fenella and Brad had a 2-week holiday here earlier in the year. For the remainder of the year it has been used by family and friends, paying less than the market rate to cover costs and it was let commercially for a total of four weeks. The property has been occupied throughout the 2019/2020 tax year.
- A fully serviced ski-lodge in the USA. Fenella and Brad spent three weeks at this property. For the rest of the 2019/2020 tax year it was continuously let on a commercial basis.

In addition to the above properties, Brad inherited a sizeable portfolio of shares which pays a substantial dividend income. As a result, in the 2019/2020 tax year Brad will remain a higher rate taxpayer. He enjoys making gifts to registered charities, by way of cash gifts and share transfers.

Brad made a Will when he was married to his former wife Katherine, which has not been updated since their divorce. According to his Will, his estate is to be distributed as follows: 30% to Katherine, 10% to charity and 60% into a discretionary trust for their two young children. Katherine is sole executor and sole trustee of the discretionary trust.

Questions

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

(a) Calculate, **showing all your workings**, Fenella's Income Tax liability for the 2019/2020 tax year. **(14)**

(b) **(i)** Calculate, **showing all your workings**, Fenella's liability to National Insurance for the 2019/2020 tax year. **(10)**

(ii) Explain briefly how the National Insurance maximum limits apply to Fenella. **(4)**

(c) Explain the conditions that must be met, to enable Fenella and Brad to claim through the Rent a Room Scheme. **(5)**

(d) **(i)** Explain, giving your reasons, the extent to which each of Brad's properties would potentially qualify as a furnished holiday let. **(9)**

(ii) Explain how a period of grace election can be made, and the requirements that need to be met, to continue to qualify as a furnished holiday let. **(4)**

(iii) Describe the taxation **advantages** of a property qualifying as a furnished holiday let. **(4)**

(e) **(i)** State how Brad's charitable gifts are treated for tax during his lifetime and on his death. **(4)**

(ii) Explain, in detail, the process for claiming gift aid on a charitable gift. **(5)**

(iii) Describe briefly how making gifts to charity in his Will can reduce the amount of Inheritance Tax paid on Brad's death. **(5)**

QUESTIONS CONTINUE OVER THE PAGE

(f) **(i)** Explain the impact of Brad's divorce on the provisions contained within his Will. **(5)**

(ii) Explain how Brad's estate would be distributed if he dies without making a new Will. **(5)**

(iii) State the conditions that need to be met for a Will to be valid. **(6)**

Total marks 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 client's circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b) and (c) which follow.

Max, a widower, died in December 2019. He left his entire estate to his children Fred, aged 25, and Lois, aged 30. Fred is an architect running a small and successful practice.

Lois has been in financial difficulties since her floristry business failed; she had been unable to service her credit card debt of over £60,000 and, as a result, she was declared bankrupt in October 2019.

Max appointed his brother as the sole executor of his Will. His estate is comprised of his main residence and investments including listed shares and unit trusts.

Fred and Lois have heard they can vary the terms of Max's Will and would like to consider the options to protect Lois' inheritance.

Fred has no experience with investments and would prefer if any inheritance was converted to cash prior to distribution.

Questions

(a) Explain, in detail, how any Capital Gains Tax (CGT) is calculated on the disposal of the assets of the estate by the executor during the estate administration, and state who is responsible for paying any tax due. *No calculations are required*. **(12)**

(b) **(i)** Describe the steps Lois must take on learning of her inheritance, considering her bankruptcy. **(4)**

(ii) Explain how the trustee in bankruptcy would deal with Lois' new inheritance. **(4)**

(c) **(i)** State the **two** main options typically available for varying the terms of a Will and explain the conditions that apply. **(15)**

(ii) Explain how Lois' bankruptcy will impact the effectiveness of the options as detailed in your answer to **part (c)(i)** above. **(2)**

(iii) Explain the responsibilities of the executor and consequences for failing to meet them, in regard to Lois' bankruptcy. **(4)**

Total marks available for this question: 41

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 client's circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c) and (d) which follow.

Don, aged 76, was divorced in 2002. He has two adult children and several grandchildren between the ages of two and 14.

On 1 May 2006 he established a discretionary trust for the potential future benefit of his children and grandchildren, with a gift of £291,000. At this time the nil-rate band for Inheritance Tax was £285,000 and this was his first lifetime gift. The trustees were named as Don and his brother Harry.

At the trust's 10-year anniversary, on 1 May 2016, the assets were valued at £400,000 and a Periodic charge of £4,500 was paid.

As of 1 April 2020, the trust assets were valued at £450,000 and so far, no distributions have been made. The trust holds a variety of equity-based collective investments. Don and Harry have ensured that these investments are reviewed each year, utilising the annual Capital Gains Tax exemption.

Don believes Harry may be losing the mental capacity to act as a trustee. Don is also concerned about his own health and that he may not be able to act as a trustee for much longer. Having consulted the trust document, he has discovered that it does not specify the conditions under which a trustee may be removed.

Don is about to establish a second trust with a gift of £331,000. This will be an interest in possession trust. The life tenant will be Don's younger sister Gail, and the remaindermen her two children. The trust assets will be invested into a range of equity income open-ended investment schemes (OEICs), expected to yield around £8,000 per annum, and corporate bond OEICs, expected to yield around £3,200 per annum.

Gail's only personal income is £11,000 per annum gross which she receives from her State Pension.

Questions

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

(a) Don would like to replace both himself and Harry as trustees.

Explain, in detail, the actions he should take in order to achieve this. **(8)**

(b) Don and Harry have distributed capital of £200,000 to Don's children from the discretionary trust.

(i) Calculate, **showing all your workings**, the exit charge that is payable.
You should assume the capital distributions were made on 1 April 2020. **(6)**

(ii) Describe briefly how the next periodic charge will be calculated in May 2026. *You should assume no further distributions are made. No calculations are required.* **(6)**

(c) In respect of the existing discretionary trust, explain in detail how:

(i) the trust assets are currently treated for Income Tax and how this is reported. **(5)**

(ii) the trust assets would be treated for Income Tax, while the money remains invested, if they consisted solely of a range of life assurance bonds. **(5)**

(d) Explain, in detail, the tax treatment of the income that will be paid to Gail from the interest in possession trust.
You should assume the expected yields are achieved. No calculations are required. **(9)**

Total marks for this question: 39

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

**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	2018/2019	2019/2020
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.*

	2018/2019	2019/2020
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%