Chartered Insurance Institute

AF1

Advanced Diploma in Financial Planning

Unit AF1 – Personal tax and trust planning

July 2020 Examination Guide

SPECIAL NOTICES

Candidates entered for the October 2020 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.

AF1 – Personal tax and trust 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. 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 question 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. The majority of the marks will be allocated for demonstrating the correct method of calculation.

Marks are not lost due to poor spelling or grammar.

You are able to flag questions and then go back to them.

Calculators

The calculator is in a pop-up box on the right-hand side of the interface. It is important to show all steps in a calculation, even if you have used a calculator.

EXAMINERS' COMMENTS

Candidates overall performance

Overall, candidates performed well across the main areas tested and showed a good understanding of income tax, in particular. Given that this was the first online session of AF1, the performance of candidates was very encouraging.

The more challenging aspects proved to be relating the technical knowledge to the details of the case study and this was shown particularly in (1)(d) and (e) as well as (3)(a).

Candidates would benefit from spending a little longer on providing full details in their answers, particularly in the higher mark questions. This will help to avoid losing accessible marks.

Question 1

The Income Tax calculation in part (a) was well-answered with many candidates scoring high marks. The most common errors were around extending both the basic rate band <u>and</u> the higher rate band, along with identifying that no Personal Savings Allowance would apply as Fenella is an additional rate taxpayer.

Another area that is often misunderstood is how the dividend allowance is applied and that it forms part of the tax band into which it is used, in this case the higher rate band. The first £2,000 of the dividends were taxed at 0% and then the remaining £28,000 was split between the remaining higher rate band (£25,500 - £2,000), taxed at 32.5% and the remainder (£28,000 - £23,500), taxed at 38.1%

Part (b) focussed on the calculation of National Insurance (NI) and the maximums that apply. The first part of this question was well-answered, with most candidates calculating class 1 and 2 correctly. A few candidates switched between weekly, monthly and/or annual amounts mid-calculation and this caused some confusion.

Many candidates were unaware of the NI maximum limits and so lost marks both in the calculation and in part (b)(ii). This was a particularly stretching question for most, but some well-prepared candidates gained high marks.

Candidates scored reasonably well on part (c) and showed a good understanding of the Rent a Room Scheme. Some candidates demonstrated poor time management by describing how the relief works and the maximum amounts, neither of which answered the question asked.

Part (d)(i) concerned the conditions that Brad's properties would need to be meet to qualify as furnished holiday lets. While most candidates scored well in this question, some listed the criteria but did not apply it correctly to the relevant properties. Very few candidates answered part (d)(ii) well and many candidates confused the period of grace election with the qualifying periods.

Part (e) focussed on the taxation of charitable gifts along with the process for claiming gift aid. Some candidates lost available marks in part (a)(i) by focussing entirely on Income Tax and not stating the treatment for other taxes.

Part (e)(ii), regarding gift aid, was generally well answered. However, many candidates missed available marks by not giving specific details, such as the fact that the charity reclaims basic rate tax.

Additionally, by relating the answers back to the case study, for example by noting that Brad can reclaim higher rate relief as he is a higher rate taxpayer.

Part (e)(iii) was a relatively straightforward question, looking for a description of the interaction between making charitable gifts in a Will and the resulting Inheritance Tax. Some candidates neglected to mention that the gift itself is exempt.

There were mixed responses in part (f). While most candidates correctly identified that the divorce would not invalidate the Will, but Katherine would no longer benefit. However, a number of candidates failed to point out that Katherine would not be able to be executor and that the discretionary trust for children would fail.

Part (f)(ii) was not well answered. The important point to note is that it was only Katherine's share that would be redistributed to a trust for the children, not the entire estate.

Candidates showed a very good understanding of the conditions needed for a Will to be valid and scored very well in part (f)(iii).

Question 2

Part (a) posed a challenge. Many candidates correctly identified that the base costs would be reset to the market value at date of death but did not describe the calculation in detail, as the question asked. Few noted that Max's full annual exempt amount would be available.

Part (b)(i) and (b)(ii) tested candidates understanding of how an inheritance would be dealt with if one of the beneficiaries is bankrupt. Most candidates noted that the trustee in bankruptcy would need to be notified and would claim the inheritance to pay outstanding debts. However, few candidates provided enough detail to gain high marks.

Candidates scored highly on part (c)(i), gaining high marks describing disclaimers and deeds of variation. However, many candidates struggled with applying the knowledge to Lois's personal situation in (c)(ii) and (c)(iii). As Lois is bankrupt, neither a deed of variation, nor a disclaimer would keep the inheritance from the trustee in bankruptcy.

Question 3

Part (a) required candidates to describe the process to replace trustees. While many candidates gained some marks for describing the process generally, many missed valuable marks by not linking the answer back to the case study. In particular, identifying how the process would differ depending on Harry's mental capacity and that if they both retired, at least one trustee would need to be appointed so that the trust would not be left without a trustee.

Candidates handled the calculation and description questions in part (b)(i) and (b)(ii) very well, with many gaining full marks working out the exit charge. Answers to part (b)(ii) were more varied with some candidates not adding distributions back in or using the wrong nil rate band.

Most candidates gained good marks on part (c)(i) but many struggled to give enough detail in part (c)(ii). In particular, many candidates did not cover the difference in tax treatment of onshore and offshore bonds and that tax would be based on the settlor, while he is alive.

Part (d) was poorly answered by many candidates. Interest in Possession trusts are still very common so understanding the tax treatment is important. Many candidates identified that the income would be taxed at the basic rate and that Gail could reclaim some of the tax. More well-prepared candidates described this in detail, including how the income would interact with her available tax allowances.

Unit AF1 – Personal tax and trust planning

Instructions to candidates

Read the instructions below before answering any questions

All questions in this examination 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.

- **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.
- The calculator is in a pop-up box on the right-hand side of the interface. 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.
- For each answer, please type in the full question number you are answering eg **1a**
- Have you shown your ID during the ID check? If not, show it to the camera now please.

- Did you show the edge of your screen with a mirror during the room scan? If not, use a mirror to show it now please.

- If you have blank paper for notes, did you show both sides to the camera? If not, show both sides to the camera now please.

Subject to providing sufficient detail you are advised to be as brief and concise as possible, using note format and short sentences.

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)**

(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)**

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

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

(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

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

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) Taxable Income

	Non-savings	Savings	Dividends
Salary	£100,000		
Self-employment	£20,000		
Bonus	£7,500		
Dividends			£30,000
Corporate Bond OEIC income		£1,250	
Bank Interest		£750	
Total	**£127,500**	**£2,000**	**£30,000**

Adjusted Net Income
(£127,500 + £2,000 + £30,000) - £5,000 = £154,500

Personal Allowance
No personal allowance as income is over £125,000

Non-savings
(£37,500 + £5,000) x 20% = £8,500
£85,000 x 40% = £34,000

Savings
No Personal Savings Allowance as she is an additional rate taxpayer
£2,000 x 40% = £800

Dividends
HR band remaining (£150,000 + £5,000) - £129,500 = £25,500
£2,000 x 0% = £0
£23,500 x 32.5% = £7,637.50
£4,500 x 38.1% = £1,714.50

Total Income Tax
£8,500 + £34,000 + £800 + £7,637.50 + £1,714.50 = £52,652

(b) (i) Answer based on annual figures

Class 1 NICs

£8,632 x 0% = £0
(£50,000 - £8,632) x 12% = £4,964.16
(£107,500 - £50,000) x 2% = £1,150
Total class 1 NICs £4,964.16 + £1,150 = £6,114.16

Class 2 NICs

£3 x 52 = £156

Class 4 NICs

No class 4 NICs payable at 9% (due to NIC maxima limits) (£0) (£20,000 - £8,632) x 2% = £227.36

Total NICs

£6,114.16 + £156 + £227.36 = £6,497.52

Alternative answer based on weekly figures

Class 1 NICs

£166 x 0% x 52 = £0
(£962 - £166) x 12% x 52 = £4,967.04
(£2,067.31 - £962) x 2% x 52 = £1,149.52
Total class 1 NICs £4,967.04 + £1,149.52 = £6,116.56

Class 2 NICs

£3 x 52 = £156

Class 4 NICs

No class 4 NICs payable at 9% (due to NIC maxima limits) (£0)
(£20,000 - £8,632) x 2% = £227.36

Total NICs

£6,116.56 + £156 + £227.36 = £6,499.92

(ii)

- As Fenella has earnings from employment and self-employment;
- the Class 4 National Insurance contributions will be restricted.
- This limits self-employed profits charged at the main 9% rate;
- and means that her self-employed profits will be subject to the uncapped 2% rate, for the amount exceeding the Primary Threshold/lower profits limit.

(c)

- As the room is furnished;
- and let as a residence/not as a business space.
- The room is within their main home/not self-contained;
- even though Brad and Fenella rent their home.
- The property is in the UK/EEA.

(d) **(i)** *Candidates would have gained full marks for any nine of the following:*

UK Property
- Qualifies;
- as it is furnished;
- and let on a commercial basis to the public.
- It was available for let for at least 210 days in the tax year.
- It was let for more than 105 days in the tax year.
- Whilst it was let continuously for more than 31 days;
- this did not exceed 155 days in the tax year.

Spain
- Does not qualify;
- as not let on a commercial basis.

USA
- Does not qualify;
- as outside of UK /EEA.

(ii) *Candidates would have gained full marks for any four of the following:*

1. **As long as the pattern of occupation and availability conditions were met; and** you may genuinely intend to meet the letting condition but were unable to. If this happens, you may be able to make a period of grace election that allows the property to qualify as a free holding.

2. **You had a genuine intention to let the property in the year.**

   To make an election, you must be able to show that you had a genuine intention to let the property in the year. For example, where you've marketed a property to the same or a greater level than in successful years, or where the lettings are cancelled due to unforeseen circumstances, including extreme adverse weather.

3. **It must have met the letting condition in the year before.**

   You can make an election where the property met the letting condition in the year before the first year you wish to make a period of grace election (either on its own or because of an averaging election).

4. **You can make a second period of grace election if the property does not need the letting condition for the second year.**

   (as long as you made an election in the previous year).

5. If your property does not reach the threshold by the fourth year, after two consecutive period of grace elections, it will no longer qualify as a furnished holiday letting.

(iii) *Candidates would have gained full marks for any four of the following:*
- Profits count as earnings for making pension contributions.
- Capital Gains Tax (CGT) rollover relief/holdover relief may be available.
- CGT entrepreneur's/Business Asset Disposal relief may be available.
- Offset expenses (legitimate)/full mortgage interest relief
- Qualifies for IHT/Business Relief if held 2 years.

(e) **(i)** *Candidates would have gained full marks for any four of the following:*

- Disposals to charity are exempt from CGT.
- Outright gifts to charity are exempt from Inheritance Tax (IHT) (exempt gift)/potential reduction in IHT rate on death.
- Gifts to charity can qualify for Income Tax relief/Gift aid.
- Contributions to charity made net of basic rate tax/extends basic rate band.
- Higher rate tax relief available via self-assessment.

(ii)

- Brad makes a gift aid declaration.
- The charity reclaims the basic rate tax from HM Revenue & Customs.
- As Brad is a higher rate taxpayer;
- he can claim higher rate tax relief of 20% which extends his basic/higher rate band;
- via self-assessment.

(iii)

- If Brad gifts at least 10% of the net value of his estate to charity (the value of the estate after taking off any debts, nil rate band, reliefs & exemptions but not the Residence Nil Rate Band), The IHT for the rest of the estate reduces from 40% to 36% and the gift to charity itself is exempt from tax.

(f) **(i)**

- Will remains valid/divorce will not invalidate Will.
- Katherine no longer receives a benefit (treated as if she pre-deceased Brad).
- Gift to charity is unaffected.
- Would need to appoint a new executor.
- Discretionary trust for children fails.

(ii)

- Katherine's share distributed equally between two children.
- Fenella receives nothing as they are not married.
- The legacy for the children is held under trust;
- until they reach age 18;
- or marry before they are 18.

(iii)

- Must be made by someone who is over 18;
- of sound mind/with full capacity;
- and under no pressure/duress to make a Will.
- Must be in writing.
- Signed by the person making it/Brad.
- In the presence of two independent witnesses.

Model answer for Question 2

(a) *Candidates would have gained full marks for any twelve of the following:*

- The executor/brother is liable for any Capital Gains Tax (CGT)on assets sold.
- Assets are treated as though they had passed to executor at the date of Max's death;
- The acquisition value is the market value as date of death/probate/base costs are reset.
- On disposal, any gain made during the administration period is potentially taxable/subject to CGT.
- The acquisition value is deducted from sale proceeds.
- Any costs of disposal are allowable.

- The full amount of the personal annual exempt amount/£12,000 is available;
- for the tax year in which Max's death occurred;
- and for the 2 tax years following the year of Max's death.

- The rate of tax payable is 20% on shares and unit trusts.
- 28%/8% surcharge would apply on disposal of residential property.

- Holdover relief can be used to defer the gain.
- In this case, beneficiaries will be subject to CGT on eventual disposal.

(b) **(i)**

- Max's date of death was after Lois was made bankrupt;
- she is yet to be discharged.
- Lois is obliged to notify the Trustee in Bankruptcy/Official Receiver about her entitlement under the terms of the Will;
- within 28 days of receipt of the inheritance.

(ii)

- The Trustee in Bankruptcy/Official Receiver will claim the monies she has inherited.
- This will be used towards her outstanding debts.
- If debts paid off in full as result, bankruptcy can be cancelled/annulled.
- Any excess will be passed to Lois.

(c) **(i)** *Candidates would have gained full marks for any twelve of the following:*

- A deed of variation can be drawn up.
- It must be in writing/state what is being varied.
- Referring specifically to the original Will.
- All affected beneficiaries must agree;
- with capacity to sign i.e. are over age 18 and of sound mind.
- It will be treated as taking place on death.
- Varied estate can be directed at the discretion of original beneficiaries.

- Disclaimer can be used;
- as inheritance has not been accepted/received.
- Person giving up the benefit must sign the disclaimer.
- Disclaimed inheritance goes back to residue of estate/no control over where the disclaimed legacy goes.
- The disclaimer is not treated as a transfer of value.

Common to both options

- Must be done within 2 years of death.
- Must not be done for consideration/money or money's worth.
- If it results in additional IHT being due, the Executors must also sign.
- Must contain statement stating that variation must be effective for IHT/CGT, as applicable.

(ii)

- The Trustee in bankruptcy will not allow/can reverse a deed of variation made or cancel the disclaimer/will be able to claim the money;
- as Lois' has no capacity to give up her right/because she is an undischarged bankrupt.

(iii)

- Ensure any inheritance is paid to correct person (Trustee in bankruptcy).
- If the executor pays Lois' instead, they have not fulfilled their responsibility;
- the Trustee in bankruptcy could get a Court order/sue/claim the amount back from the executor; executor personally liable.
- The executor could try to claim back from Lois.

Model answer for Question 3

(a)

- If Harry retains mental capacity;
- they can both retire as trustees;
- by executing a deed of retirement.

- If Harry lacks mental capacity, Don can remove and replace;
- under powers given under Section 36 of the Trustee Act 1925 or;
- failing that a new trustee can be appointed by the Court.

- Don would need to ensure he does not leave the trust without a trustee;
- he would need to appoint new trustees/or a corporate trustee.

(b) (i) Effective rate

- £4,500/
- £400,000
- = 1.125%

Exit charge

- £200,000 x 1.125
- x 15/40
- = £843.75

(ii)

- Determine the value of the trust assets on the 10-year anniversary/1 May 2026;
- then add distributions made/£200,000 (value distributed 1 April 2020).
- deduct the full;
- nil rate band;
- applicable in 2026.
- Apply 6% tax to the amount remaining (to arrive at the 10-year charge payable).

(c) (i)

- The equity-based collective investments are taxed as dividend income within the trust.
- The income within the £1,000 standard rate band;
- is taxed at 7.5%;
- with the excess taxed at 38.1%.
- Income must be declared to HM Revenue & Customs via an annual tax return.

(ii)

- A bond is non income producing/no tax return.
- An offshore bond would benefit from gross roll-up.
- An onshore bond would suffer the equivalent of basic rate tax within the fund.
- Tax would only be payable on a chargeable event.
- Taxed on Don as the settlor, while is still alive (and in the tax year of his death).

(d)

- As Gail is the life tenant entitled to the income, interest is treated as interest and dividends will be treated as dividends/it is not classed as trust income.

- Trustees of the IIP will pay basic rate tax on all the income received within the trust.

- Interest is paid to Gail with a 20% tax credit/tax credit of £640;
- which she can fully reclaim;
- as all the income will fall within her personal allowances and starting rate band.

- The dividend income will be paid with a 7.5% tax credit.
- She will be able to reclaim £150 of the tax paid within the trust;
- as she has her full dividend allowance available.
- The balance of the dividend income received falls within her basic rate tax band and so no further reclaim is possible/she will not owe any additional tax on this income.

All questions in the October 2020 paper will be based on English law and practice applicable in the tax year 2020/2021, unless stated otherwise and should be answered accordingly.

The Tax Tables which follow are applicable to the October 2019 and July 2020 examinations.

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%