



Chartered
Insurance
Institute

J05

Diploma in Financial Planning

Unit J05 – Pension income options

October 2020 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2020/2021, 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 J05 – Pension income options

Instructions to candidates

Read the instructions below before answering any questions

- **Two hours** are allowed for this paper which consists of 15 short answer questions and carries a total of 130 marks.
- You are strongly advised to attempt all questions to gain maximum possible marks. The number of marks allocated to each question part is given next to the question and you should spend your time in accordance with that allocation.
- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.
- 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.

Attempt ALL questions**Time: 2 hours**

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

1. In June 2014, Kenny's personal pension plan (PPP) was valued at £600,000. At that time, he took a pension commencement lump sum (PCLS) of £150,000. The remaining fund, currently valued at £575,000, is in a flexi-access drawdown arrangement.

Kenny will reach the age of 75 on 1 November 2020. His only other pension arrangement is an uncrystallised PPP, which is currently valued at £650,000. He has not registered for any form of transitional protection.

Calculate, **showing all your workings**, the lifetime allowance tax charge payable in respect of Kenny's pension benefits when he reaches the age of 75.

You should assume Kenny did not crystallise any further benefits prior to age 75.

(8)

2. Anika, aged 56, plans to retire when she reaches age 60. Anika is a deferred member of two separate defined benefit pension schemes, and she wishes to transfer these benefits into a personal pension plan (PPP) in order to access them flexibly. The cash equivalent transfer value (CETV) of scheme A is £25,000 and the CETV of scheme B is £135,000.

Explain, giving your reasons, the steps that Anika must take before the schemes will agree to transfer the funds to a PPP.

(8)

3. Shabana was a member of her previous employer's defined benefit pension scheme between 1985 and 2006. The scheme was contracted-out prior to April 2016.

Outline the statutory minimum increases that the scheme must apply to Shabana's pension once it is in payment.

(8)

4. George, aged 64, is currently in the process of finalising his divorce. He is in good health and plans to retire when he reaches age 65. As part of the divorce settlement, George will be awarded a share of his wife's personal pension plan (PPP).

Explain the advantages of George using a pension sharing order rather than an earmarking order in relation to his share of the PPP.

(5)

5. Outline the factors that you would take into account when advising on whether to take a lump sum from a personal pension plan (PPP) via an uncrystallised funds pension lump sum or as a pension commencement lump sum.

(10)

6. Kathryn, aged 64, is divorced and has a son aged 28, who is financially independent. She is employed on a salary of £16,000 per annum. Kathryn intends to retire when she reaches her State Pension age of 66 when she will be entitled to an estimated State Pension of £6,700 per annum. Kathryn anticipates requiring a net income of £15,000 per annum throughout her retirement and does not have any immediate planned capital expenditure.

Kathryn has deferred benefits in a defined benefit pension scheme. She will be entitled to a scheme pension of £11,680 per annum, plus a pension commencement lump sum (PCLS) of £35,040 at the scheme's normal pension age of 65. Alternatively, she has been offered a cash equivalent transfer value (CETV) of £293,000.

Outline the factors you would take into account when advising on whether Kathryn should accept the CETV and utilise flexi-access drawdown rather than take the scheme pension and PCLS offered by the scheme.

(12)

QUESTIONS CONTINUE OVER THE PAGE

7. Paulo died recently at the age of 71. At the time of his death he was in receipt of a scheme pension of £6,500 per annum from a defined benefit pension scheme, which commenced when Paulo reached age 65 and included a ten-year guarantee. The scheme pension does not include any pension protection lump sum death benefits and does not provide any defined benefit lump sum death benefits. He also held an uncrystallised personal pension plan (PPP).

Paulo, who was single with no dependants, had completed nomination forms showing that his sister, Christine, should receive the death benefits from his pensions.

Outline the death benefit options available to Christine, including the tax treatment, in respect of Paulo's:

- (a) scheme pension; (6)
- (b) uncrystallised personal pension plan. (9)
8. Rafa, aged 63, currently holds a personal pension plan (PPP) valued at £325,000. Rafa intends to use his full PPP to purchase a lifetime annuity at age 65.

State **eight** factors that will influence the annuity rate Rafa will receive.

You should consider both generic and client specific factors in your answer. (8)

9. Zeinab, who is married with three adult children, reached her State Pension age in September 2020. She has 35 qualifying years of National Insurance Contributions (NICs), but 15 of these years are as a result of NIC credits being awarded.

State the potential circumstances that could have resulted in Zeinab's NIC credits. (5)

10. Mathieu, aged 62, retired at the end of July 2020. Prior to retirement, he had relevant UK earnings of £4,000 gross per month and he has not made any pension contributions for five years.

Mathieu has savings of £20,000 which he wishes to invest. He does not anticipate requiring access to this capital for at least ten years.

Outline the factors Mathieu should consider when deciding whether to invest his savings into a personal pension plan (PPP) or an ISA. (12)

11. Identify **five** pieces of information included on a State Pension benefit statement. (5)
12. Joanne, aged 60, is considering withdrawing her entire pension fund as an uncrystallised funds pension lump sum and purchasing a buy-to-let property to provide her retirement income.
- Outline **seven** drawbacks of this course of action. (7)
13. Section 9.3 of the Financial Conduct Authority's Conduct of Business Sourcebook (COBS) outlines the relevant circumstances that should be considered when a firm is making a personal recommendation to a client regarding income withdrawals.
- Outline the relevant circumstances that must be considered. (8)
14. Sabine is aged 60. Her only income for 2020/2021 is her salary of £20,000. She has an uncrystallised personal pension fund of £130,000. Sabine wishes to take an uncrystallised funds pension lump sum (UFPLS) which will provide her with a net payment of £15,000 after all taxes have been settled.
- Calculate, **showing all your workings**, the amount of fund which must be crystallised to provide the net amount of £15,000 as an UFPLS.
- You should assume that the scheme administrator has Sabine's tax code and therefore Month 1 does not apply.* (5)
15. Tim, aged 63, is about to retire and intends to draw an income from his personal pension plan (PPP) using flexi-access drawdown. Tim would like to assess his projected income and expenditure requirements before taking an income from his PPP.
- (a) State **eight** factors that should be taken into account when carrying out a projected cash flow analysis for Tim. (8)
- (b) Outline **six** scenarios that should be discussed with Tim when carrying out a stress test of his cash flow analysis. (6)

The tax tables can be found on pages 9 – 17

INCOME TAX

| RATES OF TAX | 2019/2020 | 2020/2021 |
|-----------------------------------------------------------------------------------------------------------------------------------------------|-----------|-----------|
| 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 | £37,500 | £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 |
| *Only applicable to savings income that falls within the first £5,000 of income in excess of the personal allowance | | |
| 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) § | £12,500 | £12,500 |
| Married/civil partners (minimum) at 10% † | £3,450 | £3,510 |
| Married/civil partners at 10% † | £8,915 | £9,075 |
| Marriage Allowance | £1,250 | £1,250 |
| Income limit for Married Couple's Allowance † | £29,600 | £30,200 |
| Rent a Room scheme – tax free income allowance | £7,500 | £7,500 |
| Blind Person's Allowance | £2,450 | £2,500 |
| 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 | £2,830 |
| - family element | £545 | £545 |
| Threshold for tapered withdrawal of CTC | £16,105 | £16,385 |

NATIONAL INSURANCE CONTRIBUTIONS

| Class 1 Employee | Weekly |
|----------------------------|--------|
| Lower Earnings Limit (LEL) | £120 |
| Primary threshold | £183 |
| Upper Earnings Limit (UEL) | £962 |

| Total earnings £ per week | CLASS 1 EMPLOYEE CONTRIBUTIONS |
|---------------------------|--------------------------------|
| Up to 183.00* | Nil |
| 183.00 – 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 £120 per week. This £120 to £183 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 169.00** | Nil |
| 169.00 – 962.00 | 13.8% |
| Excess over 962.00 | 13.8% |

*** Secondary earnings threshold.*

| | |
|--------------------------------|-------------------------------------------------------------------------|
| Class 2 (self-employed) | Flat rate per week £3.05 where profits exceed £6,475 per annum. |
| Class 3 (voluntary) | Flat rate per week £15.30. |
| Class 4 (self-employed) | 9% on profits between £9,500 - £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 |
| 2020/2021 | £1,073,100 |

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.

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* |
| 2020/2021 | £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 by £1 for every £2 of 'adjusted income' over £240,000 to a minimum of £4,000 if 'threshold income' is also over £200,000.

MONEY PURCHASE ANNUAL ALLOWANCE

| 2019/2020 | 2020/2021 |
|-----------|-----------|
| £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 | 2019/2020 | 2020/2021 |
|---------------------------------------------------------------------------|-----------|-----------|
| Individuals, estates etc | £12,000 | £12,300 |
| Trusts generally | £6,000 | £6,150 |
| 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% |
| | 10% | 10% |
| Business Asset Disposal Relief* – Gains taxed at: | | |
| Lifetime limit | £10,000,000 | £1,000,000 |

**For trading businesses and companies (minimum 5% employee or director shareholding) if held for at least two years.*

INHERITANCE TAX

| RATES OF TAX ON TRANSFERS | 2019/2020 | 2020/2021 |
|-------------------------------------------------|-----------|-----------|
| Transfers made on death | | |
| - Up to £325,000 | Nil | Nil |
| - Excess over £325,000 | 40% | 40% |
| Transfers | | |
| - 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* | £150,000 | £175,000 |
| - 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% |

PRIVATE VEHICLES USED FOR WORK

| | 2019/2020 Rates | 2020/2021 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

| | 2019/2020 | 2020/2021 |
|----------------------------------------------------------------------------------------------------------|-------------|------------------|
| Plant & machinery (excluding cars) 100% annual investment allowance (first year) | £1,000,000 | £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 | 6% | 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% |
| | first year | reducing balance |
| | | reducing balance |

*If new

MAIN SOCIAL SECURITY BENEFITS

| | | 2019/2020 | 2020/2021 |
|-------------------------------------------------|-----------------------------------------------|--------------|--------------|
| | | £ | £ |
| Child Benefit | First child | 20.70 | 21.05 |
| | Subsequent children | 13.70 | 13.95 |
| | Guardian's allowance | 17.20 | 17.90 |
| Employment and Support Allowance | Assessment Phase | | |
| | Age 16 - 24 | Up to 57.90 | Up to £58.90 |
| | Aged 25 or over | Up to 73.10 | Up to £74.35 |
| | Main Phase | | |
| | Work Related Activity Group | Up to 102.15 | Up to 74.35 |
| | Support Group | Up to 111.65 | Up to 113.55 |
| Attendance Allowance | Lower rate | 58.70 | 59.70 |
| | Higher rate | 87.65 | 89.15 |
| Basic State Pension | Single | 129.20 | 134.25 |
| | Married | 201.45 | 268.50 |
| Single Tier State Pension | Single | 168.60 | 175.20 |
| Pension Credit | Single person standard minimum guarantee | 167.25 | 173.75 |
| | Married couple standard minimum guarantee | 255.25 | 265.20 |
| | Maximum savings ignored in calculating income | 10,000.00 | 10,000.00 |
| 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 | 58.90 |
| | Age 25 or over | 73.10 | 74.35 |
| Statutory Maternity, Paternity and Adoption Pay | | 148.68 | 151.20 |

CORPORATION TAX

| | 2019/2020 | 2020/2021 |
|---------------|-----------|-----------|
| Standard rate | 19% | 19% |

VALUE ADDED TAX

| | 2019/2020 | 2020/2021 |
|-------------------------------|-----------|-----------|
| 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% |

Important note: For residential properties purchased between 8th July 2020 and 31st March 2021, Stamp Duty Land Tax does not apply up to £500,000. For purchases above £500,000, the band rates above apply as normal. Additional SDLT rules still apply as below.

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 may be charged at 15% on interests in residential dwellings costing more than £500,000 purchased by certain corporate bodies or non-natural persons.

First-time buyers benefit from SDLT relief on purchases up to £500,000 when purchasing their main residence. On purchases up to £300,000, no SDLT is payable. On purchases between £300,000 and £500,000, a flat rate of 5% is charged on the balance above £300,000.

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

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