



Chartered  
Insurance  
Institute

# AF2

## Advanced Diploma in Financial Planning

Unit AF2 – Business financial planning

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 AF2 – Business financial planning

### Instructions to candidates

#### Read the instructions below before answering any questions

- **Three hours** are allowed for this paper which carries a total of 160 marks as follows:
  - Section A: 80 marks
  - Section B: 80 marks
- You are advised to spend approximately 90 minutes on Section A and 90 minutes on Section B.
- You are strongly advised to attempt **all** questions to gain maximum possible marks. The number of marks allocated to each question part is given next to the question and you should spend your time in accordance with that allocation.
- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.
- 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 clients circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c), (d), (e), (f) and (g) which follow.**

Donneil Printing is run as a partnership by Don, aged 55, and his business partner Neil. The partnership will soon be dissolved as Neil wishes to retire and realise his share of the partnership. The partnership has no long-term liabilities.

Don intends to continue the business and will be joined by Julie, aged 32, a long-standing colleague. The business has five full time employees, all over the age of 25 and all of whom have been with the firm for more than three years. They will be taking on three new employees.

Julie does not wish to enter into a partnership with Don and would prefer the business to be run as a limited company. Julie is aware of the limitations of a partnership and would like the benefits provided by a limited company. Julie will be investing £100,000 of her own money into the business to mirror the value of Don's equity in the partnership. Don's equity in the partnership will transfer to the new company in exchange for shares in the new company. They will both be equal shareholders. The formalities of transferring the business to a limited company have been agreed between all three parties.

Don and Julie have plans to expand the business which will require additional capital of £80,000. Julie owns her own house valued at £350,000, with her wife Jenny, on which they owe £95,000. Don is currently in rented accommodation and has no surplus funds.

They are projecting a gross profit for the business of £125,000 in the first trading period ending on 31 March 2021. As Julie will be investing much of her own money in the business, she wants to protect her investment in case of death or illness of either herself or Don, although Don cannot see such a need.

Julie is aware that the company must provide a pension scheme for all its staff and has asked for your advice on providing an auto-enrolment pension scheme.

**Question 1**

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

- (a) Explain briefly to Don and Julie **five** benefits and **five** drawbacks of trading as a limited company rather than a partnership under the Partnership Act 1890. (10)
- (b) Julie is considering crowdfunding as well as traditional lenders as a method of raising finance for the new business.
- (i) State the **three** main methods of crowdfunding and provide **one** characteristic of **each** method. (6)
- (ii) State **three** reasons why providers of finance might prefer to deal with a limited company rather than a partnership. (3)
- (c) Julie is considering her remuneration options. Assuming a gross profit of £125,000:
- (i) calculate, **showing all your workings**, Julie's net income, if she takes her share as a dividend in the tax year 2020/2021. Julie will have no other taxable income; (9)
- (ii) explain briefly to Julie why it is preferable for her remuneration to be taken as salary plus a dividend rather than a dividend alone. (5)
- (d) Describe briefly to Don and Julie:
- (i) the tax treatment that is applied to a partnership that has transferred its business into a limited company; (4)
- (ii) the steps the new limited company must take at outset with regard to its tax affairs. (4)

**QUESTIONS CONTINUE OVER THE PAGE**

- (e) (i)** Identify and outline the principal effect of the legal protection the employees will receive when the partnership business is transferred to the new limited company. **(3)**
- (ii)** Explain to Don and Julie the responsibilities and liabilities the regulations you have identified in **part (e)(i)** above will place on them on the transfer of the partnership business to the limited company. **(7)**
- (f)** Explain to Don and Julie, in relation to the new limited company:
- (i)** the issues that may arise if either were to die without appropriate shareholder protection planning in place; **(8)**
- (ii)** the Inheritance Tax position of their shares in the new limited company should either die during the first two years of trading, or at a later date; **(8)**
- (iii)** the options and implications for the payment of the premiums, assuming that they each effect an own life policy as part of a shareholder protection arrangement. **(5)**
- (g)** Explain to Don and Julie the key requirements and implications for the new limited company of pension auto-enrolment. **(8)**

**Total marks available for this question: 80**

**Section B questions can be found on pages 8 - 12**

## SECTION B

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

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

Dutonic Ltd is a company that produces electronic equipment and employs 20 people full time. Steven and Keir are shareholding directors of the company. It expanded very quickly and moved into larger premises two years ago borrowing £295,000 on a secured basis from Allco Bank to fund the purchase. Since the company took out the loan for the purchase of the property, the business has not met profit expectations. Over recent months the company has increased its overdraft with the bank and the directors have had to give personal guarantees.

Keir has become increasingly concerned about the company's financial position. He is also concerned that the company has missed nine months' worth of employer pension contributions to the group personal pension plan set up for employees. He previously worked in a legal firm dealing with bankruptcy and has some knowledge of the legal position and wishes to avoid a compulsory liquidation.

## Dutonic Ltd

## Profit and loss account

	Year end 31 October 2019 (£)	Year end 31 October 2020 (£)
Sales revenue	690,000	395,000
Cost of goods sold	280,000	212,000
Promotion expenses	28,000	38,000
Salaries	245,000	260,000
Administration costs	20,000	25,000
Interest on loans	19,500	28,300



## Dutonic Ltd

## Balance sheet

	as at 31 October 2019 (£)	as at 31 October 2020 (£)
<b>Fixed assets</b>		
Buildings	390,000	390,000
Machinery	30,000	19,000
	<b>420,000</b>	<b>409,000</b>
<b>Current assets</b>		
Cash	25,000	6,000
Stock	25,000	9,000
Debtors	56,000	36,000
	<b>106,000</b>	<b>51,000</b>
<b>Current liabilities</b>		
Bank overdraft	19,000	52,000
Creditors	38,000	76,000
	<b>57,000</b>	<b>128,000</b>
<b>Long term liabilities</b>		
Commercial mortgage	295,000	270,000
<b>Net assets</b>	184,000	72,000
<b>Financed by:</b>		
Share capital	10,000	10,000
Shareholder retained profit	174,000	62,000
	<b>184,000</b>	<b>72,000</b>

QUESTIONS CONTINUE OVER THE PAGE

**Question 2**

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**, the pre-tax operating profit or loss for the financial years ending October 2019 and 2020 and comment on the trend. (5)
- (b) Calculate, **showing all your workings**, the following ratios, for the financial years ending October 2019 and 2020:
- (i) the current ratio; (3)
  - (ii) creditor days ratio; (3)
  - (iii) the gearing ratio. (3)
  - (iv) Explain briefly the significance for the company of **each** of the ratios that you have calculated in **part (b)** above. (9)
- (c) With full knowledge of the company's financial position, Steven and Keir wish to continue trading.
- Explain briefly how Steven and Keir can prevent charges of wrongful trading if they continue trading. (5)
- (d) Steven and Keir are considering a members' voluntary liquidation.
- Explain why this may not be an option for them. (6)
- (e) Describe how the process of administration could help the company to avoid compulsory liquidation. (6)

**Total marks available for this question: 40**

**Question 3**

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

Bridget and Hans are directors of a floristry business called Flowers for all Ltd. They set up the business in 2014. They currently have one shop but now wish to expand and buy a second shop in a nearby town. They have found suitable commercial premises with a purchase price of £290,000. They will also have to pay VAT and Stamp Duty Land Tax. This shop currently belongs to Bridget's brother Ciaran.

Both Bridget and Hans have Self-Invested Personal Pensions (SIPPs). Bridget used her SIPP to buy the first shop and this is rented to the business for £18,000 a year. The new premises are much bigger than they need, and they will initially sub-let part of it. Bridget's SIPP is made up of the first shop that has a value of £250,000 and £150,000 held in cash and other assets. She has borrowings within her SIPP of £60,000. Hans' SIPP is invested in cash and various collective investments and has a current value of £205,000.

**QUESTIONS CONTINUE OVER THE PAGE**

**Question 3**

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

- (a) Explain the HM Revenue and Customs requirements for the purchase of the new shop premises, via their SIPPs, and the consequences if the requirements are not met. (6)
- (b) (i) Calculate, **showing all your workings**, from the information provided, the costs Bridget and Hans will incur in the purchase of the new property. (6)
- (ii) State the additional fees they may incur with the property purchase via their SIPPs. (3)
- (c) (i) Calculate, **showing all your workings**, the total amount Bridget and Hans can borrow using their SIPPs. (7)
- (ii) Calculate, **showing all your workings**, the shortfall in their SIPP funds to purchase the property, and describe briefly how the shortfall can be made up to finance the property purchase. (7)
- (d) State **seven** advantages of buying the new shop through Bridget and Hans SIPPs. (7)
- (e) Explain briefly the impact on Corporation Tax if the new shop is purchased through the limited company. (4)

**Total marks available for this question: 40**

## 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%
<b>MAIN PERSONAL ALLOWANCES AND RELIEFS</b>		
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.*

<b>Class 2 (self-employed)</b>	Flat rate per week £3.05 where profits exceed £6,475 per annum.
<b>Class 3 (voluntary)</b>	Flat rate per week £15.30.
<b>Class 4 (self-employed)</b>	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:

	0-3	3-4	4-5	5-6	6-7
- Years before death					
- Inheritance Tax payable	100%	80%	60%	40%	20%

Quick succession relief:

	0-1	1-2	2-3	3-4	4-5
- Years since IHT paid					
- Inheritance Tax relief	100%	80%	60%	40%	20%

## PRIVATE VEHICLES USED FOR WORK

	2019/2020 Rates	2020/2021 Rates
<b>Cars</b>		
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
<b>Motor Cycles</b>	24p per mile	24p per mile
<b>Bicycles</b>	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%	
<b>Motor cars:</b> Expenditure on or after 01 April 2016 (Corporation Tax) or 06 April 2016 (Income Tax)			
CO <sub>2</sub> emissions of g/km:	50 or less*	51-110	111 or more
Capital allowance:	100%	18%	6%
	first year	reducing balance	reducing balance

\*If new

## MAIN SOCIAL SECURITY BENEFITS

		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 8<sup>th</sup> July 2020 and 31<sup>st</sup> 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%