Chartered Insurance Institute

AF7

Advanced Diploma in Financial Planning

Unit AF7 – Pension transfers

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 AF7 – Pension transfers

Instructions to candidates

Read the instructions below before answering any questions

Two hours are allowed for this paper which carries a total of 100 marks as follows:

Section A: 33 marks
Section B: 67 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.
- Additional information, relevant to pension planning, is also included at the end of the tax tables on 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

The following questions are compulsory and carry a total of 33 marks

1. Bakari, aged 60, is interested in transferring the cash equivalent transfer value (CETV) of his deferred benefits in his previous employer's defined benefit pension scheme to a personal pension plan. The scheme is offering a CETV of £28,750 that has been reduced by 15% due to underfunding.

Explain to Bakari:

(a) why he must receive appropriate independent financial advice before any transfer can take place; and **(2)**

(b) the steps that must be taken to prove he has received this advice, including any timescale involved. **(5)**

2. Mallorie, aged 46, is married. She has rheumatoid arthritis which is likely to reduce her life expectancy by about ten years. Her illness has now progressed to the point where she feels unable to continue working. Mallorie is an active member of her employer's defined benefit pension scheme, having joined the scheme in April 1998.

Mallorie's employer has said that she may apply for an early retirement scheme pension on the grounds of ill health or, once she has ceased employment, a transfer of the cash equivalent value of her pension benefits.

(a) State the HM Revenue & Customs criteria that must be met to enable an ill-health early retirement scheme pension to be payable to Mallorie. **(3)**

(b) Explain the compensation that is likely to be provided in respect of Mallorie's benefits if the scheme enters the Pension Protection Fund whilst she is in receipt of an ill-health early retirement scheme pension. **(6)**

(c) State why, based on Mallorie's state of health, a cash equivalent transfer value may represent good value. **(2)**

3. Liam, aged 55, is married. He was a member of a former employer's defined benefit pension scheme between 1986 and 2000. He has received a statement of entitlement that shows part of the scheme benefits are made up of a guaranteed minimum pension (GMP) that is subject to fixed rate revaluation.

With specific regard to the **GMP benefits**, outline **eight** factors that you would consider when evaluating a potential transfer of the cash equivalent value to a defined contribution arrangement. **(8)**

4. Anvil is a deferred member of a former employer's defined benefit pension scheme. He has recently received a cash equivalent transfer value (CETV) which is higher than one he obtained three years ago.

Outline **seven** possible reasons for the increase in the CETV. **(7)**

Total marks available for this question: 33

Section B questions can be found on pages 7 - 10

SECTION B

All questions in this section are compulsory and carry an overall total of 67 marks

Case study 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.

Zak, who will be 65 in December 2020, is married to Martina, aged 66. The couple are both in excellent health and have a history of longevity in their families. Zak and Martina do not have any children so legacy planning is not important to them as they plan to leave their estate to charity.

The couple retired in 2019. Their house, which is mortgage free, is valued at £650,000. Their only other assets are an emergency fund of £20,000 plus stocks and shares ISAs valued at £140,000. The couple, who both have a medium attitude to investment risk, would like to purchase a holiday cottage for £210,000.

The couple require an inflation proofed, net income of £3,750 per month to cover essential and discretionary expenditure; this will reduce to £2,500 per month net on first death. They also require £5,000 - £10,000 per annum net to cover ad-hoc expenditure. Martina receives a scheme pension of £30,200 per annum gross from her previous employer's defined benefit scheme. This includes a 50% spouse's pension. She also receives a State Pension of £130 per week. The couple currently use capital and income from their stocks and shares ISAs to cover the shortfall in their income.

Zak left his previous employer's defined benefit scheme in 2014. The scheme permits partial transfers, with Zak able to transfer just the pre-97 benefits or the post-97 benefits if he wishes. Some details of the scheme are shown below:

Pre-commutation pension at age 65	£31,000 gross per annum, of which £12,600 is in respect of pre-97 accrual and £18,400 is in respect of post-97 accrual
Maximum pension commencement lump sum (PCLS)	£143,077 Commutation rate is 15:1 at age 65
Guarantee period	5 years (payable as continuing income)
Spouse's Pension	50% of member's pre-commutation pension
Increases to pension in payment	In line with statutory requirements
Cash equivalent transfer value (CETV)	£976,000 of which £365,000 is in respect of pre-97 accrual; and £611,000 is in respect of post-97 accrual

Zak will be entitled to a State Pension of £140 per week when he reaches his State Pension age in 2022.

Zak would like to ensure the couple's essential and discretionary expenditure continues to be met throughout retirement, and would like advice on whether this would be best achieved by taking his full benefits from the defined benefit scheme or transferring some or all of his benefits into a defined contribution pension arrangement and accessing them flexibly.

Zak would also like to use some of the capital currently held in their ISAs plus some of his PCLS to purchase the holiday cottage.

Questions

5. An option you are considering is for Zak to transfer the cash equivalent of his pre-97 benefits into a defined contribution arrangement, leaving the post-97 benefits preserved in the defined benefit pension scheme.

Based on the information provided in the case study, outline the factors that should be taken into account when deciding whether this option should be recommended. **(15)**

6. In the event of Zak's death, outline the potential death benefits payable to Martina, including their Income Tax treatment, in respect of:

(a) a scheme pension being received by Zak in respect of the post-97 benefits within the defined benefit pension scheme; **(4)**

(b) a defined contribution pension arrangement following the transfer of the cash equivalent of Zak's pre-97 pension benefits. **(8)**

7. You have recommended that Zak takes the scheme pension in respect of his post-97 benefits and transfers the pre-97 CETV into a defined contribution arrangement.

Based on the information provided in the case study, outline the factors you would take into account when designing an investment strategy for Zak's transferred pension fund. **(7)**

Total marks available for this question: 34

Case study 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.

Rosie, aged 50, is a widow with two dependent children, aged 12 and 14. Her husband Lloyd died in March 2020 of cancer, aged 59. A couple of months before he died, Lloyd completed a transfer of benefits from a previous employer's defined benefit pension scheme to a personal pension plan. This was done with the intention of improving the death benefits payable to Rosie. The amount transferred was £135,200 and Lloyd did not make any withdrawals prior to his death. Rosie has recently notified the scheme administrator that she wishes to designate the funds to a dependant's flexi-access drawdown pension.

The mortgage on Rosie's home was cleared with the proceeds of a joint life first death life policy and she has funds held in ISAs valued at £38,000. Rosie has no other savings or life cover in place.

Rosie earns £55,000 per annum gross. She is a member of her employer's workplace pension scheme to which she and her employer contribute 5% of her salary. Her fund is currently valued at £76,000.

Rosie recently obtained a statement of entitlement in respect of her membership of a former employer's contracted-in defined benefit pension scheme. This includes the following information:

Cash equivalent transfer value	£730,000
Date of membership	1/5/1990 – 30/4/2010
Deferred pension at date of leaving	£18,350 per annum
Scheme normal pension age	65
Dependants' pension payable?	Yes
Revaluation in deferment	All benefits: inflation capped at 5%
Escalation in payment	All benefits: inflation capped at 5%

Although currently in good health, Rosie wants to make sure her children will be well provided for in the event that she dies before they are financially independent. For this reason, she has asked for advice about transferring the cash equivalent of her benefits in her former employer's pension scheme to a defined contribution pension arrangement.

Ideally Rosie would like to retire before age 60, although she has no firm plans at the moment. Neither does she have any clear idea of what annual income she will require in retirement but expects it to be at least £30,000 net in today's terms. At present, Rosie has between £300-£400 surplus income per month. She has a cautious to moderate attitude to risk.

Questions

8. Identify the additional information an adviser would require in respect of Rosie's former employer's defined benefit pension scheme before advising her on the suitability or otherwise of transferring the benefits. **(11)**

9. Based on the information provided in the case study, explain the factors that would support a potential recommendation for Rosie to retain her pension benefits within the defined benefit pension scheme at this point in time. **(12)**

10. Explain why Rosie should complete nominations in favour of her children for the dependant's flexi-access drawdown pension and her workplace pension scheme. **(5)**

11. The executor of Lloyd's estate has advised Rosie that the transfer of benefits from Lloyd's previous employer's defined benefit pension scheme is likely to be deemed a transfer of value for Inheritance Tax (IHT) purposes.

Assuming HM Revenue & Customs do assign a value to this transfer for IHT purposes, outline the impact this will have for Rosie when carrying out any future IHT planning. **(5)**

Total marks available for this question: 33

The tax tables can be found on pages 12 – 19

Also the additional information for the pension paper can be found on pages 21 – 22

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	2019/2020	2020/2021
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%

§ 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.*

	2019/2020	2020/2021
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

	2019/2020	2020/2021
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.*

	2019/2020	2020/2021
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% first year	18% reducing balance	6% 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%

The additional information for the pension paper can be found on pages 21 – 22

Supplementary Information Pension Papers – AF7 2020/2021

Revaluation

Guaranteed Minimum Pension – Fixed rate

Date of leaving service	Fixed rate of revaluation
Before 6 April 1988	8.5%
Between 6 April 1988 and 5 April 1993	7.5%
Between 6 April 1993 and 5 April 1997	7.0%
Between 6 April 1997 and 5 April 2002	6.25%
Between 6 April 2002 and 5 April 2007	4.5%
Between 6 April 2007 and 5 April 2012	4.0%
Between 6 April 2012 and 5 April 2017	4.75%
After 5 April 2017	3.5%

Non GMP benefits – statutory minimum rates

Date of leaving service	Statutory rate of revaluation
Before 1 January 1986	No requirement to revalue benefits
Between 1 January 1986 and 31 December 1990	CPI capped at 5% in respect of non GMP benefits accrued from 1 January 1985
Between 1 January 1991 and 5 April 2009	CPI capped at 5% in respect of all non GMP benefits
After 5 April 2009	CPI capped at 5% in respect of all non GMP benefits accrued before 6 April 2009 CPI capped at 2.5% in respect of all benefits accrued after 5 April 2009

NOTE: Statutory revaluation is based on RPI for revaluation prior to 2011

Escalation

Statutory rates of escalation: Member reached State Pension age before 6 April 2016

Accrual	Statutory rate of escalation
GMP: Accrual prior to 6 April 1988	**Scheme:** No requirement to provide any increases in payment **State:** Fully in line with CPI
GMP: Accrual between 6 April 1988 and 5 April 1997	**Scheme:** CPI capped at 3% **State:** Any increases in CPI in excess of 3%
Non GMP: Accrual prior to 6 April 1997	**Scheme:** No requirement to increase in payment
Non GMP: Accrual between 6 April 1997 and 5 April 2005	**Scheme:** CPI capped at 5% (LPI)
Non GMP: Accrual from 6 April 2005	**Scheme:** CPI capped at 2.5%

NOTE: Statutory escalation was based on RPI prior to 2011

Statutory rates of escalation: Member reaches State Pension age on or after 6 April 2016

Accrual	Statutory rate of escalation
GMP: Accrual prior to 6 April 1988	**Scheme:** No requirement to provide any increases in payment
GMP: Accrual between 6 April 1988 and 5 April 1997	**Scheme:** CPI capped at 3%
Non GMP: Accrual prior to 6 April 1997	**Scheme:** No requirement to increase in payment
Non GMP: Accrual between 6 April 1997 and 5 April 2005	**Scheme:** CPI capped at 5% (LPI)
Non GMP: Accrual from 6 April 2005	**Scheme:** CPI capped at 2.5%

NOTE: No increase to GMP is made by the State (via the State Pension) for individuals who reach State Pension age on or after 6 April 2016

Pension Protection

Compensation cap at age 65 (2020/2021): £41,461

Revaluation of deferred benefits within PPF

Service	Rate of revaluation
All service before 6 April 2009	CPI capped at 5%
All service after 5 April 2009	CPI capped at 2.5%

Escalation of benefits in payment from PPF

Service	Rate of revaluation
All service before 6 April 1997	No increases
All service after 5 April 1997	CPI capped at 2.5%