Chartered Insurance Institute

AF1

Advanced Diploma in Financial Planning

Unit AF1 – Personal tax and trust planning

April 2021 Examination Guide

SPECIAL NOTICES

Candidates entered for the September 2021 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 questions 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.

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.

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Tips for laying out calculations in on-screen written exams

Where you are asked to perform a calculation, it is important to show **all the steps** in your answer. Most of the marks will be allocated for demonstrating the correct method of calculation.

While there are no marks for presentation, laying the calculation out well will make it easier for the examiner to identify all of the marks you have achieved. It does not matter how long the calculation is, if it is well set out. There is no preferred format but following the below guidelines is often helpful:

- Set out each stage of your calculation on a separate line.
- Label the values used i.e. in an IHT calculation:
    - Main residence £500k,
    - Onshore Bond £100k.
- Identify all allowances, exemptions, tax rate bands, tax rates used in £ terms.
- Use subtotals, where appropriate: i.e.:
    - Total assets - £1,500,000
    - Nil rate band – (£325,000)
    - Residence nil rate band – (£175,000)
    - Assets after allowances - £1,000,000
- Show all your workings. This includes:
    - grossing up of pension contributions,
    - how you work out the allowances if they are not standard,
- Make notes where appropriate. For example:
    - Bond loss is excluded
    - ISA income ignored
- Double check all of your figures, specifically:
    - That you have calculated each section correctly.
    - That you have added up all of your figures correctly.

EXAMINERS' COMMENTS

Candidates' overall performance

This exam paper covered a variety of subject areas, and overall performance was good from those candidates who were well prepared.

Many candidates seemed to have taken on board comments from previous exam guides, and the quality and structure of answers relating to frequently tested areas continue to improve, which is pleasing to see.

Residence and domicile remain challenging for most candidates despite being tested on a regular basis. The majority of candidates did not perform well in this area,losing valuable marks as a result.

As is often the case, to get maximum marks, candidates needed to provide sufficient detail in their answers. As a general rule, the number of marks available should give an idea of how much detail is required. Therefore, it is advisable to add more in-depth answers to the questions that offer the highest marks.

Candidates are also urged to revise all areas of the syllabus prior to sitting the examination by referring to the relevant study texts and reading widely to ensure their knowledge is current and complete.

Question 1

Question (a) took the candidates through various aspects of calculating Inheritance Tax (IHT) and finished with the duties of an executor. Part (a)(i) was, on the whole, not answered well. Most candidates were able to recognise that the executors of Ron's estate could not claim any transferable nil rate band (NRB) from Molly's estate since her NRB had been fully used when £325,000 was placed in a Will Trust on her death. A number of candidates deducted two £3,000 annual gift exemptions from the amount placed in trust, forgetting that this exemption only applies to gifts made during lifetime, not on death.

Hardly any candidates recognised that Molly's death before 6 April 2017 meant she was entitled to a Residence Nil Rate band (RNRB) of £100,000, and this amount needed to form the basis of the calculation of her transferable RNRB. This then meant that those candidates who attempted the calculation and correctly recognised that tapering applied did not arrive at the correct answer.

Part (a)(ii) was relatively well answered with most candidates banking marks for recognising that the Potentially Exempt Transfer has failed and the excess over NRB would be taxable, and that taper relief would apply. Many candidates deducted two annual gift exemptions from the £500,000 outright gift, not realising that this exemption was already being used when discounted gift trust (DGT) withdrawals were redirected to fund Ron's whole of life policy. Not all candidates remembered to state that Arthur, as the gift's recipient, would be liable to pay the tax.

Most candidates received a decent number of marks for part (a)(iii), although very few candidates arrived at the correct answer. Where the candidates incorrectly calculated Molly's transferable RNRB in part (a)(i) and then carried this through to part (a)(iii), they were not penalised twice.

Some candidates did not deduct Ron's EIS from the chargeable estate before calculating IHT, and the vast majority of candidates struggled to correctly identify that the outstanding loan amount under Ron's loan trust formed part of his estate for IHT purposes.

Part (a)(iv) was well answered, with many candidates scoring high marks. Some candidates confused this question with the duties and responsibilities of trustees or did not provide sufficiently detailed answers to gain full marks.

It was pleasing to see that a good number of candidates correctly identified the protection arrangements which could have been put in place by Ron. The better prepared candidates stated the right sum assured for each plan. Some candidates proposed a whole of life plan or a decreasing term insurance policy, but this answer would not have achieved maximum marks.

Part (c)(i) was answered well with a number of candidates demonstrating a good level of knowledge and achieving relatively high marks, although few candidates achieved maximum marks. Candidates are reminded to link their answers to the case study where possible. For example, very few candidates identified that due to the level of discount, Ron's gift did not exceed NRB and therefore did not attract the immediate 20% lifetime IHT entry charge.

In part (c)(ii), candidates were asked to identify the factors which should have been considered before Ron established a DGT. This type of question tests the application of the candidates' technical knowledge. It is, therefore, important that the candidates relate their answers to the case study. It is a good idea to think about the questions which should have been asked before taking a particular course of action. In this instance, most candidates provided a good number of factors, but some answers focussed on the suitability of a bond as an investment vehicle and did not relate sufficiently to a DGT and Ron's specific circumstances.

Part (a)(iii) was poorly answered, with the majority of candidates not demonstrating a sufficiently thorough understanding to gain meaningful marks. Even where the candidates knew that the outstanding loan belonged to Ron's estate, very few knew that the trustees had to pay it back or linked it to the fact the bond would need to be accessed.

The vast majority of candidates found part (d)(i) and (ii) straightforward.

Intestacy has been tested on a number of previous occasions, so it was pleasing to see that a high proportion of candidates provided correct and detailed answers to part (e)(i), with many achieving high marks.

Part (e)(ii) tested another frequently appearing area. Most candidates scored well and could remember the key conditions required for a Will to be valid. However, the less well-prepared candidates failed to provide a sufficient level of detail we would expect at the advanced level.

Again, the impact of marriage on a person's Will would have been tested previously, so it was good to see that the vast majority of candidates provided the correct answer, achieving high marks in part (e)(iii).

Question 2

This question tested the candidates' knowledge of Capital Gains Tax (CGT) as well as residence and domicile, which most candidates found challenging.

Part (a) provided the candidates with an opportunity to collect a good number of marks for correctly calculating Jolene's CGT liability. Most candidates scored well, with many achieving high marks. Only a handful of candidates correctly identified that the top-sliced gain of £1,000 would be added to Jolene's taxable income for the purposes of calculating CGT, thus affecting the remaining basic rate band. Those candidates would typically go on to achieve the maximum number of marks.

Other common mistakes included not realising that the gain realised on the sale of the painting would be exempt as the value on disposal was under £6,000 or assuming that the holiday cottage was classed as a furnished holiday let, although there was no mention of it in the case study. Candidates are, therefore, reminded to refer to the case study at all times to avoid making assumptions – any information applicable to the expected answer will be made available to the candidates in the case study or the question itself, where relevant.

Parts (b)(i) and (b)(ii) asked the candidates to explain when Jolene should report and pay any CGT due on the sale of her holiday cottage and other assets. Most candidates correctly identified that the tax should be paid within 30 days of the property sale. However, hardly any answers referred to the 'CGT on UK property account', which applies to property sales after 6 April 2020.

Part (b)(ii) was generally well answered with the better prepared candidates correctly referring to the real time CGT service, thus gaining maximum marks.

In part (c), the candidates were asked to apply their knowledge in practice and identify how Jolene's CGT liability could be reduced using Ricardo's losses. Most candidates correctly stated that the mining shares could be transferred to Jolene to be encashed in her name. Some candidates recommended that Jolene transfers assets to Ricardo, which resulted in some marks but did not allow the candidates to obtain full marks available for this question.

Part (d) focussed on excluded property trusts (EPTs). Part (d)(i) was generally poorly answered, although the better prepared candidates were able to identify that an EPT would provide a non-UK domiciled individual with a means of protecting their non-UK assets from UK IHT. Part (d)(ii) was also not answered well, with the majority of candidates listing the benefits of an offshore bond rather than an EPT, thus limiting their chances of gaining meaningful marks.

Candidates' answers to part (e) generally fell short of the expected standard. A good number of candidates correctly stated that Ricardo would be deemed domiciled once he has been a UK resident for 15 out of 20 tax years. However, few candidates then went on to explain the impact of Ricardo moving to Portugal on his deemed domicile status for Income Tax, CGT and IHT purposes.

Candidates are encouraged to revise their knowledge of residence and domicile before sitting the examination. This is an important part of the syllabus which is repeatedly poorly answered.

Question 3

The final question of this paper tested the candidates' knowledge of Income Tax and a number of related concepts.

Part (a) required the candidates to carry out a straightforward Income Tax calculation. It was pleasing to see that a large number of candidates achieved high marks. Where mistakes were made, this predominantly related to the candidates not realising that while dividends received from a VCT are tax-free, dividends paid by an EIS are taxable and therefore had to be included in the calculation.

Many candidates found part (b) a challenge. While we appreciate that Maximum Investment Plans (MIPs) are not typically recommended to clients since the changes introduced on 6 April 2013, there are still many clients who hold qualifying policies, and we would expect the candidates sitting an examination at the advanced level to have a good understanding of the qualifying rules. It was particularly disappointing to see a number of candidates not recognising that a gain realised on the encashment of a qualifying policy would be tax-free and instead suggesting that the taxation of these plans is subject to Income Tax or CGT.

Part (c)(i) was generally well answered, with many candidates receiving the majority of marks available. Part (c)(ii), on the other hand, was very poorly answered, with only the best prepared candidates recognising that since Martina was not able to claim Income Tax relief on her EIS investment, the gain realised on the eventual encashment of the investment would be subject to CGT.

In part (d), candidates were asked to explain how Martina's state pension entitlement would be calculated. While some candidates provided excellent answers achieving high marks, the majority of answers lacked sufficient detail to gain a good number of marks.

Finally, in part (e), the candidates were asked about the Marriage Allowance. Most candidates linked their answers to the case study and correctly identified that 10% of Martina's Personal Allowance could be transferred to Emiliano. However, few candidates were aware that the lower earner would need to make a claim to HM Revenue & Customs, and even fewer candidates knew that the claim could be backdated.

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 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.

If you are sitting via remote invigilation please

- **Write down the following number +44 (0)80 8273 9244 this is the number to use if your system freezes or you get forced out of your exam. It is fine to phone it if you have these issues.**
- Show your ID to the camera now, if you did not do so during the ID checks.
- Show the edge of your screen with a mirror, if you did not do this during the room scan.
- Show any blank sheets of paper for notes, if you did not show both sides to the camera during the room scan.

If you are sitting in a test centre and encounter a problem, please alert the invigilator.

For candidates sitting via remote invigilation or at a test centre

- **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 e.g. **1a**
- **Please note each answer must be typed in the correct corresponding answer box**
- **If you are wearing headset, earphones, smart watch please take them off.**
- Please familiarise yourself with **all** questions before starting the exam.

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

Ron, a widower, died on 1 March 2021, aged 76. In his Will, he left his entire estate to his only son, Arthur, who is also the executor of the estate. Shortly before his death, Ron completed new death benefit nomination forms indicating Arthur as his beneficiary.

Arthur is not married but lives with his long-term partner, Olga, and their two children, aged 10 and 8. Arthur does not have a Will, but following his father's death, he is now planning to see a solicitor.

Ron's late wife, Molly, died in May 2016, aged 68. Molly's net estate was £2,050,000. All of her assets, including her share of the family home, passed to Ron under the terms of her Will, apart from £325,000 which was placed into a discretionary trust.

In January 2011 Ron made a loan of £300,000 which his chosen trustees invested into a loan trust. The trustees invested the loan amount into an offshore capital redemption bond. Ron received loan repayments of 5% of the original investment every year, starting in February 2012. At the time of his death the bond was worth £257,000.

In February 2011 he invested £400,000 into an onshore investment bond held in a discounted gift trust (DGT), from which he has been taking annual withdrawals of £20,000 since March 2012. At the time of investment, the insurance company calculated a potential discount of 60%. The current value of the bond is £297,000.

To address his potential Inheritance Tax liability, Ron set up an own life whole of life assurance policy in March 2013 with a sum assured of £300,000 for a monthly premium of £250, which he funded using the DGT withdrawals. The policy was placed in trust for Arthur and, at the time of Ron's death, had a surrender value of £28,000.

In 2016, he invested £150,000 into an Enterprise Investment Scheme (EIS) which was worth £198,000 on 1 March 2021.

At the time of his death Ron's other assets were as follows:

Assets	Value (£)
Home	600,000
Current and savings accounts	166,000
Stocks & Shares ISAs	478,000
General Investment account	255,000
Self-invested personal pension plan (SIPP) in flexi-access drawdown	731,000
Dependant's drawdown (inherited from Molly)	432,000

In February 2018 Ron gave Arthur £500,000 to help him with a house purchase.

PLEASE ENSURE YOU ANSWER EACH QUESTION IN THE CORRECT ANSWER BOX

Questions

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

(a) You have been advising Arthur in his capacity as executor of his father's estate.

(i) Calculate, **showing all your workings and explaining your reasons**, any transferable nil rate band(s) available to Ron's estate. **(9)**

(ii) Explain, **using figures where appropriate**, why and how the gift to Arthur of £500,000 would be taxed following Ron's death. **(5)**

(iii) Calculate, **showing all your workings**, and using your answers from **parts (a)(i)** and **(a)(ii)** above, the total Inheritance Tax liability following Ron's death on 1 March 2021. **(7)**

(iv) List Arthur's duties as executor of his father's estate. **(6)**

(b) Outline the protection arrangement(s) which could have been put in place to mitigate the potential Inheritance Tax liabilities following Ron's gift to Arthur in February 2018. *You should assume Ron was in good health at the time of the gift.* **(8)**

(c) **(i)** Describe **five** advantages and **five** disadvantages of Ron establishing the discounted gift trust (DGT). *You should assume a discretionary trust is used.* **(10)**

(ii) Identify the factors which should have been considered prior to Ron investing in the DGT. **(8)**

(iii) Explain how the Loan Trust will be dealt with following Ron's death.
You should assume that Ron's Will did not contain any provision in this respect. **(7)**

(d) **(i)** Explain briefly the tax treatment of any income withdrawals Arthur could take directly from each of the drawdown plans he has inherited from his father. *No calculations are required.* **(2)**

(ii) State how the tax treatment of the income withdrawn by Arthur would differ if he had inherited his mother's pension **directly** on her death. **(2)**

(e) **(i)** Detail how Arthur's estate would be distributed in the event he was to die before making a Will. **(7)**

(ii) State the conditions which must be met for Arthur's new Will to be valid. **(7)**

(iii) Explain briefly the impact, if any, on Arthur's new Will if he decides to marry Olga in the future. **(2)**

Total marks for this question: 80

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

Ricardo is domiciled in Portugal but has so far spent over 13 tax years living permanently in the UK. He is married to Jolene who is both UK domiciled and UK resident.

They are both aged 58 and are planning to retire in the next 2 or 3 years, at which point they will divide their time between the UK and Portugal. They are currently purchasing a home in Portugal and, in order to do so, Jolene disposed of the following assets in March 2021:

Asset	Date of purchase	Original value/ Amount invested (£)	Disposal proceeds (net of costs) (£)
Painting	February 2000	2,400	5,300
Share of a holiday cottage	October 2004	50,000	140,000
Onshore investment bond	March 2001	20,000	40,000
Unit trust	November 2003	25,000	44,000
Shares in XYZ PLC	April 2005	10,000	8,000
Enterprise Investment Scheme (EIS)	May 2007	50,000	73,000
NS&I Savings Certificates	June 2019	25,000	30,000

Jolene earned a taxable gross income of £45,000 in the tax year 2020/2021.

Ricardo owns an offshore bond with a current value of £200,000 which he has held for 10 years. In August 2022, Ricardo will have spent 15 years living in the UK. In anticipation of this he is considering placing the bond into an excluded property trust.

Ricardo invested £20,000 in listed mining shares in 2017 which he sold in March 2021, making a loss of £8,000. He did not realise any other gains or losses in the 2020/2021 tax year.

PLEASE ENSURE YOU ANSWER EACH QUESTION IN THE CORRECT ANSWER BOX

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**, Jolene's liability to Capital Gains Tax (CGT) in the 2020/2021 tax year. **(14)**

(b) Explain briefly when Jolene must report and pay any CGT due on the sale of:

(i) the holiday cottage; **(2)**

(ii) her other assets. **(3)**

(c) Explain briefly how the loss realised on the sale of Ricardo's mining shares could have been used to reduce Jolene's CGT in the 2020/2021 tax year. **(3)**

(d) **(i)** Explain briefly the main features of an excluded property trust. **(4)**

(ii) Explain the benefits to Ricardo of him placing the offshore bond into an excluded property trust. **(6)**

(e) Explain, in detail, what will happen to Ricardo's domicile status if they decide to permanently retire to Portugal. **(8)**

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.

Emiliano, aged 64, is retired. He is married to Martina, aged 62, and they have one daughter, Lola, aged 26.

In the 2020/2021 tax year, Emiliano received an annual gross pension of £18,000 from his former employer's final salary pension scheme. He also had income from the following:

Investment	**Income received in 2020/2021 (£)**
Deposit account	100
Cash ISA	3,150
Corporate bond unit trusts	3,200
Equity unit trusts	12,900
Enterprise Investment Scheme (EIS)	900
Venture Capital Trust (VCT)	1,200

Martina started full-time employment after leaving school, aged 16. She moved to Italy when she was 25 and returned to the UK just after Lola was born. She returned to work for 4 years before retiring 2 years ago, at age 60. Martina's only income is an annuity of £6,000 per annum.

On 1 April 2004, Emiliano set up a Maximum Investment Plan (MIP) into which he has been contributing £250 each month. The plan was valued at £50,000 on 1 April 2021, and Emiliano is considering a full encashment in the 2021/2022 tax year to help Lola with a deposit on her first house.

Emiliano would also like to invest £15,000 into a new issue of VCT shares, while Martina is thinking of investing £10,000 into an EIS.

PLEASE ENSURE YOU ANSWER EACH QUESTION IN THE CORRECT ANSWER BOX

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**, the Income Tax payable by Emiliano in the 2020/2021 tax year. **(8)**

(b) Outline the conditions which must be met for Emiliano's MIP to be classed as a qualifying policy and state the tax treatment should he encash the policy as planned. **(6)**

(c) **(i)** Describe the extent to which Emiliano and Martina can benefit from Income Tax relief on their planned VCT and EIS investments. *Assume their income remains unchanged in the 2021/2022 tax year.* **(7)**

(ii) Explain briefly how any gains on Martina's EIS would be taxed in the 2025/2026 tax year under the current rules on disposal. **(4)**

(d) Explain how Martina's State pension entitlement will be calculated. **(8)**

(e) Explain how Emiliano and Martina could benefit from the Marriage Allowance in the 2020/2021 tax year. **(7)**

Total marks for this question: 40

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) (i)

- Ron's estate could not claim a transferable NRB from Molly
- As this was when £325,000 of her estate on death was placed in a Will Trust.

- Although Molly died before 6 April 2017,
- she is deemed to have been entitled to a Residence Nil Rate band (RNRB) of £100,000.

- As Molly's estate on death was worth £2,050,000/over £2million, her RNRB is tapered.
- £2,050,000 - £2,000,000 = £50,000
- £50,000/2 = £25,000
- (£25,000/£100,000) x 100 = 25% reduction in RNRB, which means that 75% of Molly's RNRB is available to be claimed by Arthur (as the executor of Ron's estate).
- Therefore: £175,000 x 75%
- = £131,250

(ii)

- £500,000 that Ron gave Arthur in February 2018 was a Potentially Exempt Transfer (PET) in excess of Ron's NRB/£325,000.
- As Ron died during the 7 years following the gift, the PET fails, and the excess over NRB/£175,000 is now subject to IHT.
- The excess is taxed at 32%/20% taper relief applies to the tax rate/ 80% of the tax is payable
- which means that tax of £56,000 is due on the gift
- and payable by Arthur as the recipient.

(iii) Ron's death estate comprises the following:

Home	£600,000
Current and savings accounts	£166,000
Stocks & Shares ISAs	£478,000
General Investment Account	£255,000
Loan trust (outstanding loan amount)	£150,000
Enterprise Investment Scheme (EIS)	£198,000
Total	**£1,847,000**

Chargeable estate	£1,847,000
Less available NRBs	(£0)
Molly's inherited RNRB	(£131,250)
Ron's available RNRB	(£175,000)
	(£306,250)
Less assets qualifying for 100% Business Relief	(£198,000)
Estate subject to tax	£1,342,750

£1,342,750 x 40%
= £537,100

Total IHT due £56,000 (failed PET from (a)(ii)) + £537,100 IHT = £593,100

(iv) *Candidates would have scored full marks for **any six** of the following:*

- Determine the assets and liabilities of the estate, and
- any gifts made in the previous 7 years/any gifts with reservation of benefit (GWR).
- Collect in the assets.
- Pay any debts Ron may have had.
- Settle any tax liabilities/pay Income Tax/Capital Gains Tax (CGT) due in the tax year of death/complete the accounts.
- Calculate and claim the transferable RNRB.
- Calculate and pay IHT due.
- Obtain probate.
- Distribute the estate/assets in accordance with the Will.

(b)

- Level term assurance (on Ron's life)
- with a sum assured of £130,000 (because £325,000 x 40% = £130,000)
- to cover the loss of NRB/the 40% IHT due on the part of the estate that no longer benefits from NRB.

- Gift-inter-vivos policy (on Ron's life)
- for an initial sum assured of 40% of the excess over NRB (of £70,000).
- To cover the reducing tax liability (payable by Arthur).

- Both plans should be established with a 7-year term and
- in trust for Arthur/on a life of another basis.

(c) **(i)** *Candidates would have scored five marks for **any five** of the following:*

Advantages

- Ability to make an immediate gift for IHT purposes/the discount is immediately outside of the estate.
- but Ron would retain a regular payment stream/could take withdrawals of up to 5% of the initial sum invested (tax-deferred)
- without the GWR/POAT provisions applying (to the withdrawals).
- Investment growth would have been immediately outside Ron's estate.
- The investment amount could exceed Ron's NRB (because the potential discount brought it below the NRB),
- so the 20% lifetime IHT entry charge did not apply.
- The entire gifted amount dropped out of the estate after 7 years.
- By using a discretionary trust, Ron retained an element of control over who could benefit.

*Candidates would have scored five marks for **any five** of the following:*

Disadvantages

- Loss of access to capital.
- Inflexibility/payments cannot usually be adjusted.
- The fund could be exhausted before Ron died or
- withdrawals could become chargeable events after 20 years/once the original capital has been repaid.
- Withdrawals from investment bonds would not be regarded as surplus income for gifting purposes.
- Periodic/10-year charges and exit charges could apply.

(ii) *Candidates would have scored full marks for **any eight** of the following:*

- Ron's age and health./Was Ron likely to survive 7 years?
- Was Ron happy to be medically underwritten?
- Potential IHT liability on the estate.
- Could Ron afford to give capital away?/Did Ron need access to capital being gifted?
- Did Ron need/want additional income?/Could Ron spend the extra income?
- Ron's attitude to risk/capacity for loss.
- Was Ron happy with a fixed amount of income/income which would be eroded by inflation over time?
- Did Ron make any other gifts in the previous 7 years?
- Should the bond have been in single or joint names?/Should his wife's circumstances have been taken into account at the time?

(iii)
- The outstanding loan/£150,000
- will form part of Ron's estate,
- and must be called in by Arthur as the executor.
- The trustees must pay back the outstanding loan (unless a specific clause in the loan arrangement precludes this).

- The bond will have to be accessed
- and any chargeable event would result in Income Tax liability.

- The growth (which is outside the estate) can be distributed to beneficiaries under the terms of the trust/trust can continue.

(d) (i)
- As Ron died after age 75,
- the income withdrawals Arthur takes from both pension plans will be taxed at his marginal rate of tax.

(ii)
- As Molly was under 75 when she died,
- Arthur could have received the benefits tax-free.

(e) (i)
- Arthur would die intestate/intestacy rules would apply.
- As Arthur and Olga are not married,
- the entire estate would pass to Arthur's two children/Olga would receive nothing.
- As the children are minors/under 18,
- the assets would be held on statutory trust
- until they reach 18
- or marry under that age.

(ii)
- Arthur must be over 18,
- of sound mind and
- under no pressure to make the Will.
- It must be in writing and
- signed by Arthur
- in the presence of two independent witnesses,
- who must also sign.

(iii)
- A marriage revokes an existing Will,
- unless the Will states that it was made in anticipation of marriage.

Model answer for Question 2

(a)

- Ricardo's losses cannot be offset against her gains (husband and wife taxed independently).

- Jolene has taxable income of £32,500 + top sliced gain of £1,000 on the bond (which must be added for CGT calculation purposes) = £33,500 taxable income /£46,000 total income

- Gain on unit trust – 19,000
- Gain on property – 90,000
- Minus losses on shares – (2,000)
- Total gains - 107,000

CGT on unit trust

- £4,000 (£37,500 basic rate threshold - £33,500 taxable income)
- x 10% = £400
- £15,000 (£19,000 - £4,000) x 20% = £3,000

CGT on property

- £88,000 gain on property – (£2,000 losses)
- **- £12,300** (annual exempt amount)
- = £75,700
- x 28% = £21,196

- Total CGT payable = £24,596

(b) **(i)**

- As Jolene sold the property after 6 April 2020, she must report and pay any tax due using a 'CGT on UK property account'
- within 30 days of the sale.

(ii)

- Immediately using the real time CGT service
- or via self-assessment,
- in which case it would be payable by 31 January 2022.

(c)

Candidates would have scored full marks for ***any three*** *of the following:*

- Although married couples cannot transfer realised losses to one another,
- Ricardo could have transferred the shares to Jolene (no loss no gain basis).
- to be sold in her own name
- to enable Jolene to offset the loss against her other gains.

(d) **(i)**

- Typically, an excluded property trust (EPT) is a discretionary trust used with offshore bonds.
- It protects investments held outside the UK from UK IHT
- for those that are non-UK domiciled.
- This means that even if Ricardo becomes UK domiciled in the future, the assets (held in the EPT) will not be liable to UK IHT on his death.

(ii)

- Ricardo can place his existing offshore bond into the EPT and have full access to it.
- It will not be treated as a chargeable lifetime transfer as the transfer is exempt under excluded property rules.
- There will be no periodic or exit charges.
- Ricardo can be a trustee, which means he will keep an element of control.
- Beneficiaries can be chosen from the discretionary class of beneficiary.
- The asset is free from IHT on his death.

(e)

- He will be deemed UK domiciled
- due to the 15 out of 20 tax years rule in August 2022.

- For Income Tax and CGT purposes,
- he will remain deemed domiciled
- for a further 6 tax years after he leaves the UK.

- For IHT purposes, his UK deemed domicile status is lost
- once he has been non-resident
- for at least 4 consecutive tax years.

Model answer for Question 3

(a) **Adjusted Net Income**
£18,000 pension income + £3,300 interest + £13,800 dividends = £35,100

Non-savings
£12,500 x 0% = £0

£5,500 x 20% = £1,100

Savings
£1,000 Personal Savings Allowance (PSA) x 0% = £0

£2,300 x 20% = £460

Dividends
£2,000 dividend allowance x 0%= £0

£11,800 x 7.5% = £885

Total income tax to pay = £2,445

(b)

- The policy term must be 10 years or more.
- Premiums must be paid yearly or more frequently.
- The premiums paid in any 12-month period must not exceed twice the premiums in any other period, or
- one-eighth of the total premiums paid for a period of 10 years.
- The sum assured must be not less than 75% of the premiums payable during the policy term.
- The gain realised on encashment would be tax-free.

(c) **(i)**

- Investments into VCTs benefit from 30% Income Tax relief.
- Therefore, on his £15,000 investment, Emiliano could claim a maximum of £4,500 tax relief.
- However, the amount he can reclaim is limited to his tax liability of £2,445.
- The remaining unclaimed tax relief on his VCT investment cannot be carried back to the previous tax year.

- As Martina has no tax to pay/is a non-taxpayer,
- she cannot claim any tax relief,
- even though EIS investments benefit from 30% tax relief.

(ii)

- As Martina will not be able to claim Income Tax relief on her EIS investment,
- the gain realised on eventual encashment will be taxable/will not be exempt,
- even though the investment was held for the required minimum of 3 years.
- The gain will be subject to capital gains tax (CGT)/she can use her CGT exemption.

(d)

- Martina's entitlement is based on her National Insurance record.
- She will not be entitled to the maximum State Pension as she has fewer than 35 qualifying years.
- She will receive 1/35th of the full amount/new State Pension for each qualifying year
- subject to a minimum 10 qualifying years.
- Her entitlement will be based on a starting amount/foundation amount of the higher of
- the amount she would have received under the old State Pension rules,
- and the amount she would have received if the new State Pension had been in force.
- She would have also received tax credits for the time she was not working but claiming Child Benefit for Lola (until Lola was 12 years old).

(e) *Candidates would have scored full marks for **any seven** of the following:*

- As Martina and Emiliano are married
- and Martina's income is £6,000/below Personal Allowance/she is a non-taxpayer
- and Emiliano pays income at basic rate/20%,
- Martina can make a claim to HM Revenue & Customs as the lower earner
- to transfer £1,250/10% of her Personal Allowance to Emiliano
- saving him £250 (£1,250 x 20%) in 2020/2021/Emiliano's tax liability will reduce.

- For the current tax year, both Martina's and Emiliano's tax codes will be adjusted.
- The claim can be backdated to include any tax year since 5 April 2016/4 tax years
- and the backdated amount will be paid by HM Revenue & Customs as a lump sum/cheque.

All questions in the September 2021 paper will be based on English law and practice applicable in the tax year 2021/2022, unless stated otherwise and should be answered accordingly.

The Tax Tables which follow are applicable to the February 2021 and April 2021 examinations.

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%

§ 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	£2,830
- 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% 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%