

AF2

Advanced Diploma in Financial Planning

Unit AF2 – Business financial planning

October 2014 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2014/2015, 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.

Instructions

- Three hours are allowed for this paper.
- **Do not begin writing until the invigilator instructs you to.**
- **Read the instructions on page 3 carefully before answering any questions.**
- Provide the information requested on the answer book and form B.
- You are allowed to write on the inside pages of this question paper, but you must **NOT** write your name, candidate number, PIN or any other identification anywhere on this question paper.
- The answer book and this question paper must **both be handed in personally by you** to the invigilator before you leave the examination room. **Failure to comply with this regulation will result in your paper not being marked and you may be prevented from entering this examination in the future.**

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.
- You may find it helpful in some places to make rough notes in the answer booklet. If you do this, you should cross through these notes before you hand in the booklet.
- It is important to show all steps in a calculation, even if you have used a calculator.
- If you bring a calculator into the examination room, it must be a silent, battery or solar-powered, non-programmable calculator. The use of electronic equipment capable of being programmed to hold alphabetic or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements.
- Tax tables are provided at the back of this question paper.
- Answer each question on a new page and leave six lines blank after each question part.

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 the following carefully, then carry out **ALL** of the tasks **(a), (b), (c), (d), (e), (f)** and **(g)** which follow.

Santhill Telesales is run as a partnership by Bob and his business partner Peter. The partnership will soon be dissolved as Peter wishes to retire and realise his share of the partnership. The partnership has no long-term liabilities.

Bob intends to continue the business and will be joined by a long standing colleague Jason. The business has nine full-time employees, all over the age of 25 and all of whom have been with the firm for more than three years.

Jason does not wish to form a partnership with Bob and would prefer the business to continue as a limited company. Jason is aware of the limitations of a partnership and would like the benefits a limited company provides. Jason will be investing £100,000 of his own money into the business to mirror the value of Bob's equity in the partnership, which 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.

Bob and Jason have plans to expand the business which will require additional capital of £70,000. Jason owns his own house valued at £350,000, with his wife Jenny, on which they owe £95,000. Bob is currently in rented accommodation and has no surplus funds.

They are projecting a gross profit of £130,000 in the first trading period ending on 31 March 2015. As Jason will be investing much of his own money in the business he wants to protect his investment in case of death or illness of either himself or Bob, although Bob cannot see such a need.

Jason has heard that all companies must provide pension schemes for their staff and has asked your advice on the obligations to provide a pension scheme for the new company. Currently only Bob and Jason have pension arrangements.

Questions

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

- (a) Explain to Bob and Jason **five** benefits and **five** drawbacks of trading as a limited company rather than a partnership under the Partnership Act 1890. (10)
- (b) State **four** different sources of finance that Bob and Jason could use to borrow the additional capital of £70,000 and explain **one** potential difficulty of using each of these sources. (8)
- (c) Jason is considering his remuneration options. Assuming a gross profit of £130,000:
- (i) calculate, **showing all your workings**, the post tax profit from which Bob and Jason's dividends could be distributed; (2)
- (ii) calculate, **showing all your workings**, Jason's net income, if he takes his share as a dividend in the tax year 2014/2015. Jason will have no other taxable income; (8)
- (iii) explain to Jason why it is preferable for his remuneration to be taken as salary plus a dividend rather than a dividend alone. (4)
- (d) Describe to Bob and Jason:
- (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 Bob and Jason 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 a limited company. **(8)**
- (f)** Explain to Bob and Jason, in relation to the new company:
- (i)** the issues that may arise if either were to die without appropriate planning being in place; **(8)**
- (ii)** the Inheritance Tax position of their shares in the new company should either die during the first two years of the new trading company, or at a later date; **(8)**
- (iii)** the options for the payment of the life policy premiums, assuming that they each effect an own life policy as part of a shareholder protection arrangement. **(5)**
- (g)** Explain to Bob and Jason the key requirements and implications for the company of pension auto-enrolment, and state the likely date by which they will have to implement auto-enrolment. **(8)**

Total marks available for this question: 80

Section B questions can be found on pages 8 - 13

SECTION B

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

Question 2

Read the following carefully, then carry out **ALL** of the tasks **(a)**, **(b)**, **(c)**, and **(d)**, which follow.

Fireplaces Galore Ltd is considering moving to larger premises due to the continued expansion of the business. Their existing lease is due to expire in three months time. The two full-time directors and shareholders, James and Larry, are now considering the option of purchasing new premises.

Recently, they have been offered a building owned by Larry's father, which has a large warehouse and additional office space to purchase. The warehouse space is in excess of what they require currently and they are considering the option of sub-letting a portion of the premises. This would provide them with some rental income and the option to use the additional space in the future if the business expands. They are looking for advice on the best way to structure the purchase.

James and Larry have decided they do not want to purchase the premises through the company and are considering the following options for the property purchase:

- Purchase the property themselves using existing cash and resources, and by taking on additional borrowing on their main residences up to the maximum available.
- Fireplaces Galore Ltd has a small self-administered pension scheme (SSAS) for James and Larry, to which contributions of £35,000 are currently made each year. The scheme was set up in 2001 and the fund, which is currently invested in various equity tracker collectives and a loan to the sponsoring employer with £30,000 outstanding, is currently valued at £520,000. Their accountant has suggested that purchasing the property through the SSAS would be the most tax efficient way of acquiring the new property. All contributions are up to date.

Questions

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

- (a) Explain HM Revenue & Customs specific requirements for a purchase from a connected person, through the small self-administered pension scheme (SSAS) and state the consequences of non-compliance. (6)
- (b) If James and Larry decide to purchase the new property themselves:
- (i) explain the tax implications for them assuming that Fireplaces Galore Ltd leases and pays a full market rent for the property; (6)
- (ii) state **six** advantages for James and Larry of buying the property themselves, compared to purchasing the premises through the company. (6)
- (c) It has been agreed that the SSAS will purchase the property at an agreed price of £550,000. You have discovered that the property is subject to VAT at 20% and Stamp Duty Land Tax at 4%.
- (i) Calculate, **showing all your workings**, the maximum amount available to the SSAS for the purchase. (5)
- (ii) Calculate, **showing all your workings**, the total cost of the acquisition assuming legal and ancillary fees are £10,000 inclusive. (4)
- (iii) State **five** advantages for James and Larry of buying the property through the SSAS compared to purchasing the premises themselves. (5)
- (d) Explain the financial and taxation consequences for Fireplaces Galore Ltd and the SSAS if:
- (i) the company rents the whole property from the SSAS and sublets a portion of the premises; (5)
- (ii) the SSAS lets only part of the property to the company. (3)

Total marks available for this question: 40

QUESTIONS CONTINUE OVER THE PAGE

Question 3

Read the following carefully, then carry out **ALL** of the tasks **(a), (b), (c), (d)** and **(e)** which follow.

GMB Manufacturing Ltd is a company that produces photographic equipment and employs 20 people full-time. Kevin and Joe are shareholding directors of the company. The company expanded very quickly and moved into larger premises two years ago. In order to do this, it borrowed £300,000 on a secured basis from Allco Bank. Since the company took out the loan for the purchase of the property, the business has not met expectations. Over recent months the company has increased its overdraft with the bank and the directors have given personal guarantees.

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

GMB Manufacturing Ltd
Profit and loss account

	Year end 30 Sept 2013 (£)	Year end 30 Sept 2014 (£)
Sales Revenue	720,000	430,000
Cost of goods sold	290,000	208,000
Promotion expenses	27,500	37,300
Salaries	242,100	253,000
Administration costs	21,000	24,400
Interest on loans	19,500	28,300

GBM Manufacturing Ltd
Balance sheet

	as at 30 Sept 2013 (£)	as at 30 Sept 2014 (£)
Fixed assets		
- Buildings	390,000	390,000
- Machinery	<u>30,000</u>	<u>19,000</u>
	420,000	409,000
Current assets		
- Cash	24,000	4,000
- Stock	21,000	8,000
- Debtors	<u>60,000</u>	<u>35,000</u>
	105,000	47,000
Current liabilities		
- Bank overdraft	21,000	53,000
- Creditors	<u>40,000</u>	<u>75,000</u>
	61,000	128,000
Long Term liabilities		
- Commercial Mortgage	<u>300,000</u>	<u>285,000</u>
Net assets	<u>164,000</u>	<u>43,000</u>
Financed by:		
- Share Capital	10,000	10,000
- Shareholder retained profit	<u>154,000</u>	<u>33,000</u>
	<u>164,000</u>	<u>43,000</u>

QUESTIONS CONTINUE OVER THE PAGE

Questions continue on page 13

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 pre-tax operating profit **or** loss for the financial years ending September 2013 and 2014 and comment on the trend. (5)
- (b) For the financial years ending 2013 and 2014, calculate, **showing all your workings**, the following ratios:
- (i) • the current ratio (current assets/current liabilities); (2)
 - creditor days ratio (creditors/cost of goods sold x 365); (2)
 - the gearing ratio (total long- term loans/net assets x 100%). (2)
- (ii) Explain briefly the significance for the company of each of the ratios that you have calculated in part **(b)(i)** above. (9)
- (c) The bank has refused to extend the company's overdraft facility any further following its analysis of the company's ratios. With full knowledge of the company's financial position, Kevin and Joe wish to continue trading.
- Explain the implications for Kevin and Joe if they continue trading. (8)
- (d) Kevin and Joe 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

The tax tables can be found on pages 15 - 21

INCOME TAX

RATES OF TAX	2013/2014	2014/2015
Starting rate for savings*	10%	10%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	45%	45%
Starting-rate limit	£2,790*	£2,880*
Threshold of taxable income above which higher rate applies	£32,010	£31,865
Threshold of taxable income above which additional rate applies	£150,000	£150,000
Child benefit charge from 7 January 2013:		
1% of benefit for every £100 of income over	£50,000	£50,000

*Restricted to savings income only and not available if taxable non-savings income exceeds starting rate band.

MAIN PERSONAL ALLOWANCES AND RELIEFS

Income limit for Personal Allowance §	£100,000	£100,000
Personal Allowance (basic if born after 5 April 1948) §	£9,440	£10,000
Personal Allowance (if born between 6 April 1938 and 5 April 1948) §	£10,500	£10,500
Personal Allowance (if born before 6 April 1938) §	£10,660	£10,660
Married/civil partners (minimum) (if born before 6 April 1935) at 10% †	£3,040	£3,140
Married/civil partners (if born before 6 April 1935) at 10% †	£7,915	£8,165
Income limit for age-related allowances	£26,100	£27,000
Blind Person's Allowance	£2,160	£2,230
Enterprise Investment Scheme relief limit on £1,000,000 max	30%	30%
Seed Enterprise Investment relief limit on £100,000	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.		
Child Tax Credit (CTC)		
- Child element per child (maximum)	£2,720	£2,750
- family element	£545	£545
Threshold for tapered withdrawal of CTC	£15,910	£16,010

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	Weekly	Monthly	Yearly
Lower Earnings Limit (LEL)	£111	£481	£5,772
Primary threshold	£153	£663	£7,956
Upper Accrual Point	£770	£3,337	£40,040
Upper Earnings Limit (UEL)	£805	£3,489	£41,865

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS	
	Contracted-in rate	Contracted-out rate (final salary)
Up to 153.00*	Nil	Nil
153.01 – 770.00	12%	10.6%
770.01 – 805.00	12%	12%
Above 805.00	2%	2%

**This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £111 per week. This £111 to £153 band is a zero rate band introduced in order to protect lower earners' rights to contributory State benefits e.g. Basic State Pension.*

Total earnings £ per week	CLASS 1 EMPLOYER CONTRIBUTIONS		
	Contracted-in rate	Contracted-out rate	
		Final salary	Money purchase
Below 153.00**	Nil	Nil	Nil
153.01 – 770.00	13.8%	10.4%	13.8%
770.01 – 805.00	13.8%	13.8%	13.8%
Excess over 805.00	13.8%	13.8%	13.8%

*** Secondary earnings threshold.*

Class 2 (self-employed)	Flat rate per week £2.75 where earnings exceed £5,885 per annum.
Class 3 (voluntary)	Flat rate per week £13.90.
Class 4 (self-employed)	9% on profits between £7,956 - £41,865 2% on profits above £41,865.

PENSIONS

TAX YEAR	LIFETIME ALLOWANCE	ANNUAL ALLOWANCE
2006/2007	£1,500,000	£215,000
2007/2008	£1,600,000	£225,000
2008/2009	£1,650,000	£235,000
2009/2010	£1,750,000	£245,000
2010/2011	£1,800,000	£255,000
2011/2012	£1,800,000	£50,000
2012/2013	£1,500,000	£50,000
2013/2014	£1,500,000	£50,000
2014/2015	£1,250,000	£40,000

ANNUAL ALLOWANCE CHARGE

20% - 45% member's tax charge on the amount of total pension input in excess of the annual allowance.

LIFETIME ALLOWANCE CHARGE

55% of excess over lifetime allowance if taken as a lump sum.

25% of excess over lifetime allowance if taken in the form of income, which is subsequently taxed under PAYE.

CAPITAL GAINS TAX

EXEMPTIONS	2013/2014	2014/2015
Individuals, estates etc	£10,900	£11,000
Trusts generally	£5,450	£5,500
Chattels proceeds (restricted to five thirds of proceeds exceeding limit)	£6,000	£6,000
TAX RATES		
Individuals:		
Up to basic rate limit	18%	18%
Above basic rate limit	28%	28%
Trustees and Personal Representatives	28%	28%
Entrepreneurs' Relief* – Gains taxed at:	10%	10%
Lifetime limit	£10,000,000	£10,000,000

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

INHERITANCE TAX

RATES OF TAX ON DEATH TRANSFERS

2013/2014 2014/2015

Transfers made after 5 April 2014

- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
- Lifetime transfers to and from certain trusts	20%	20%

**For deaths after 5 April 2014, a lower rate of 36% applies where at least 10% of deceased's net estate is left to 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
- UK-registered charities	No limit	No limit

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	£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%

CAR BENEFIT FOR EMPLOYEES

The charge for company car benefits is based on the carbon dioxide (CO₂) emissions. There is no reduction for high business mileage users.

For 2014/2015:

- Cars that cannot emit CO₂ have a 0% charge.
- The percentage charge is 5% of the car's list price for CO₂ emissions of 75g/km or less.
- For cars with CO₂ emissions of 76g/km to 94g/km the percentage is 11%.
- For cars with CO₂ emissions of 95g/km to 99g/km the percentage is 12%.
- Cars with CO₂ emissions of 100g/km have a percentage charge of 13% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 35% (emissions of 210g/km and above).

There is an additional 3% supplement for diesel cars not meeting Euro IV emission standards. However, the maximum charge remains 35% of the car's list price.

Car fuel The benefit is calculated as the CO₂ emissions % relevant to the car and that % applied to a set figure (£21,700 for 2014/2015) e.g. car emission 100g/km = 13% on car benefit scale. 13% of £21,700 = £2,821.

1. **Accessories** are, in most cases, included in the list price on which the benefit is calculated.
2. **List price** is reduced for capital contributions made by the employee up to £5,000.
3. **Car benefit** is reduced by the amount of employee's contributions towards running costs.
4. **Fuel scale** is reduced only if the employee makes good **all** the fuel used for private journeys.
5. **All car and fuel benefits** are subject to employers National Insurance Contributions (Class 1A) of 13.8%.

PRIVATE VEHICLES USED FOR WORK

	2013/2014 Rates	2014/2015 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

	2013/2014	2014/2015	
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£250,000	£500,000	
Plant & machinery (reducing balance) per annum	18%	18%	
Patent rights & know-how (reducing balance) per annum	25%	25%	
Certain long-life assets, integral features of buildings (reducing balance) per annum	8%	8%	
Energy & water-efficient equipment	100%	100%	
Zero emission goods vehicles (new)	100%	100%	
Qualifying flat conversions, business premises & renovations	100%	100%	
Motor cars: Expenditure on or after 01 April 2014 (Corporation Tax) or 06 April 2014 (Income Tax)			
CO ₂ emissions of g/km:	95 or less*	96-130	131 or more
Capital allowance:	100%	18%	8%
	first year	reducing balance	reducing balance

*If new

CORPORATION TAX

	2013/2014	2014/2015
Full rate	23%	21%
Small companies rate	20%	20%
Small companies limit	£300,000	£300,000
Effective marginal rate	23.75%	21.25%
Upper marginal limit	£1,500,000	£1,500,000

VALUE ADDED TAX

	2013/2014	2014/2015
Standard rate	20%	20%
Annual registration threshold	£79,000	£81,000
Deregistration threshold	£77,000	£79,000

MAIN SOCIAL SECURITY BENEFITS

		2013/2014	2014/2015
		£	£
Child Benefit	First child	20.30	20.50
	Subsequent children	13.40	13.55
	Guardian's allowance	15.90	16.35
Employment and Support Allowance	Assessment Phase		
	Age 16 – 24	Up to 56.80	Up to 57.35
	Aged 25 or over	Up to 71.70	Up to 72.40
	Main Phase		
	Work Related Activity Group	Up to 100.15	Up to 101.15
	Support Group	Up to 106.50	Up to 108.15
Attendance Allowance	Lower rate	53.00	54.45
	Higher rate	79.15	81.30
Retirement Pension	Single	110.15	113.10
	Married	176.15	180.90
Pension Credit	Single person standard minimum guarantee	145.40	148.35
	Married couple standard minimum guarantee	222.05	226.50
	Maximum savings ignored in calculating income	10,000.00	10,000.00
Bereavement Payment (lump sum)		2,000.00	2,000.00
Widowed Parent's Allowance		108.30	111.20
Jobseekers Allowance	Age 16 - 24	56.80	57.35
	Age 25 or over	71.70	72.40
Statutory Maternity, Paternity and Adoption Pay		136.78	138.18

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