THE CHARTERED INSURANCE INSTITUTE

CII

J05

Diploma in Financial Planning

Unit J05 – Pension income options

April 2015 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.

Candidates should answer based on the legislative position immediately BEFORE the 2015 budget.

Instructions

- Two 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 J05 – Pension income options

Instructions to candidates

Read the instructions below before answering any questions

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

Attempt ALL questions

Time: 2 hours

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

1. Sandra deferred her State Pension exactly two years ago and is now thinking of taking it.

(a) Calculate, **showing all your workings**, the percentage by which Sandra's State Pension would increase if she decided to take it immediately as an income. **(3)**

(b) Outline the changes to the State Pension deferral rules that are due to be introduced from April 2016. **(2)**

2. Englebert, aged 62, has a small self-administered scheme (SSAS) which was valued at £225,000 on 1 April 2015. On 5 April 2006 it was valued at £156,000 including a tax free cash entitlement of £52,000. Englebert also has a personal pension plan which was valued at £1,570,000 on 1 April 2015 and he has fixed protection 2012.

Englebert crystallised his SSAS on 1 April 2015, taking the maximum pension commencement lump sum (PCLS) and using the balance of the fund to purchase a scheme pension with an annuity rate of 5.6%.

Calculate, **showing all your workings**:

(a) the maximum PCLS Englebert received from the SSAS; **(7)**

(b) the percentage of Englebert's lifetime allowance remaining after crystallising the SSAS. **(6)**

3. Some members of occupational pension schemes had a contractual right on 5 April 2006 to take pension benefits before age 55.

Explain, in detail, the eligibility conditions that must be satisfied for a scheme member to take advantage of this right. **(8)**

4. State the **seven** circumstances when an individual's lifetime allowance could be greater than the standard lifetime allowance in a given tax year. **(7)**

5. Charles, aged 65, has been divorced since 2003. Charles is about to retire and take his benefits from the Teachers' Pension Scheme. As part of the divorce settlement his ex-wife was granted a pension sharing order of 40% of his pension benefits and this was arranged as an internal pension share.

Explain briefly how the pension debit will be calculated when it is deducted from Charles' pension benefits. **(5)**

6. Thomas, aged 58, is about to retire. He has an uncrystallised personal pension fund of £950,000. Thomas is considering a `third way' annuity to provide his retirement income. Thomas is single, in good health, has no dependants and has a balanced attitude to risk.

Explain why a `third way' annuity might be a better option for Thomas than purchasing a conventional lifetime annuity. **(5)**

7. **(a)** Outline the protection provided under the Pension Protection Fund (PPF) for a member who retired at the scheme's normal retirement age on 1 September 2013. The scheme's PPF assessment period started on 1 April 2015. **(5)**

(b) Outline the protection available for an annuitant in the event of the default of the annuity provider. **(3)**

QUESTIONS CONTINUE OVER THE PAGE

8. Terry died recently at the age of 61. He leaves his civil partner Allan, aged 52, and their adopted son Charlie, aged six.

Terry had been a member of his employer's defined benefit pension scheme since 2005. Terry retired early as a result of ill-health six months ago and was drawing a scheme pension of £12,000 per annum. The scheme provides a dependant's pension of 50% of the member's pension.

(a) Explain in detail the death benefits that may be payable to Allan from Terry's defined benefit scheme, including their tax treatment. **(9)**

(b) Outline **three** potential benefits that may be paid to Charlie in the event of Allan's subsequent death. **(3)**

9. State **nine** factors that should be taken into account during an annual review of a client's phased drawdown pension arrangement. **(9)**

10. Digby, aged 57, is married to Honoria, aged 53. In March 2014 Digby was a higher rate taxpayer. Digby crystallised part of his personal pension plan (PPP) using a phased annuity purchase to produce a net pension income for the 2013/2014 tax year of £12,000. The £12,000 was made up of a combination of pension commencement lump sum and lifetime annuity income. The annuity is on a single life, level payment basis with a ten year guarantee period providing £918 net income in 2013/2014.

Digby, who now works part-time on a salary of £18,000 per annum, requires a total net pension income of £12,000 for the 2014/2015 tax year and has no other income. The new annuity is to be set up on the same basis as the existing annuity. The annuity rate will be 4.8% and Digby's PPP is currently valued at £1,180,000.

(a) Calculate, **showing all your workings**, the amount of pension fund Digby must crystallise in March 2015 to achieve his required income. **(7)**

(b) Outline the death benefits that would be available to Honoria if Digby were to die in May 2015. Explain how these would be valued against the lifetime allowance. **(8)**

11. Cedric, aged 58, has a self-invested flexible drawdown pension plan from which he took his pension commencement lump sum (PCLS) in 2012. Cedric has an adventurous attitude to risk and has invested entirely in equities, which have achieved an average return of 8.2% per annum. The fund is currently valued at £192,000.

Having taken no income from the drawdown plan so far, Cedric now wishes to draw an income of £20,000 gross per annum for at least the next two years. Cedric's main objective is to maintain the capital value of his pension fund.

Outline **five** potential benefits and **five** potential drawbacks of using a performance driven strategy to produce this income rather than an earmarked withdrawal strategy. **(10)**

12. The Financial Conduct Authority Conduct of Business Sourcebook (COBS) considers a number of aspects of a client's personal and financial circumstances that should be taken into account by an adviser recommending a drawdown pension.

List **eight** circumstances which should be taken into account. **(8)**

13. Janice will have accrued 32 years National Insurance credits towards her State Pension entitlement when she reaches State Pension age in June 2017. Janice has retained benefits in a previous employer's contracted-out defined benefit scheme, and has no other pension benefits.

Explain to Janice how her State Pension will be calculated when she retires. *No calculation is required.* **(6)**

QUESTIONS CONTINUE OVER THE PAGE

14. Jason, aged 58, is about to retire and, following his retirement, he will become permanently non-UK resident.

Jason is entitled to take immediate early retirement benefits from his employer's defined benefit scheme and has been offered a scheme pension of £60,000 per annum, plus a maximum pension commencement lump sum of £180,000. Alternatively, he has been offered a cash equivalent transfer value (CETV) of £1,300,000.

Jason cannot decide whether to take the benefits directly from the scheme or take the CETV and transfer this into a Qualifying Recognised Overseas Pension Scheme (QROPS). *Assume Jason has no form of transitional protection.*

Calculate, **showing all your workings,** the lifetime allowance charges that may apply if Jason:

(a) takes his benefits directly from the defined benefit scheme; **(6)**

(b) transfers his CETV into a QROPS. **(3)**

15. Doris, aged 55, is divorced and has a son aged 27, who is financially independent. Doris was made redundant by RTD Ltd in 2013 and now has a part-time job earning £10,000 per annum. Doris would like to repay her £80,000 mortgage and feels that she needs an additional annual income of £8,000 gross.

Doris, who has no savings, has accrued pension rights in RTD Ltd's defined benefit pension scheme. The scheme's normal retirement age is 65. Doris is entitled to an immediate early retirement pension of £9,884 per annum, plus a pension commencement lump sum (PCLS) of £65,893. The scheme pension includes a five year guarantee. Alternatively, she could take a cash equivalent transfer value (CETV) of £366,160 and utilise the drawdown pension option.

Outline **five** potential benefits and **five** potential drawbacks for Doris if she elects to accept the CETV and utilises the drawdown pension option, rather than accepting the offer of the early retirement pension and PCLS offered by the scheme. **(10)**

The tax tables can be found on pages 10 – 16

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 (CO_2) emissions. There is no reduction for high business mileage users.

For 2014/2015:

- Cars that cannot emit CO_2 have a 0% charge.
- The percentage charge is 5% of the car's list price for CO_2 emissions of 75g/km or less.
- For cars with CO_2 emissions of 76g/km to 94g/km the percentage is 11%.
- For cars with CO_2 emissions of 95g/km to 99g/km the percentage is 12%.
- Cars with CO_2 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 CO_2 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% first year	18% reducing balance	8% 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