THE CHARTERED INSURANCE INSTITUTE

AF1

Advanced Diploma in Financial Planning

Unit AF1 - Personal tax and trust planning

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

- 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 AF1 - Personal tax and trust 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)**, **(g)** and **(h)** which follow.

Toby, aged 61, retired from full-time work in May 2008 after selling his consultancy firm for the sum of £1,500,000 and using his lifetime allowance for entrepreneurs' relief. Since retiring Toby has made and sold a number of investments. Toby splits his time equally between his homes in the UK and Spain, where his wife Elicia resides full-time.

His current personal portfolio is listed below:

Assets	Current value (£)	Acquisition cost (£)
NISA	186,000	110,000
Venture Capital Trust	70,000	50,000
Enterprise Investment Scheme	85,000	50,000
Share account	965,000	840,000
Family home	1,000,000	370,000
Cash	120,000	120,000

In January 2012, Toby sold a large holding of UK listed shares and realised a gain of £100,000, which he then invested equally into the Venture Capital Trust and the Enterprise Investment Scheme, as shown above. Full tax relief was received on both of these investments.

As a result of buying and selling assets since his retirement, Toby has carried forward losses that have been correctly applied for, totalling £62,000.

In 2008, Toby and Elicia jointly purchased a property for their son Ben to live in whilst at university. The purchase price was £125,000 plus fees of £3,000. In 2010, Ben left the property when he bought his own house and the property has been rented out subsequently. In 2011, Toby and Elicia spent £22,000 adding a conservatory to the property and they have spent a further £7,000 over the past four years in refurbishing the house after tenancy changes. A sale of the property has now been agreed for £230,000. Toby expects the sale costs to be no more than £5,000. In the tax year 2014/2015 the rental property earned no taxable income and this resulted in Elicia having no UK income that was subject to Income Tax.

In February 2003, Elicia settled £75,000 into an onshore investment bond, comprised of 100 segments, into a bare trust for the benefit of Ben. In April 2010, 25 segments were surrendered when Ben bought his house, these segments realised £26,000. The remainder of the bond has now been surrendered. The surrender value at the end of March 2015 was £85,200.

In September 2013, a former business partner of Toby offered him a 12% stake in his company Consultandsee Ltd, in return for an investment of £50,000, in addition to a part-time job, which has resulted in him becoming a higher rate taxpayer in the tax year 2014/2015. In March 2015, the company was bought by an AIM listed company and Toby has been offered the sum of £250,000 for his shares. Ben has recently started working at the company and has expressed an interest in taking on Toby's shares if possible. In the tax year 2014/2015 Ben's total earnings from all sources were £40,000.

In October 2013, Toby sold his late father's World War II medals that were awarded for valour, for the sum of £19,000 and also his pocket watch for the sum of £14,500. The medals were valued at £5,000 at the time of his father's death and the watch was valued at £3,000.

Living apart has placed undue strain on Toby and Elicia's marriage and as a result Toby has decided to move to Spain permanently. Toby completed the sale of all his UK assets, apart from the family home, in March 2015.

Questions

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

(a) **(i)** Calculate, **showing all your workings**, Toby's total Capital Gains Tax (CGT) liability resulting from the sale of all of his UK assets apart from the family home in March 2015. **(15)**

(ii) State the final date by which the tax must be paid. **(1)**

(b) State the steps Toby would have taken to report a loss to HM Revenue & Customs (HMRC) during the time he held his UK assets, including timescales and amounts where relevant. **(4)**

(c) **(i)** Explain the HMRC criteria surrounding the disposal of Consultandsee Ltd assets in order to qualify for entrepreneurs' relief. **(5)**

(ii) Instead of selling his shares in Consultandsee Ltd, Toby has decided to transfer his shares to Ben as a gift as he starts his career with the company.

Explain how holdover relief could be used to mitigate Toby's CGT liability if he makes this transfer and the consequences to both Toby and Ben of such a transfer. **(7)**

QUESTIONS CONTINUE OVER THE PAGE

Questions continue on page 7

(d) **(i)** Detail the **five** sufficient UK ties that HMRC will use to demonstrate Toby's future residency, if this cannot be proved by the automatic tests. **(5)**

(ii) Explain how double taxation agreements, such as arrangements between UK and Spain, usually operate, especially in cases where time is equally spent between countries. **(5)**

(e) Calculate, **showing all your workings**, the chargeable event that will arise on the surrender of the investment bond, detailing any tax due and who would be liable. **(11)**

(f) Describe the CGT rules on the transfer of assets between Toby and Elicia:

(i) while married; **(2)**

(ii) if they separated; **(3)**

(iii) or if they divorced. **(2)**

(g) **(i)** Explain how shares are identified when they are disposed of and why this is relevant for the calculation of CGT. **(5)**

(ii) Explain the differences in CGT treatment regarding shares acquired as bonus issues, rights issues and scrip dividends. **(6)**

(h) **(i)** Explain how tax would have been applied in the 2013/2014 tax year on the sale of Toby's father's medals and explain how this would have been different if Toby's father had sold the medals himself. **(4)**

(ii) Explain how the maximum gain, if any, would have been calculated on the sale of Toby's father's watch. *Show all relevant workings in your answer.* **(5)**

Total marks available for this question: 80

QUESTIONS CONTINUE OVER THE PAGE

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)** and **(c)** which follow.

Simon and Emma, both aged 39, live together with their nine-year-old son, Jack. Simon is employed as the Branch Manager of a local estate agent and earns a basic salary of £38,225. Simon also received £11,000 in bonuses in the tax year 2014/2015 and is a member of his firm's non-contributory final salary pension scheme, to which his company contributes 12% of his basic salary.

Simon's employer also provides him with a company car to undertake his duties. Whilst the vehicle is available for his personal use outside of work hours, they do not contribute towards private petrol for him. The list price of the car is £29,000 and additional options were added to the vehicle totalling £2,750. The CO_2 emissions are 144g/km, and it was first registered in March 2013. Simon makes gift aid payments of £100 per month to a registered charity.

Emma has decided to become a driving instructor and is researching whether to set-up her own business or work for one of the local driving schools in her area. This would provide her with the opportunity to work flexible hours to fit around the child care of Jack.

Simon has a savings account that paid £168 in net interest in the tax year 2014/2015. In addition, he owns some shares in a utility company that he purchased several years ago. The shares paid a net dividend in November 2014 of £405. Simon and Emma also have a joint current account that pays no interest. Their only other income is the Child Benefit that Emma receives every four weeks in respect of Jack.

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 Simon for the tax year 2014/2015. **(19)**

(b) If Emma decided to work on an informal basis for a local driving school, state the factors that HM Revenue & Customs would use to distinguish whether Emma is:

(i) self-employed; **(4)**

(ii) employed. **(4)**

(c) **(i)** Compare how Emma's income would be taxed should she decide to set up a personal service company or become an employee of a local driving school. **(9)**

(ii) Emma has decided to set up her own driving school as a limited company. Outline the consequences for her if the business fails. **(4)**

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.

Donald and Jackie, both aged 60, are married. They have two sons, James, aged 30, and Mark, aged 28, both of whom are financially independent. Donald and Jackie had another son, Terry, who died in October 2014.

Donald and Jackie's home is worth £500,000 and they have an outstanding mortgage of £100,000. They have no life or other protection policies in place to cover this debt. The house is owned on a tenants in common basis, in equal shares and they have not made Wills.

Donald and Jackie have a joint current account which has a current balance of £75,000 and Donald owns a portfolio of NISAs worth £600,000. Donald has not made any lifetime gifts.

In August 2010, Terry settled £325,000 into a discretionary trust, with James and Mark as trustees. Terry had not made any other gifts.

Questions

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

(a) Donald and Jackie are considering gifting their house to James and Mark whilst continuing to live in it. Outline the taxation implications of this course of action in respect of:

(i) Income Tax; **(6)**

(ii) Capital Gains Tax; **(3)**

(iii) Inheritance Tax. **(6)**

(b) As an alternative to gifting the house, Donald is considering encashing £400,000 of his NISA investments and settling the proceeds into a relevant property trust for the benefit of his family.

Calculate, **showing all your workings**, any Inheritance Tax payable on the transfer. **(6)**

(c) Explain how Donald's estate would be distributed if he had died on 31 March 2015. *No calculations are required.* **(8)**

(d) Explain the steps that would need to be completed for Donald to appoint James and Mark as his attorneys under a Lasting Power of Attorney, for property and financial affairs. **(5)**

(e) Following Terry's death, James and Mark are concerned about the length of time they will be expected to continue in their role as trustees.

Outline the rules concerning perpetuities and accumulations that apply to Terry's trust. **(6)**

Total marks available for this question: 40

The tax tables can be found on pages 13 - 19

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

	2013/2014	2014/2015
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.*

	2013/2014	2014/2015
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

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