

## J05

### Diploma in Financial Planning

#### Unit J05 – Pension income options

October 2015 examination

#### SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2015/2016, 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

- 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. The Financial Conduct Authority's Conduct of Business Sourcebook provides guidance to advisers when they are recommending a flexi-access drawdown pension.

Outline the key risk factors that must be explained to the client in the suitability letter. **(5)**
  
2. Outline the benefits that would be paid by the Financial Assistance Scheme when a deferred member of an underfunded defined benefit scheme reaches the scheme's normal pension age of 65. **(6)**
  
3. Steve, aged 64, is a member of his employer's defined benefit pension scheme. He will be entitled to a scheme pension of £700 per annum gross as well as a pension commencement lump sum of £2,100, when he reaches age 65. Steve has the option to commute these benefits for a trivial commutation lump sum.

Steve is in receipt of a lifetime annuity of £450 per annum gross. The annuity is on a level basis and commenced in 2005. This is his only other pension.

  - (a) Outline how Steve's pension benefits would be valued for trivial commutation purposes. *No calculations are required.* **(3)**
  - (b) Explain briefly why Steve will be able to commute his benefits from the defined benefit scheme on the grounds of triviality. **(4)**
  - (c) Explain **five** potential drawbacks for Steve if he commutes his benefits under the defined benefit scheme for a trivial commutation lump sum. **(5)**
  
4. Outline the factors that should be taken into account when carrying out an annual review of a client's phased capped drawdown plan. **(9)**

5. Zoe, aged 60, has taxable income of £60,000 per annum. She has an uncrystallised personal pension fund of £315,000. Zoe wishes to take an uncrystallised funds pension lump sum (UFPLS) which will provide her with a net payment of £18,000 after all taxes have been settled.
- (a) Calculate, **showing all your workings**, the amount of fund which must be crystallised to provide the net amount of £18,000 as an UFPLS. (5)
- (b) Outline **four** potential drawbacks of Zoe taking an UFPLS. (4)
6. In October 2006, David had funds of £900,000 held in a personal pension plan (PPP). At that time he took a pension commencement lump sum (PCLS) of £225,000. The remaining fund, currently valued at £1,100,000, is held in a capped drawdown arrangement.
- David is about to reach his 75<sup>th</sup> birthday. His only other pension arrangement is an uncrystallised PPP valued at £200,000 and he has not registered for any form of transitional protection.
- Calculate, **showing all your workings**, the lifetime allowance tax charge payable in respect of David's pension benefits when he reaches age 75. (10)
7. Anthony, aged 57, is a widower with two non-dependant children. He is a member of a defined benefit pension scheme and wants to retire and take his pension benefits now. The scheme's normal pension age is 65.
- Outline **five** benefits and **five** drawbacks to Anthony of transferring from his defined benefit pension scheme to a flexi-access drawdown arrangement. (10)
8. Sally, aged 57, was recently widowed. Her late husband, David, was aged 58, when he died as a result of an accident at work. They do not have any children. Sally is entitled to both the State Bereavement Allowance and the State Bereavement Payment.
- Outline the benefits that will be paid and the conditions that need to be met for Sally to claim both entitlements. (8)

QUESTIONS CONTINUE OVER THE PAGE

9. Outline the conditions that must be met in order that a member's pension benefits can be commuted for a serious ill health lump sum. (6)

10. Jason, aged 64, is about to retire with 38 years of pensionable service in his employer's defined benefit pension scheme. The scheme offers members the option to commute part of their pension for a pension commencement lump sum (PCLS).

State the factors that Jason should consider before deciding whether or not to commute any of his pension for a PCLS. (8)

11. Harry, aged 72, has an uncrystallised personal pension plan (PPP) valued at £1,100,000. He is also in receipt of a scheme pension of £12,000 per annum from a defined benefit pension scheme, which commenced when Harry reached age 65, and includes a 50% dependant's pension and a 10-year guarantee.

Harry is a widower with no dependants and his only family is his sister, Louise, aged 76. Harry has completed nomination forms showing that Louise should receive the benefits from his pensions when he dies.

In the event of Harry's death before the age of 75, outline the options Louise will have in how she receives the benefits and how they will be taxed in respect of Harry's:

(a) scheme pension; (5)

(b) uncrystallised PPP. (10)

*No calculations are required. You should assume there will be no change in the format of Harry's pensions.*

12. Saleema, aged 61, is employed and a higher-rate taxpayer. She has a self-invested personal pension (SIPP) into which her employer contributes.

In August 2014, Saleema crystallised £200,000 of her SIPP into a capped drawdown pension in order to release a £50,000 pension commencement lump sum. She is now interested in drawing an income from her pension and recycling this into her SIPP using one of the following options:

OPTION ONE

- Retaining the capped drawdown pension and recycling the maximum income (currently £11,475) back into her SIPP.

OPTION TWO

- Switching the capped drawdown fund to a flexi-access drawdown fund which will allow her to recycle a higher amount if she wishes to.

(a) Explain why Saleema should choose option one rather than option two. (6)

(b) Explain the impact option one would have on Saleema's Income Tax position and why this would be the case. (3)

13. Freda, aged 61, has a self-invested personal pension. This is currently valued at £800,000, of which £120,000 is uncrystallised. The balance is in a capped drawdown arrangement and the maximum permitted income is currently £55,000 per annum.

Freda wishes to crystallise £120,000, so that she can take a pension commencement lump sum of £30,000. The balance of £90,000 will be designated into her existing capped drawdown arrangement.

Calculate, **showing all your workings**, the revised maximum income that can be paid to her from her capped drawdown fund. *Assume the GAD basis amount is £52 per £1,000.* (5)

14. Outline the changes that have been made to HM Revenue and Customs' rules surrounding lifetime annuities from 6 April 2015, including their tax treatment. (10)

15. Joachim, aged 59, is married to Andrew, aged 51. He wishes to reduce his working hours as his health has started to deteriorate. Joachim has a personal pension plan valued at £550,000. He has no capital requirements and intends to draw an income via phased annuity purchase.

Outline the potential **benefits** to Joachim of using this approach rather than phased flexi-access drawdown. (8)

**The tax tables can be found on pages 9 – 15**



## INCOME TAX

| RATES OF TAX  | 2014/2015 | 2015/2016 |
|---|-----------|-----------|
| Starting rate for savings*                                      | 10%       | 0%        |
| Basic rate  | 20%       | 20%       |
| Higher rate   | 40%       | 40%       |
| Additional rate   | 45%       | 45%       |
| Starting-rate limit   | £2,880*   | £5,000*   |
| Threshold of taxable income above which higher rate applies     | £31,865   | £31,785   |
| 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) §              | £10,000  | £10,600  |
| Personal Allowance (if born between 6 April 1938 and 5 April 1948) § | £10,500  | £10,600  |
| Personal Allowance (if born before 6 April 1938) §                   | £10,660  | £10,660  |
| Married/civil partners (minimum) at 10% †                            | £3,140   | £3,220   |
| Married/civil partners at 10% †                                      | £8,165   | £8,355   |
| Transferable tax allowance for married couples/civil partners        | N/A      | £1,060   |
| Income limit for age-related allowances §                            | £27,000  | £27,700  |
| Blind Person's Allowance   | £2,230   | £2,290   |
| Enterprise Investment Scheme relief limit on £1,000,000 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.

|   |         |         |
|---|---------|---------|
| Child Tax Credit (CTC)                  |         |         |
| - Child element per child (maximum)     | £2,750  | £2,780  |
| - family element                        | £545    | £545    |
| Threshold for tapered withdrawal of CTC | £16,010 | £16,105 |

## NATIONAL INSURANCE CONTRIBUTIONS

| Class 1 Employee           | Weekly | Monthly | Yearly  |
|----------------------------|--------|---------|---------|
| Lower Earnings Limit (LEL) | £112   | £486    | £5,824  |
| Primary threshold          | £155   | £672    | £8,060  |
| Upper Accrual Point        | £770   | £3,337  | £40,040 |
| Upper Earnings Limit (UEL) | £815   | £3,532  | £42,385 |

| Total earnings £ per week | CLASS 1 EMPLOYEE CONTRIBUTIONS |                                    |
|---------------------------|--------------------------------|------------------------------------|
|                           | Contracted-in rate             | Contracted-out rate (final salary) |
| Up to 155.00*             | Nil                            | Nil                                |
| 155.01 – 770.00           | 12%                            | 10.6%                              |
| 770.01 – 815.00           | 12%                            | 12%                                |
| Above 815.00              | 2%                             | 2%                                 |

*\*This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £112 per week. This £112 to £155 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 156.00**            | Nil                            | Nil                 | Nil            |
| 156.01 – 770.00           | 13.8%                          | 10.4%               | 13.8%          |
| 770.01 – 815.00           | 13.8%                          | 13.8%               | 13.8%          |
| Excess over 815.00        | 13.8%                          | 13.8%               | 13.8%          |

*\*\* Secondary earnings threshold.*

|                                |   |
|--------------------------------|---|
| <b>Class 2 (self-employed)</b> | Flat rate per week £2.80 where profits exceed £5,965 per annum.         |
| <b>Class 3 (voluntary)</b>     | Flat rate per week £14.10.  |
| <b>Class 4 (self-employed)</b> | 9% on profits between £8,060 - £42,385.<br>2% on profits above £42,385. |

## 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          |
| 2015/2016 | £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.

| MONEY PURCHASE ANNUAL ALLOWANCE | 2014/2015 | 2015/2016 |
|---------------------------------|-----------|-----------|
|                                 | N/A       | £10,000*  |

### 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.

§ increased to £80,000 from 6 April - 8 July 2015. If not used, can be carried forward to 9 July 2015 - 5 April 2016, subject to a maximum of £40,000.

\* transitional rules apply to the calculation for pre/post 8 July 2015 position.

## CAPITAL GAINS TAX

| EXEMPTIONS  | 2014/2015 | 2015/2016 |
|---|-----------|-----------|
| Individuals, estates etc  | £11,000   | £11,100   |
| Trusts generally  | £5,500    | £5,550    |
| 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 TRANSFERS

|   | 2014/2015 | 2015/2016 |
|---|-----------|-----------|
| Transfers made on death after 5 April 2015      |           |           |
| - Up to £325,000                                | Nil       | Nil       |
| - Excess over £325,000                          | 40%       | 40%       |
| Transfers made after 5 April 2015               |           |           |
| - Lifetime transfers to and from certain trusts | 20%       | 20%       |

*For deaths after 5 April 2015, 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:

|                           | 0-3  | 3-4 | 4-5 | 5-6 | 6-7 |
|---------------------------|------|-----|-----|-----|-----|
| - Years before death      |      |     |     |     |     |
| - 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<sub>2</sub>) emissions. There is no reduction for high business mileage users.

### For 2015/2016:

- The percentage charge is 5% of the car's list price for CO<sub>2</sub> emissions of 50g/km or less.
- For cars with CO<sub>2</sub> emissions of 51g/km to 75g/km the percentage is 9%.
- For cars with CO<sub>2</sub> emissions of 76g/km to 94g/km the percentage is 13%.
- Cars with CO<sub>2</sub> emissions of 95g/km have a percentage charge of 14% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 37% (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 37% of the car's list price.

**Car fuel** The benefit is calculated as the CO<sub>2</sub> emissions % relevant to the car and that % applied to a set figure (£22,100 for 2015/2016) e.g. car emission 100g/km = 15% on car benefit scale. 15% of £22,100 = £3,315.

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 contribution's (Class 1A) of 13.8%.

## PRIVATE VEHICLES USED FOR WORK

|  | 2014/2015 Rates | 2015/2016 Rates |
|--|-----------------|-----------------|
| <b>Cars</b>                                    |                 |                 |
| 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    |
| <b>Motor Cycles</b>                            | 24p per mile    | 24p per mile    |
| <b>Bicycles</b>                                | 20p per mile    | 20p per mile    |

## MAIN CAPITAL AND OTHER ALLOWANCES

|  | 2014/2015   | 2015/2016        |
|--|-------------|------------------|
| Plant & machinery (excluding cars) 100% annual investment allowance (first year) §                       | £500,000    | £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%             |
| <b>Motor cars:</b> Expenditure on or after 01 April 2015 (Corporation Tax) or 06 April 2015 (Income Tax) |             |                  |
| CO <sub>2</sub> emissions of g/km:   | 75 or less* | 76-130           |
| Capital allowance:   | 100%        | 18%              |
|  | first year  | reducing balance |
|  |             | 131 or more      |
|  |             | 8%               |
|  |             | reducing balance |

\*If new

§ From 01 January 2016 allowance will decrease to £200,000.

## CORPORATION TAX

|                         | 2014/2015  | 2015/2016  |
|-------------------------|------------|------------|
| Full rate               | 21%        | 20%        |
| Small companies rate    | 20%        | 20%        |
| Small companies limit   | £300,000   | £300,000   |
| Effective marginal rate | 21.25%     | 20%        |
| Upper marginal limit    | £1,500,000 | £1,500,000 |

## VALUE ADDED TAX

|                               | 2014/2015 | 2015/2016 |
|-------------------------------|-----------|-----------|
| Standard rate                 | 20%       | 20%       |
| Annual registration threshold | £81,000   | £82,000   |
| Deregistration threshold      | £79,000   | £80,000   |

## MAIN SOCIAL SECURITY BENEFITS

|   |   | 2014/2015    | 2015/2016    |
|---|---|--------------|--------------|
|   |   | £            | £            |
| Child Benefit                                   | First child                                   | 20.50        | 20.70        |
|   | Subsequent children                           | 13.55        | 13.70        |
|   | Guardian's allowance                          | 16.35        | 16.55        |
| Employment and Support Allowance                | Assessment Phase                              |              |              |
|   | Age 16 – 24                                   | Up to 57.35  | Up to 57.90  |
|   | Aged 25 or over                               | Up to 72.40  | Up to 73.10  |
|   | Main Phase                                    |              |              |
|   | Work Related Activity Group                   | Up to 101.15 | Up to 102.15 |
|   | Support Group                                 | Up to 108.15 | Up to 109.30 |
| Attendance Allowance                            | Lower rate                                    | 54.45        | 55.10        |
|   | Higher rate                                   | 81.30        | 82.30        |
| Retirement Pension                              | Single  | 113.10       | 115.95       |
|   | Married                                       | 180.90       | 185.45       |
| Pension Credit                                  | Single person standard minimum guarantee      | 148.35       | 151.20       |
|   | Married couple standard minimum guarantee     | 226.50       | 230.85       |
|   | 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                      |   | 111.20       | 112.55       |
| Jobseekers Allowance                            | Age 18 - 24                                   | 57.35        | 57.90        |
|   | Age 25 or over                                | 72.40        | 73.10        |
| Statutory Maternity, Paternity and Adoption Pay |   | 138.18       | 139.58       |

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