

## J05

# Diploma in Financial Planning

## Unit J05 – Pension income options

April 2016 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.

Candidates should answer based on the legislative position immediately BEFORE the 2016 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. Jayne, who is a member of her previous employer's defined benefit scheme, holds fixed protection 2012 and intends to retire in June 2016. She can either take an annual pension of £112,500 or commute part of her pension for a pension commencement lump sum (PCLS) of £195,000. The commutation rate is 12:1 and Jayne has decided to take the PCLS and a reduced pension.

Calculate, **showing all your workings**, the lifetime allowance tax charge payable if Jayne takes the excess above the lifetime allowance as income. **(8)**

2. Outline the criteria that must be met for a pension scheme member to draw an uncrystallised funds pension lump sum (UFPLS) from their pension fund. **(6)**

3. Pia, aged 55, is in receipt of a dependant's scheme pension of £80 gross per month following the death of her husband at the age of 58, in December 2015. Her late husband also had an uncrystallised personal pension fund, which Pia designated into dependant's flexi-access drawdown. This fund is currently valued at £350,000. Pia would like to take these benefits in the form of a lump sum.

(a) Explain why Pia is able to commute her dependant's scheme pension for a trivial commutation lump sum death benefit and outline the tax treatment of this payment. **(6)**

(b) Explain why the entire dependant's flexi-access drawdown fund can be paid to Pia tax-free. **(2)**

4. Andrew retired in February 2011, aged 65. He crystallised a self-invested personal pension valued at £1,300,000, by taking the maximum pension commencement lump sum and purchasing a lifetime annuity. He also has an uncrystallised personal pension currently valued at £450,000. Andrew has no other form of pension benefits and has registered for fixed protection 2014.

Andrew has been diagnosed with a serious illness and has a life expectancy of less than a year. He wishes to commute his personal pension plan for a serious ill-health lump sum.

Calculate, **showing all your workings**, the serious ill-health lump sum that Andrew will receive. (6)

5. Ian, aged 70, is about to purchase a lifetime annuity from his uncrystallised personal pension plan. Explain in detail the death benefits that he can include and their tax treatment. (8)

6. (a) State the HM Revenue & Customs requirements for a short-term annuity. (3)

- (b) Outline **three** potential benefits and **three** potential drawbacks of using a short-term annuity to provide income. (6)

7. Anil, aged 61, has recently retired and is in receipt of a scheme pension of £20,000 per annum. When he retired, he also took the maximum pension commencement lump sum from a personal pension plan and designated the balance into a flexi-access drawdown fund. This is currently valued at £250,000 and no withdrawals have been taken.

Anil would like to draw a gross income of £10,000 per annum from his flexi-access drawdown fund to supplement his scheme pension. He will take this as a lump sum withdrawal each year.

Explain in detail how the scheme administrator will apply Income Tax to the withdrawal taken from the flexi-access drawdown fund:

*No calculations are required.*

- (a) in the first year; (5)

- (b) in subsequent years. (2)

QUESTIONS CONTINUE OVER THE PAGE

8. Examples of the risk factors that should be considered when advising on pension decumulation are set out in Section 19.7 of the Financial Conduct Authority (FCA) Conduct of Business Sourcebook (COBS).

List **ten** of these risk factors.

**(10)**

9. Ceri, aged 59, is divorced with one adult, non-dependent son. On 3 March 2015 she entered phased capped drawdown. Her capped drawdown fund is currently valued at £40,300 and the maximum income is currently set at £2,051 per pension year. Ceri has not taken any income from the capped drawdown fund in the current pension year. The contract allows additional funds to be designated to the existing arrangement. Ceri also has an uncrystallised personal pension plan (PPP) currently valued at £760,000.

Ceri's only other income in 2015/2016 is £20,000 from her part-time employment. Ceri would now like to generate a net income of £15,000 from her pension funds via phased capped drawdown. In doing so she would like to crystallise as little of her PPP as possible.

(a) Calculate, **showing all your workings**, the amount of funds in Ceri's PPP that must be crystallised to provide the income she requires. *Assume the GAD basis amount is £47 per £1,000.*

**(8)**

(b) In the event of Ceri's death before the age of 75, outline the options Ceri's son will have in how he receives the benefits from her pensions, including the tax treatment. *Assume death benefits are paid within two years of death.*

**(6)**

10. The Pension Wise service can only provide guidance to consumers and must not give advice. Describe the guidance that can be given, including any limitations.

**(8)**

11. Angela, currently aged 59, will reach her State Pension age (SPA) of 66 in December 2023. She started working for her current employer as a trainee manager when she was aged 22 and is now a senior manager within the organisation. Angela has never been contracted-out.

(a) Explain, giving your reasons, why Angela's foundation amount calculated on 5 April 2016 will be higher than the full rate of single tier State Pension that applies for 2016/2017.

**(5)**

(b) Describe how Angela's State Pension will be increased each year once Angela reaches her SPA.

**(4)**

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- 12.** Janice is considering withdrawing her entire pension fund as an uncrystallised funds pension lump sum (UFPLS) and purchasing a buy-to-let property to provide her retirement income.
- Outline **seven** drawbacks of this course of action. **(7)**
- 13.** State **eight** circumstances in which a scheme pension may be reduced or stopped. **(8)**
- 14.** Alice and Bernard are married and both have adult children from previous marriages. Alice has a significant pension fund. On her death she would like this fund to provide for Bernard but ultimately ensure that, on Bernard's death, the residual value will pass to her children.
- Explain why nominating the death benefits to a spousal bypass trust would be suitable in these circumstances. **(8)**
- 15.** Colin, aged 60, is about to retire and intends to draw an income using phased flexi-access drawdown. Colin would like to assess his projected income and expenditure requirements before taking an income from his fund.
- (a)** State **eight** factors that should be taken into account when carrying out a projected cash flow analysis for Colin. **(8)**
- (b)** Outline **six** scenarios that should be discussed with Colin when carrying out a stress test of his cash flow analysis. **(6)**

**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. 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%
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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:

- 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<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%

**Motor cars:** 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	131 or more
Capital allowance:	100%	18%	8%
	first year	reducing balance	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 Support Group	Up to 101.15 Up to 108.15	Up to 102.15 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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