

AF2

Advanced Diploma in Financial Planning

Unit AF2 – Business financial planning

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

- 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), (g)** and **(h)** which follow.

Apex Printing Ltd (APL) is wholly owned and run by its two directors Karl and his sister Sheridan. The business was incorporated in 1975. They inherited the business from their father's estate two years ago. Karl and Sheridan have no experience of running a business. They have awarded themselves annual salaries of £130,000 each, much higher than the £45,000 previously taken by their father. APL pays pension contributions, up to the annual allowance for Karl and Sheridan since they took control, with the last payment made on 6 April 2016. APL currently employs 25 staff excluding the two directors.

The company has a strong order book and a loyal customer base, looked after by the long-standing sales manager, Peter. Karl has recently introduced a number of new customers, mainly close friends, who he insists on dealing with himself. Peter believes these orders have been incorrectly priced and are uncommercial. Karl's new customers are slow in settling their bills and a number remain outstanding.

Helen, the company's financial controller for the last 10 years, is becoming increasingly concerned about the recent financial management of the business. Since inheriting the business, Sheridan has taken over the banking and accounts functions from Helen. The business is up to date with payroll, but has fallen behind with PAYE and VAT. They have also missed some payments on a bank loan taken out to buy new equipment.

The business is run from a rented warehouse and the quarterly rent for March 2016 has not been paid.

The realisable assets of the company are shown in the table below:

	£
Trade debtors	122,000
Two vans	36,000
Office and IT equipment	5,000
Printing and finishing machinery	220,000
Total:	383,000

The total amounts owed by the company are:

	£
Bank loan*	150,000
Bank overdraft	25,000
VAT	120,000
PAYE	60,000
Unpaid rent	6,000
Other unsecured creditors	48,000
Total:	409,000

*Secured by debenture

Peter and Helen have discussed taking over the business. Peter has personal savings that he could use to help fund the purchase, and would prefer to access these funds if required. Peter wants to minimise the risk to his capital where possible.

Peter and Helen are seeking your advice on their plans.

QUESTIONS CONTINUE OVER THE PAGE

Questions continue on pages 7 – 8

Questions

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

- (a) Outline the criteria a court would take into account when assessing whether a business was unable to pay its debts. (6)
- (b) HM Revenue & Customs have advised of their intention to petition for a winding up order on Apex Printing Ltd (APL).
- (i) Outline the effect that granting a winding up order would have on the business. (7)
- (ii) Explain the potential impact of the winding up order on Karl and Sheridan personally, and as directors. (9)
- (c) (i) Outline the process of appointing an administrator as an alternative course of action. (5)
- (ii) Explain the benefits for Karl and Sheridan of appointing an administrator. (3)
- (d) Peter and Helen have created a new limited company in which they will be equal shareholders. The main purpose will be to buy the assets and undertakings of APL and continue trading.
- (i) Explain the process which would enable the administrator to sell the assets and undertakings to Peter and Helen's new company. (4)
- (ii) Peter has £150,000 to invest in the new company.
- List the different options available to him to introduce this capital into the new company. (4)
- (iii) State, giving your reasons, which two of the options identified in part (d)(ii) above, could meet Peter's objectives. (8)

QUESTIONS CONTINUE OVER THE PAGE

- (e) In addition to buying the company, Peter and Helen have made an offer to the administrator of £221,850, at a 15% discount, for the machinery, vans and IT equipment which has been accepted.

Calculate, **showing all your workings**, the capital allowances the new business will be able to claim based on the proposed expenditure. *Assume that the accounting year end is 31 March 2017, and the Annual Investment Allowance does not change throughout the accounting period.* (5)

- (f) (i) Describe briefly **four** internal management controls that could be adopted by Peter and Helen in their new company to avoid the issues that have arisen in APL. (8)

(ii) State **three** benefits and **three** drawbacks of using invoice factoring to fund short-term cash flow. (6)

- (g) Explain how the existing employees would be treated on the transfer of assets and undertakings from APL to the new company. (8)

- (h) State the **seven** statutory duties for directors under the Company's Act 2006 with which Peter and Helen will have to comply. (7)

Total marks available for this question: 80

Section B questions can be found on pages 10 – 15

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.

Jack, aged 59, Zeenat, aged 45, and Gregg, aged 50, are partners in a software design partnership. They do not have a partnership agreement.

Jack wishes to retire as he has recently had a mild heart attack. Having made this decision he is keen to make the transition as soon as possible. Jack has sufficient pension benefits to provide him with an income in retirement, and various assets and investments of £150,000 in addition to his main residence valued at £250,000. Jack has no liabilities.

Zeenat and Gregg would like to continue the business.

Zeenat is widowed with three young children, and is in good health. She paid off her mortgage early and has some modest investments valued at £25,000 in addition to her main residence valued at £225,000. Zeenat has recently updated her Will to leave her estate equally between her three children. She is keen to ensure that her children are properly compensated for her share of the business and any tax is minimised where possible.

Gregg has recently divorced and the financial settlement has left him with few liquid assets.

Current balance sheet for the partnership:

Partners Accounts	£
Debtors	45,000
Cash	12,000
Property, Plant & Equipment	
Office Building	175,000
Office equipment	12,000
Intangible Assets	
Goodwill	50,000
Current Liabilities	
Creditors	22,500
Bank mortgage on office	125,000
Total net assets	146,500

Partners Accounts	£
Jack - Capital Account	20,000
Jack - Current Account	<u>65,000</u>
	85,000
Zeenat - Capital Account	20,000
Zeenat - Current Account	<u>55,000</u>
	75,000
Gregg - Capital Account	20,000
Gregg - Current Account	<u>(33,500)</u>
	(13,500)
Partners Funds	146,500

QUESTIONS CONTINUE OVER THE PAGE

Questions continue on page 13

Questions

- (a) (i) Explain the effect Jack's proposed retirement would have on the partnership including the assets of the partnership. (6)
- (ii) State **two** elements they should include in a partnership agreement to meet all the partners aims and objectives. (2)
- (b) The partners have put in place a partnership agreement which addresses their aims and objectives.
- (i) Outline the steps that would have to be undertaken by Zeenat and Gregg to comply with Jack's notice to retire and the potential problems that may arise for all the partners based on their current circumstances. (9)
- (ii) State **three** possible solutions to avoid the problems described in your answers to part (b)(i) above. (3)
- (c) Given Jack's recent health problems, Zeenat is anxious to implement partnership protection arrangements.
- Outline how these arrangements should be implemented taking Zeenat's needs and objectives into account in relation to:
- (i) protection on death; (10)
- (ii) serious illness. (5)
- (d) Outline the main reasons why a special business trust should be used for partnership protection arrangements rather than a standard flexible power of appointment trust. (5)

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)** and **(d)** which follow.

Andrew is a quantity surveyor and trades through a private limited company called AMQS Ltd (AMQS). Andrew is the sole shareholder and director. He typically has eight projects running at any one time for different customers.

AMQS's year end is the 31 March 2016. You are visiting Andrew two weeks before the year end to provide advice on the company's Corporation Tax liabilities and his remuneration options.

At the previous year end, the company's balance sheet value was a negative amount of £10,000, comprising issued and fully paid shares of £1,000 and brought forward losses of £11,000.

The anticipated trading profits for the year end 31 March 2016 are £100,000, before awarding Andrew any salary or pension contribution and after supplying Andrew with a brand new company owned car on the 6 April 2015. The list price of the car is £44,000 with emissions of 160g/km. All Andrew's petrol, including that used for his private mileage, is included. The car was purchased at a cost of £42,000.

Andrew has drawn cash out of the company at a rate of £6,000 per month throughout the year and now has an overdrawn director's loan account of £72,000. Andrew has no other sources of income or any realised gains for 2015/2016.

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**, the value of the car and fuel benefit for the year 2015/2016. (5)
- (ii) Calculate, **showing all your workings**, the capital allowances available to AMQS in respect of the company car. (3)
- (iii) All AMQS's profit is derived from trading activity and does not include any interest, gains, disallowable expenses or capital allowances.
- Calculate, **showing all your workings**, the Corporation Tax payable on the basis that Andrew receives no salary or pension contributions for the year to 31 March 2016. (4)
- (b) Explain briefly what is meant by the term 'close company'. (3)
- (c) (i) Explain the limit placed on the amount of dividend AMQS can pay Andrew, stating if this would be sufficient amount to clear Andrew's overdrawn director's loan account. (6)
- (ii) Calculate, **showing all of your workings**, the gross salary that AMQS could pay Andrew together with his P11d benefits to bring his total taxable remuneration up to the threshold for higher rate tax. (2)
- (iii) Using your answer from part (c)(ii) above, calculate, **showing all of your workings**, the net salary Andrew would receive. (4)
- (d) (i) Assuming that AMQS pays Andrew the gross salary calculated in part (c)(ii) above, calculate, **showing all your workings**, AMQS revised net profit, Corporation Tax liability and the maximum dividend amount they can pay Andrew to clear the balance of his loan. (5)
- (ii) Explain the difficulty the company will face if Andrew does not clear his overdrawn director's loan account by 31 March 2016. (4)
- (iii) Outline briefly any additional actions that could be undertaken by Andrew or AMQS to avoid the difficulties outlined in part (d)(ii) above. (4)

Total marks available for this question: 40

The tax tables can be found on pages 17 – 23

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.*

Class 2 (self-employed)	Flat rate per week £2.80 where profits exceed £5,965 per annum.
Class 3 (voluntary)	Flat rate per week £14.10.
Class 4 (self-employed)	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%
---------------------------------------	-----	-----

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 (CO₂) 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 CO₂ emissions of 50g/km or less.
- For cars with CO₂ emissions of 51g/km to 75g/km the percentage is 9%.
- For cars with CO₂ emissions of 76g/km to 94g/km the percentage is 13%.
- Cars with CO₂ 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 CO₂ 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
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

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 ₂ 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	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

BLANK PAGE

BLANK PAGE

BLANK PAGE

