THE CHARTERED INSURANCE INSTITUTE

AF3

Advanced Diploma in Financial Planning

Unit AF3 – Pension 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 AF3 – Pension 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)**, and **(e)** which follow.

Gabriella and her twin sister Yvonne, aged 52, are the directors of Cyclat Printing Ltd. They are currently considering purchasing additional plant and machinery to expand their business and estimate that they would need to borrow £200,000 for this purpose.

Gabriella and Yvonne are members of the company's small self-administered scheme (SSAS), which has assets of £450,000 currently held in the trustee bank account.

Yvonne lives with her long term partner Susan. In addition to her share of the SSAS, Yvonne has the following preserved benefits in the H&BZ Ltd retirement benefit scheme, a former employer's defined benefit scheme which is currently underfunded.

H&BZ Ltd retirement benefit scheme	
Date of joining scheme	05.09.1983
Date of leaving scheme	02.10.1989
Total pension at date of leaving	£1,971.36 per annum
Including guaranteed minimum pension (GMP)	Pre-1988 £286.96 per annum Post-1988 £82.32 per annum
Member contributions at date of leaving	£3,468
GMP revaluation	Fixed rate of 7.5% per annum
Excess above GMP	Statutory minimum revaluation
Increases to pensions in payment	GMP – statutory increases All excess benefits increase by Retail Prices Index capped at 5% per annum
Normal pension age (NPA)	60
Death in deferment	Return of member contributions with interest
Death in retirement	Dependant's pension of 2/3rds of member's pension at date of death
Definition of dependant under scheme rules	Legally married spouse or civil partner at date of retirement

Yvonne is considering transferring these benefits into a money purchase pension in order to access them flexibly in a few years time. Having recently received a cash equivalent transfer value of £94,856, she has been informed that the critical yield is 7.1% based on the NPA of the scheme.

Gabriella, who was widowed in January 2015, has a son Joseph, aged 18. She designated her late husband's pension fund to a dependant's capped drawdown arrangement in March 2015 and has nominated Joseph to receive the drawdown benefits upon her death. The current maximum permitted income is £14,976 per annum and Gabriella has not yet drawn any income from the fund. The capped drawdown plan is currently valued at £256,000. Joseph will be starting university in September 2016 and Gabriella would like to use the drawdown plan to fund his education which she estimates will cost £20,000 per annum.

Questions

(a) In respect of Yvonne's preserved benefits in the H&BZ Ltd retirement benefit scheme:

(i) Describe, in detail, how revaluation will be applied to Yvonne's benefits up to her normal pension age. *Your answer should include the specific rates of revaluation as well as the process for applying any cap where relevant.* **(10)**

(ii) Describe, in detail, how the cash equivalent transfer value of £94,856 was calculated. *No calculations are required.* **(10)**

(b) **(i)** State the conditions under which the scheme would enter the Pension Protection Fund (PPF). **(3)**

(ii) If the scheme entered the PPF before Yvonne reached the scheme's normal pension age, outline the likely impact that this would have on the retirement benefits payable to her. **(5)**

(c) In respect of the potential transfer of Yvonne's benefits under the H&BZ Ltd retirement benefit scheme to a money purchase pension scheme:

(i) Explain to Yvonne what is meant by the term 'critical yield'. **(5)**

(ii) Explain the circumstances in which the money purchase pension scheme might be unable to provide sufficient benefits to replicate those provided under the H&BZ Ltd retirement benefit scheme at age 60, despite the critical yield being achieved. **(5)**

(iii) Explain why the critical yield is less relevant when assessing the suitability of the transfer, given Yvonne's intention to access benefits flexibly instead of purchasing a lifetime annuity. **(5)**

(iv) Outline the significance of establishing Yvonne's attitude to risk and capacity for loss before considering whether a transfer would be appropriate. **(6)**

(v) Explain why the death benefits would be more favourable under the money purchase pension scheme if Yvonne was to die before reaching minimum pension age. *Assume there are no changes to the circumstances outlined in the case study.* **(4)**

QUESTIONS CONTINUE OVER THE PAGE

(d) Gabriella and Yvonne want to explore the possibility of the small self-administered scheme (SSAS) making a loan to Cyclat Printing Ltd to help fund the purchase of additional plant and machinery.

(i) Outline **four** potential benefits and **four** potential drawbacks of using the SSAS to provide the required loan. **(8)**

(ii) Outline the factors and requirements that they would need to consider when setting the level of interest charged on such a loan. **(7)**

(e) In respect of Gabriella's dependant's capped drawdown plan:

(i) State the actions Gabriella could take in order that the fund can provide the £20,000 per annum required to fund Joseph's education. **(2)**

(ii) State, giving your reasons, the tax position of any income that is withdrawn from the plan by Gabriella. *Assume the actions in part **(e)(i)** above have taken place and that Gabriella's husband died before reaching age 75.* **(3)**

(iii) Outline the options available to Joseph in respect of the drawdown fund in the event of Gabriella's death and state the tax treatment of the benefits payable. **(7)**

Total marks available for this question: 80

Section B questions can be found on pages 8 – 11

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.

Matthew, aged 47, and Lucy, aged 41, are married. They have two daughters, Millie, aged 14, and Alice, aged 12.

Matthew is a self-employed graphic designer and he has relevant UK earnings totalling £115,000 for the 2015/2016 tax year. He does not have any savings or investment income as all of the couple's non-pension savings are held in Lucy's name. Lucy received Child Benefit of £1,788.80 in the 2015/2016 tax year.

Matthew has a self-invested personal pension (SIPP) and prior to the changes announced in the July 2015 Emergency Budget his pension input period (PIP) ran from 1 May to 30 April each year. Matthew funds his SIPP with one-off single contributions now and then. His contribution history is as follows:

Date of contribution	Gross contribution
10 April 2013	£30,000
10 May 2013	£22,000
10 April 2015	£42,000
10 August 2015	£15,000

Lucy is an accountant and works part-time on a salary of £25,000 per annum. She was automatically enrolled into the National Employment Savings Trust (NEST) in 2014. Lucy has selected a retirement age of 55 and as a result her contributions are being paid into the NEST 2029 Retirement Date Fund.

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 maximum amount of unused annual allowance that Matthew can carry forward into the 2016/2017 tax year. **(10)**

(b) Describe in detail, **using calculations to support your answer**, how the tax relief in respect of the contributions made in the 2015/2016 tax year is awarded, including the impact on Matthew's overall tax position. **(12)**

(c) In respect of Lucy's current investment strategy:

(i) Describe the investment objectives of the growth and consolidation phases of the National Employment Savings Trust 2029 Retirement Date Fund that will apply to Lucy. **(6)**

(ii) Explain the impact on Lucy's current investment strategy should she decide to take her pension benefits at age 60. **(4)**

(iii) Outline the factors that should be considered when recommending an investment fund that may be more suitable for Lucy. **(8)**

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.

David and Karen have recently finalised their divorce. The couple have no children or dependants.

David will turn 63 on 1 May 2016. He has a deferred benefits under the RTQ Ltd occupational pension scheme. The details of this scheme, which is fully funded, are shown below:

Defined Benefit Section	
Pension payable at scheme's normal pension age (NPA) of 65	£55,000 per annum increasing in line with statutory minimum rates of escalation
Dependant's benefits	50% spouse's pension
Pension commencement lump sum (PCLS)	Up to HM Revenue & Customs maximum paid by commutation using a commutation rate of 12:1 at age 65 and 15:1 at age 63.
Period of service	May 1997 – March 2014
Early retirement factor	0.15% for each month or part thereof that benefits are taken prior to age 65
Defined Contribution Section	
Additional voluntary contribution fund (AVC)	£310,000

David also has an uncrystallised personal pension plan (PPP). Following the application of a pension sharing order and consequent transfer of £300,000 from his PPP to Karen's PPP, David's fund is now valued at £45,000. He has not made any contributions to this plan since March 2014 when he registered for Fixed Protection 2014. The PPP and AVC funds are currently invested in fixed interest and cash, reflecting David's cautious attitude to risk.

David, who is in excellent heath, plans on crystallising all his pension benefits in May 2016. He only requires a PCLS of £200,000. His primary objective is to receive a secure index linked income. The best single life, index linked annuity rate available to him is 3.9%. His plans for his retirement include spending more time with his parents who are in good health and both nearing their 90th birthday.

Karen, who has always been self-employed, has a PPP which, following the transfer of the pension credit from David's PPP, is currently valued at £1,100,000. She reached her State Pension age in January 2015 with 35 qualifying years' of National Insurance contributions and credits for State Pension entitlement. Karen has started to receive her State Pension but does not currently need this income and is keen to know if she could defer future income payments.

Questions

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

(a) Explain why it was advantageous for David to have the pension debit of £300,000 applied to his PPP rather than the RTQ Ltd occupational pension scheme. **(10)**

(b) David has the choice of taking his PCLS of £200,000 from his AVC fund or by commuting some of his RTQ Ltd scheme pension.

(i) Outline why David is able to draw all of his required PCLS from the AVC fund. **(3)**

(ii) Explain why it would be advantageous for David to take his PCLS from the AVC fund. **(4)**

(c) Calculate, **showing all your workings**, the percentage of David's lifetime allowance that will be utilised when his pension benefits are crystallised in May 2016. *You should assume that the PCLS is paid from the AVC funds.* **(7)**

(d) In respect of Karen's personal pension:

(i) Explain why Karen will not qualify for an enhancement to her lifetime allowance as a result of the pension credit. **(2)**

(ii) Recommend the actions Karen should take in order to reduce the likelihood of incurring a lifetime allowance tax charge in the future. **(6)**

(e) Karen would like to stop receiving the income from her State Pension with effect from May 2016.

(i) State why Karen is able to do this. **(2)**

(ii) Outline, giving your reasons, the options that will be available to her, in respect of her State Pension, assuming she defers receipt until age 67. **(6)**

Total marks available for this question: 40

The tax tables can be found on pages 13 – 19

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 (CO_2) 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_2 emissions of 50g/km or less.
- For cars with CO_2 emissions of 51g/km to 75g/km the percentage is 9%.
- For cars with CO_2 emissions of 76g/km to 94g/km the percentage is 13%.
- Cars with CO_2 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_2 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% first year	18% reducing balance	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

BLANK PAGE

BLANK PAGE

BLANK PAGE