

AF1

Advanced Diploma in Financial Planning

Unit AF1 – Personal tax and trust planning

October 2016 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2016/2017, 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

- Three hours are allowed for this paper.
- **Do not begin writing until the invigilator instructs you to.**
- **Read the instructions on page 3 carefully before answering any questions.**
- Provide the information requested on the answer book and form B.
- You are allowed to write on the inside pages of this question paper, but you must **NOT** write your name, candidate number, PIN or any other identification anywhere on this question paper.
- The answer book and this question paper must **both be handed in personally by you** to the invigilator before you leave the examination room. **Failure to comply with this regulation will result in your paper not being marked and you may be prevented from entering this examination in the future.**

Unit AF1 – Personal tax and trust planning

Instructions to candidates

Read the instructions below before answering any questions

- **Three hours** are allowed for this paper which carries a total of 160 marks as follows:
 - Section A: 80 marks
 - Section B: 80 marks
- You are advised to spend approximately 90 minutes on Section A and 90 minutes on Section B.
- You are strongly advised to attempt **all** questions to gain maximum possible marks. The number of marks allocated to each question part is given next to the question and you should spend your time in accordance with that allocation.
- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.
- You may find it helpful in some places to make rough notes in the answer booklet. If you do this, you should cross through these notes before you hand in the booklet.
- It is important to show all steps in a calculation, even if you have used a calculator.
- If you bring a calculator into the examination room, it must be a silent, battery or solar-powered, non-programmable calculator. The use of electronic equipment capable of being programmed to hold alphabetic or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements.
- Tax tables are provided at the back of this question paper.
- Answer each question on a new page and leave six lines blank after each question part.

Subject to providing sufficient detail you are advised to be as brief and concise as possible, using note format and short sentences on separate lines wherever possible.

SECTION A

This question is compulsory and carries 80 marks

Question 1

Read carefully all information provided in the case study before attempting the questions. Your answers should take into account the clients circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c), (d), (e), (f) and (g) which follow.

Heather, aged 63, is a widow after the death of her husband Connor in March 2015, aged 62. Heather spent the first 30 years of her life in Australia before moving to the UK, when she married Connor. Heather's granddaughter, Bonnie, aged 21, lives with her as Bonnie's mother and father are both deceased.

Heather receives a basic salary of £46,000 in addition to benefits-in-kind of £8,700 per year, from her work as a Legal Executive, where she has spent her entire 25 year working career. She contributes 9% of her basic salary to her final salary pension scheme that was contracted out of the State Earnings-Related Pension Scheme (SERPS) until 5th April 2016. Heather reached her State Pension age in March 2016 and decided to defer taking her State Pension. She currently has no plans to retire until at least 2019. Heather has received notification from HM Revenue & Customs that her PAYE tax code for the tax year 2016/2017 is K870.

Heather owns five rental properties inherited from Connor. The current value of the properties is £1,400,000 which is part funded by interest only mortgages totalling £600,000 at an average variable rate of 2.8%. The properties are currently let, providing a gross rental income of £6,000 per month. The properties are managed by an agent who receives 10% of the gross rental income for their services.

Heather has a deposit account and she expects to receive interest of £4,626 in the tax year 2016/2017. She also owns a selection of single company shares and UK based real estate investment trusts (REITs). Heather expects to receive dividend payments of £2,890 from her shares and a net property income distribution (PID) of £8,400 in the tax year 2016/2017. She also receives income of £4,000 per annum from her ISAs, which were inherited from Connor after his death. At the date of his death the value of the ISA account was £200,000.

Heather receives a spouse's pension of £1,460 gross per month from her late husband's defined benefit pension scheme and £1,500 per month from his self-invested personal pension (SIPP) under dependant's drawdown which commenced in October 2015.

Heather intends to help Bonnie buy a house for £240,000, for her to live in when she goes to university next year. Bonnie has £120,000 available from a trust fund established by her late mother. Heather will provide the other £120,000 plus the costs of the purchase. They intend to buy the house as tenants in common, on a 50:50 basis.

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**, Heather's Income Tax payable in the tax year 2016/2017. (20)
- (b) Explain how HM Revenue & Customs would have calculated the PAYE tax code of K870 for Heather for the tax year 2016/2017. (6)
- (c) Heather has questions relating to the taxation treatment of her real estate investment trusts (REITs).
- (i) Explain briefly the internal taxation position of her REITs. (2)
- (ii) State the requirements that the REITs must satisfy to qualify for its favourable tax treatment. (7)
- (iii) Explain how the disposal of Heather's REITs would be taxed if she decided to sell. (4)
- (d) Heather chose to defer her State Pension in March 2016 and is aware deferring it will increase the amount that she will eventually claim.
- (i) Explain to Heather how her entitlement to State Pension would have been calculated had she retired at her State Pension age and started to draw her pension. *No calculations are required.* (7)
- (ii) Explain how Heather can currently increase her entitlement to State Pension by making further National Insurance contributions and the additional benefits that this could provide. (5)
- (iii) Should Heather decide to retire to Australia, explain how her State Pension entitlement would be affected. (3)

QUESTIONS CONTINUE OVER THE PAGE

- (e) Heather has some questions about the proposed house purchase for Bonnie relating to Stamp Duty Land Tax (SDLT) and how it will be owned.
- (i) Explain how SDLT will apply to the purchase of Bonnie's property. *Assume that the property purchased is freehold.* (6)
 - (ii) Explain how the share of the property owned by Heather will be dealt with on her death. *Assuming that Heather is the first to die.* (4)
- (f) Heather has read in the press of measures to tackle aggressive tax avoidance and tax evasion.
- (i) List the UK taxes to which the general anti-abuse rules (GAAR) apply. (6)
 - (ii) State the conditions that need to be satisfied for the application of the GAAR. (4)
- (g) With regard to the ISAs inherited from her late husband Connor:
- (i) Identify why Heather was eligible to inherit Connor's ISAs. (2)
 - (ii) Explain to Heather how the ISA allowance she inherited from Connor was calculated and its impact on her personal ISA allowance. (4)

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 carefully all information provided in the case study before attempting the questions. Your answers should take into account the clients circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c) and (d) which follow.

Helen, aged 38, and Emma, aged 35, live together and are civil partners. They both work as Administration Managers and are higher-rate tax payers. They both contribute on a monthly basis to their employer's group personal pensions.

Helen has a daughter, Lucy, aged 10, from a previous relationship, who lives with them. They own their home as joint tenants with a small mortgage outstanding. This is protected by two single decreasing term assurance plans.

Helen has a building society savings account set up five years ago nominally for the benefit of Lucy which now holds £5,000.

Helen has short term high interest loans and credit card debts totalling £40,000 in addition to an overdraft of £3,500 on her current account. She is finding it more and more difficult to cope with her payments and her creditors are now pressing for immediate payment. Apart from their mortgage, Helen and Emma have always tended to keep their finances separate.

Emma acquired 4,500 shares in her employers company, having purchased them through a recently matured Save As You Earn (SAYE) share scheme. She saved a total of £9,000 and received a bonus of £250 at the maturity of the scheme. She sold all her SAYE shares in September 2016. In addition, she also sold a vintage watch in June 2016 that she purchased seven years ago for £1,700.

Full details of these disposals are given in the table below.

	Purchase Price	Bonus	Sale Costs	Gross Proceeds
SAYE	£9,000	£250	£25	£17,235
Vintage Watch	£1,700	N/A	9% of gross proceeds	£11,000

In addition, prior to selling the watch, Emma had some minor defects repaired costing her £350. She has no recorded losses to carry forward.

As Emma's SAYE share scheme has recently matured she has the option of replacing it with either a new SAYE share scheme or a Share Incentive Plan but she is unsure which scheme offers the better tax advantages.

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**, Emma's Capital Gains Tax (CGT) liability in the tax year 2016/2017. (12)
- (b) Explain briefly how Emma should report any CGT due and the appropriate reporting timescales for disposals in the tax year 2016/2017. (3)
- (c) (i) Explain the impact on Helen's assets and possessions should she be declared bankrupt. (10)
- (ii) Explain how a Junior ISA in Lucy's name would have protected the funds nominally set aside for her, in the event of Helen's bankruptcy. (5)
- (d) Compare the tax treatment, for Emma, of the SAYE share scheme with the Share Incentive Plan. (10)

Total marks available for this question: 40

QUESTIONS CONTINUE OVER THE PAGE

Question 3

Read carefully all information provided in the case study before attempting the questions. Your answers should take into account the clients circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c), (d) and (e) which follow.

Richard died almost 10 years ago, having made no lifetime gifts and was survived by his wife Lydia, three adult children and four grandchildren. Richard's Will created a discretionary trust. His letter of wishes informed the trustees that the primary purpose of the trust was to support his wife as tax efficiently as possible and then, on her death, to benefit all his children and grandchildren. They were also to consider requests for capital from his children in order to purchase property. The trustees appointed were his wife Lydia and his accountant Tom.

The investments currently held within the trust comprise a portfolio of shares, money held on deposit and an onshore life assurance bond. The bond is currently valued at £150,000 and was effected 11 years ago by Richard as the policy holder, with one of his children as a joint life assured, to ensure continuity of investment following his death. Over the term of the bond, the trustees have already withdrawn £70,000. Lydia is currently considering encashing the bond in order to assist her children buy their own properties. In addition to any bond withdrawals, deposit interest of £1,500 and dividend payments of £1,200 are expected to be received in the tax year 2016/2017.

Tom has recently died, leaving Lydia as the sole surviving trustee. Prior to Tom's death, he had been the lead trustee when dealing with HM Revenue & Customs.

Lydia is now trying to understand more of the tax and financial planning issues connected with the trust, particularly as the trust is approaching its tenth anniversary. It was set up on Richard's death in October 2006 with an initial value of £500,000 after the Inheritance Tax had been paid on his estate, when the nil rate band for Inheritance Tax was £285,000. The valuation at the tenth anniversary of the trust is expected to be the same as the current valuation of £625,000.

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**:
- (i) the periodic charge to Inheritance Tax (IHT) at the tenth anniversary of the discretionary Will trust; (3)
 - (ii) the effective rate of IHT applicable to the trust. (2)
 - (iii) the charge to IHT that would result if a withdrawal of £100,000 was made from the trust in November 2019. (3)
- (b) Lydia is considering distributing money from the trust by using the onshore life assurance bond:
- (i) explain the tax treatment if the onshore life assurance bond is fully encashed by Lydia as the sole remaining trustee; (8)
 - (ii) explain how the tax treatment would differ if the onshore life assurance bond is assigned equally to the grandchildren and then surrendered. (4)
- (c) Calculate, **showing all your workings**, the amount of Income Tax payable by the trustees in the tax year 2016/2017 in respect of:
- (i) interest received; (5)
 - (ii) dividend payments. (3)
- (d) Explain briefly the most Inheritance Tax efficient method of providing immediate funds of £50,000 to Lydia from the trust. (4)
- (e) (i) Explain briefly how the trust would be administered following Lydia's death. (2)
- (ii) Explain briefly the trustee responsibilities to HM Revenue & Customs in managing any Income and Capital Gains tax liabilities. (6)

Total marks available for this question: 40

The tax tables can be found on pages 13 – 19

INCOME TAX

RATES OF TAX	2015/2016	2016/2017
Starting rate for savings*	0%	0%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	45%	45%
Starting-rate limit	£5,000*	£5,000*
Threshold of taxable income above which higher rate applies	£31,785	£32,000
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) §	£10,600	£11,000
Personal Allowance (if born between 6 April 1938 and 5 April 1948) §	£10,600	£11,000
Personal Allowance (if born before 6 April 1938) §	£10,660	£11,000
Married/civil partners (minimum) at 10% †	£3,220	£3,220
Married/civil partners at 10% †	£8,355	£8,355
Transferable tax allowance for married couples/civil partners	£1,060	£1,100
Income limit for age-related allowances §	£27,700	£27,700
Blind Person's Allowance	£2,290	£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)	£2,780	£2,780
- family element	£545	£545
Threshold for tapered withdrawal of CTC	£16,105	£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 Earnings Limit (UEL)	£827	£3,583	£43,000

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS
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Up to 155.00*	Nil
155.01 – 827.00	12%
Above 827.00	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
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Below 156.00**	Nil
156.01 – 827.00	13.8%
Excess over 827.00	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 - £43,000. 2% on profits above £43,000.

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 §
2016/2017	£1,000,000	£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

2015/2016	2016/2017
£10,000*	£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	2015/2016	2016/2017
Individuals, estates etc	£11,100	£11,100
Trusts generally	£5,550	£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%	10%
Above basic rate limit	28%	20%
Surcharge for residential property and carried interest	0%	8%
Trustees and Personal Representatives	28%	20%
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

	2015/2016	2016/2017
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%

A lower rate of 36% applies where at least 10% of deceased's net estate is left to a registered 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 2016/2017:

- The percentage charge is 7% 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 11%.
- For cars with CO₂ emissions of 76g/km to 94g/km the percentage is 15%.
- Cars with CO₂ emissions of 95g/km have a percentage charge of 16% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 37% (emissions of 200g/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 (£22,200 for 2016/2017) e.g. car emission 100g/km = 17% on car benefit scale. 17% of £22,200 = £3,774.

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

	2015/2016 Rates	2016/2017 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

	2015/2016	2016/2017
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£500,000	£200,000
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 2016 (Corporation Tax) or 06 April 2016 (Income Tax)		
CO ₂ emissions of g/km:	75 or less*	76-130
		131 or more
Capital allowance:	100%	18%
	first year	reducing balance
		reducing balance

*If new

CORPORATION TAX

	2015/2016	2016/2017
Standard rate	20%	20%
Small companies rate	20%	N/A
Small companies limit	£300,000	N/A
Effective marginal rate	20%	N/A
Upper marginal limit	£1,500,000	N/A

VALUE ADDED TAX

	2015/2016	2016/2017
Standard rate	20%	20%
Annual registration threshold	£82,000	£83,000
Deregistration threshold	£80,000	£81,000

MAIN SOCIAL SECURITY BENEFITS

		2015/2016	2016/2017
		£	£
Child Benefit	First child	20.70	20.70
	Subsequent children	13.70	13.70
	Guardian's allowance	16.55	16.55
Employment and Support Allowance	Assessment Phase		
	Age 16 – 24	Up to 57.90	Up to 57.90
	Aged 25 or over	Up to 73.10	Up to 73.10
	Main Phase		
	Work Related Activity Group	Up to 102.15	Up to 102.15
	Support Group	Up to 109.30	Up to 109.30
Attendance Allowance	Lower rate	55.10	55.10
	Higher rate	82.30	82.30
Retirement Pension	Single	115.95	119.30
	Married	185.45	190.80
Single Tier State Pension	Single	N/A	£155.65
Pension Credit	Single person standard minimum guarantee	151.20	155.60
	Married couple standard minimum guarantee	230.85	237.55
	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		112.55	112.55
Jobseekers Allowance	Age 18 - 24	57.90	57.90
	Age 25 or over	73.10	73.10
Statutory Maternity, Paternity and Adoption Pay		139.58	139.58

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