THE CHARTERED INSURANCE INSTITUTE

J05

Diploma in Financial Planning

Unit J05 – Pension income options

October 2017 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2017/2018, unless stated otherwise in the question, and should be answered accordingly.

It should be assumed that all individuals are domiciled and resident in the UK unless otherwise stated.

Instructions

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

Unit J05 – Pension income options

Instructions to candidates

Read the instructions below before answering any questions

- **Two hours** are allowed for this paper which consists of 15 short answer questions and carries a total of 130 marks.

- You are strongly advised to attempt **all** questions to gain maximum possible marks. The number of marks allocated to each question part is given next to the question and you should spend your time in accordance with that allocation.

- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.

- You may find it helpful in some places to make rough notes in the answer booklet. If you do this, you should cross through these notes before you hand in the booklet.

- It is important to show all steps in a calculation, even if you have used a calculator.

- If you bring a calculator into the examination room, it must be a silent, battery or solar-powered, non-programmable calculator. The use of electronic equipment capable of being programmed to hold alphabetic or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements.

- Tax tables are provided at the back of this question paper.

- Answer each question on a new page and leave six lines blank after each question part.

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

Attempt ALL questions

Time: 2 hours

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

1. John, aged 57, is about to retire. He is entitled to a scheme pension of £60,000 per annum, plus a pension commencement lump sum (PCLS) of £180,000 from his employer's defined benefit pension scheme.

John has been offered a cash equivalent transfer value (CETV) of £1,600,000. He has not registered for any form of transitional protection.

Assuming any excess is taken as income, calculate, **showing all your workings,** the lifetime allowance charge that may apply, if John:

(a) takes his benefits directly from the defined benefit pension scheme; **(5)**

(b) transfers his CETV into a personal pension plan and takes the maximum PCLS, designating the balance into flexi-access drawdown. **(2)**

2. Peter retired and took benefits from his employer's defined benefit pension scheme five years ago at the scheme's normal pension age of 65. He had been a member of the scheme for 25 years. Peter is married and has no children.

Peter's former employer has suffered serious financial difficulties and the pension scheme has now entered the Pension Protection Fund (PPF).

Explain the compensation that Peter will receive as a result of the scheme entering the PPF. **(6)**

3. State the **seven** circumstances when an individual's lifetime allowance could be greater than the standard lifetime allowance in a given tax year. **(7)**

4. Zaila, aged 60, has an uncrystallised personal pension plan valued at £600,000 and a capped drawdown arrangement valued at £150,000. The maximum permitted income is currently £11,700 per annum.

Zaila wishes to crystallise £100,000, so that she can take a pension commencement lump sum of £25,000, with the balance of £75,000 being designated into her existing capped drawdown arrangement.

Calculate, **showing all your workings**, the revised maximum income that can be paid to Zaila from her capped drawdown fund. *Assume the GAD basis amount is £43 per £1,000.* **(5)**

5. Ian, aged 61, is married to Sarah, aged 57. Ian has recently retired and Sarah has reduced her working hours with a view to retiring fully at age 66. As a result of the reduction in working hours, Sarah's salary is now £40,000 per annum.

Ian is in receipt of a scheme pension, which is currently £28,000 per annum. He also has an uncrystallised personal pension plan (PPP) with a current value of £220,000. Sarah is an active member of her employer's group personal pension (GPP) scheme which has a current value of £45,000. Ian and Sarah would like to withdraw an additional £15,000 per annum from their pension assets to top up their income.

(a) Outline **five** benefits of taking the withdrawals using phased flexi-access drawdown. **(5)**

(b) Explain why they should take the withdrawals from Ian's PPP rather than Sarah's GPP. **(5)**

6. Angela is aged 60. Her only income for 2017/2018 is her salary of £33,000. She has an uncrystallised personal pension fund of £315,000. Angela wishes to take an uncrystallised funds pension lump sum (UFPLS) which will provide her with a net payment of £25,000 after all taxes have been settled.

Calculate, **showing all your workings**, the amount of fund which must be crystallised to provide the net amount of £25,000 as an UFPLS. *You should assume that the scheme administrator has Angela's tax code and therefore Month 1 does not apply.* **(12)**

QUESTIONS CONTINUE OVER THE PAGE

7. Harry, aged 61, will retire when he reaches his State Pension age of 66. His only pension is a personal pension plan currently valued at £320,000. This is wholly invested in a fund that adopts a lifestyling approach with a selected pension age of 65.

He has calculated that in addition to his State Pension, he will require an extra guaranteed income of £8,000 per annum to cover his committed outgoings in retirement. In order to provide this income, he plans to crystallise £210,000 of his fund to purchase a lifetime annuity.

Any amount remaining after the annuity purchase will be left uncrystallised. Harry plans to flexibly access this part of the fund in later retirement.

(a) Outline **three** benefits and **three** drawbacks of the lifestyling approach in relation to Harry purchasing a lifetime annuity. **(6)**

(b) Explain why the lifestyling approach may not be suitable for the part of the fund he intends to flexibly access. **(4)**

8. Bernard, aged 73, has an uncrystallised personal pension plan (PPP). He is also in receipt of a scheme pension of £2,000 per annum from a defined benefit pension scheme, which commenced when Bernard reached age 65. The scheme pension does not include any pension protection lump sum death benefits and the scheme does not provide any defined benefit lump sum death benefits.

Bernard is a widower with no dependants and has completed nomination forms showing that his sister, Irene, should receive the death benefits from his pensions.

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

(a) scheme pension; **(5)**

(b) uncrystallised PPP. **(9)**

9. Karen will reach her State Pension age (SPA) in November 2017. She is employed on a salary of £56,000 per annum and plans to retire in 2021 when she will receive an index linked scheme pension of £32,000 per annum.

Karen's current income is more than sufficient for her needs. When she retires, her scheme pension, plus the income from her State Pension, will be her only taxable income.

Explain the **benefits** to Karen of deferring receipt of her State Pension and outline the rates of increase that would be applied in deferment. **(7)**

10. **(a)** Explain the conditions that must be satisfied in order that a member's pension benefits can be commuted for a serious ill-health lump sum. **(6)**

(b) Outline the tax treatment of a serious ill-health lump sum. **(4)**

11. Outline the factors that should be taken into account when carrying out an annual review of a client's phased capped drawdown plan. **(10)**

12. 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's (FCA) Conduct of Business Sourcebook (COBS).

State **ten** of these risk factors. **(10)**

13. State **eight** factors that influence lifetime annuity rates. *You should consider both general and client specific factors in your answer.* **(8)**

QUESTIONS CONTINUE OVER THE PAGE

14. Gareth, aged 64, is looking to reduce his working hours and semi-retire. He is going to crystallise his personal pension plan and take an income via a flexi-access drawdown pension to bridge his income shortfall until he fully retires. Gareth plans on working part-time until he is 75 at which point he anticipates purchasing a lifetime annuity to replace his earnings.

In relation to this course of action:

(a) outline what is meant by the term 'mortality drag'; **(3)**

(b) outline the effects of mortality drag, assuming Gareth does choose the flexi-access drawdown pension option. **(3)**

15. Rebecca, aged 60, has a personal pension plan valued at £800,000. She is about to retire and, as she does not have an immediate need for a capital lump sum, her adviser has recommended that she uses the entire fund to purchase a non-increasing lifetime annuity on a single life basis.

However, Rebecca is considering taking the pension commencement lump sum (PCLS) and using this to purchase a rental property to provide part of her income.

Outline **four** benefits and **four** drawbacks of using the PCLS to purchase a rental property compared to using the entire fund to purchase a lifetime annuity. **(8)**

The tax tables can be found on pages 10 – 18

INCOME TAX

RATES OF TAX	2016/2017	2017/2018
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	£32,000	£33,500
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

**not applicable if taxable non-savings income exceeds the starting rate band.*

Dividend Allowance		£5,000
Dividend tax rates		
Basic rate		7.5%
Higher rate		32.5%
Additional rate		38.1%
Trusts		
Standard rate band		£1,000
Rate applicable to trusts		
- dividends		38.1%
- other income		45%

MAIN PERSONAL ALLOWANCES AND RELIEFS

	2016/2017	2017/2018
Income limit for Personal Allowance *§*	£100,000	£100,000
Personal Allowance (basic)	£11,000	£11,500
Married/civil partners (minimum) at 10% †	£3,220	£3,260
Married/civil partners at 10% †	£8,355	£8,445
Transferable tax allowance for married couples/civil partners	£1,100	£1,150
Income limit for age-related allowances†	£27,700	£28,000
Rent a Room relief	£4,250	£7,500
Blind Person's Allowance	£2,290	£2,320
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.

	2016/2017	2017/2018
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
Lower Earnings Limit (LEL)	£113
Primary threshold	£157
Upper Earnings Limit (UEL)	£866

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS
Up to 157.00*	Nil
157.01 – 866.00	12%
Above 866.00	2%

**This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £113 per week. This £113 to £157 band is a zero-rate band introduced in order to protect lower earners' rights to contributory State benefits e.g. the new State Pension.*

Total earnings £ per week	CLASS 1 EMPLOYER CONTRIBUTIONS
Below 157.00**	Nil
157.01 – 866.00	13.8%
Excess over 866.00	13.8%

*** Secondary earnings threshold.*

Class 2 (self-employed)	Flat rate per week £2.85 where profits exceed £6,025 per annum.
Class 3 (voluntary)	Flat rate per week £14.25.
Class 4 (self-employed)	9% on profits between £8,164 - £45,000. 2% on profits above £45,000.

PENSIONS

TAX YEAR	LIFETIME ALLOWANCE
2006/2007	£1,500,000
2007/2008	£1,600,000
2008/2009	£1,650,000
2009/2010	£1,750,000
2010/2011	£1,800,000
2011/2012	£1,800,000
2012/2013	£1,500,000
2013/2014	£1,500,000
2014/2015	£1,250,000
2015/2016	£1,250,000
2016/2017	£1,000,000
2017/2018	£1,000,000

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.

ANNUAL ALLOWANCE

TAX YEAR	ANNUAL ALLOWANCE
2011/2012	£50,000
2012/2013	£50,000
2013/2014	£50,000
2014/2015	£40,000
2015/2016	£40,000~
2016/2017	£40,000*
2017/2018	£40,000*

~ increased to £80,000 for pension input between April - 8 July 2015. If not used, can be carried forward to pension input period of 9 July 2015 - 6 April 2016, subject to a maximum of £40,000.

**tapered at a rate of £1 for every £2 of adjusted income in excess of £150,000 where threshold income exceeds £110,000.*

MONEY PURCHASE ANNUAL ALLOWANCE	2016/2017	2017/2018
	£10,000	£10,000

ANNUAL ALLOWANCE CHARGE

20% - 45% determined by the member's taxable income and the amount of total pension input in excess of the annual allowance or money purchase annual allowance.

CAPITAL GAINS TAX

EXEMPTIONS	2016/2017	2017/2018
Individuals, estates etc	£11,100	£11,300
Trusts generally	£5,550	£5,650
Chattels proceeds (restricted to five thirds of proceeds exceeding limit)	£6,000	£6,000

TAX RATES		
Individuals:		
Up to basic rate limit	10%	10%
Above basic rate limit	20%	20%
Surcharge for residential property and carried interest	8%	8%
Trustees and Personal Representatives	20%	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	2016/2017	2017/2018
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
- main residence nil rate band*	£100,000	£100,000
- UK-registered charities	No limit	No limit

**Available for estates up to £2,000,000 and then tapered at the rate of £1 for every £2 in excess until fully extinguished*

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/bride and/or groom	£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%

Quick succession relief:

- Years since IHT paid	0-1	1-2	2-3	3-4	4-5
- Inheritance Tax relief	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 2017/2018:

- The percentage charge is 9% 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 13%.
- For cars with CO_2 emissions of 76g/km to 94g/km the percentage is 17%.
- Cars with CO_2 emissions of 95g/km have a percentage charge of 18% 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 CO_2 emissions % relevant to the car and that % applied to a set figure (£22,600 for 2017/2018) e.g. car emission 100g/km = 17% on car benefit scale. 17% of £22,600 = £3,842.

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

	2016/2017 Rates	2017/2018 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

	2016/2017	2017/2018
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£200,000	£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% first year	18% reducing balance	8% reducing balance

**If new*

MAIN SOCIAL SECURITY BENEFITS

		2016/2017	2017/2018
		£	£
Child Benefit	First child	20.70	20.70
	Subsequent children	13.70	13.70
	Guardian's allowance	16.55	16.70
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 109.65
Attendance Allowance	Lower rate	55.10	55.65
	Higher rate	82.30	83.10
basic State Pension	Single	119.30	122.30
	Married	190.80	195.60
new State Pension	Single	155.65	159.55
Pension Credit	Single person standard minimum guarantee	155.60	159.35
	Married couple standard minimum guarantee	237.55	243.25
	Maximum savings ignored in calculating income	10,000.00	10,000.00
Bereavement Payment Support Payment*		2,000.00	2,000.00
Higher rate - lump sum		N/A	3,500.00
Higher rate - monthly payment		N/A	350.00
Standard rate – lump sum		N/A	2,500.00
Standard rate – monthly payment		N/A	100.00
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	140.98

*Only applicable where spouse or civil partner died on or after 6 April 2007**

CORPORATION TAX

	2016/2017	2017/2018
Standard rate	20%	19%

VALUE ADDED TAX

	2016/2017	2017/2018
Standard rate	20%	20%
Annual registration threshold	£83,000	£85,000
Deregistration threshold	£81,000	£83,000

STAMP DUTY LAND TAX

	Residential
Value up to £125,000	0%
£125,001 - £250,000	2%
£250,001 and £925,000	5%
£925,001 and £1,500,000	10%
£1,500,001 and over	12%

Stamp Duty Land Tax (SDLT) is payable in England, Wales and Northern Ireland only. Land and Buildings Transaction Tax (LBTT) is payable in Scotland at different rates to the above.

Additional SDLT of 3% may apply to the purchase of additional residential properties purchased for £40,000 or greater.

SDLT is charged at 15% on interests in residential dwellings costing more than £500,000 purchased by certain corporate bodies or non-natural persons.

	Non residential
Value up to £150,000	0%
£150,001 and £250,000	2%
£250,001 and over	5%