THE CHARTERED INSURANCE INSTITUTE

CII

AF1

Advanced Diploma in Financial Planning

Unit AF1 – Personal tax and trust planning

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

- 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.

Penny, aged 54, and Ian, aged 56, married in 2014. It is the second marriage for each of them and in both cases their first marriages ended in divorce. Penny has a son, Ben, aged 26, from her first marriage. Ian has a daughter, Emma, aged 27, from his first marriage. Emma had been running her own business but this business has now failed. She is living with her father and Penny, and is concerned she may be declared bankrupt.

Penny is the Managing Director of a successful online shopping website. In 2017/2018, she will receive a salary of £110,000 per annum. As part of her remuneration package, the company provide membership, for both Penny and Ian, of the company's private medical insurance plan. The taxable value of this benefit in 2017/2018 is £2,000. In addition, the company pay £40,000 per annum into Penny's self-invested personal pension plan (SIPP). This is the only contribution that is made into the plan and Penny has no unused annual allowance available to carry forward. The contribution for the tax year 2017/2018 was paid on 1 May 2017.

Ian has worked as a journalist and broadcaster since he left university. He is currently writing his first book and will have no earned income for the tax year 2017/2018. The couple can afford to live comfortably on Penny's earnings plus their investment income. The investment income they will receive in 2017/2018 is as follows:

Owner	Investment	Amount (£)	Income (£)
Joint	30-day notice deposit account	125,000	1,250
Joint	Portfolio of equity unit trusts	330,000	9,240
Joint	Portfolio of corporate bond unit trusts	48,000	1,200
Penny	Stocks and Shares ISA	135,000	4,415
Ian	Stocks and Shares ISA	87,000	1,566

In May 2016, Penny and Ian started making a monthly payment of £250 via direct debit to a UK registered charity. The payment is made from their joint current account. The couple have signed the appropriate forms to allow the payment to benefit from gift aid.

Penny's SIPP is currently valued at £890,000 and Ian's personal pension plan (PPP) is valued at £675,000. These are their only pension plans. Both have completed nomination forms in favour of the other in the event of their death.

Ian's mother, Rosemary, is aged 85. She has pension income of £70,000 per annum which more than meets her income needs plus other investments and assets totalling £2,750,000. She is in good physical health and is mentally competent.

In May 2016, Rosemary invested £60,000 into shares in an Enterprise Investment Scheme (EIS). She claimed £18,000 tax relief against her Income Tax liability for the tax year 2016/2017. The shares are performing poorly and are currently valued at £35,000.

Ian is the executor of Rosemary's Will. Ian and Emma are the attorneys jointly appointed under Rosemary's Health and Welfare and Property and Financial Affairs, Lasting Powers of Attorney (LPA). Both LPAs have been registered. Rosemary's Will currently divides her estate equally between Ian and Emma. Rosemary has become very fond of Penny and her son Ben and would like to make provision for them in her Will.

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 amount of Income Tax Penny will pay in the tax year 2017/2018. **(14)**

(b) Penny has been informed that, as her Threshold Income exceeds £110,000 and her Adjusted Income exceeds £150,000, her annual allowance for 2017/2018 will be tapered. *In answering parts (b)(i) and (b)(ii) you should assume no changes are made to the circumstances outlined in the case study.*

(i) Calculate, **showing all your workings**, Penny's Adjusted Income for the tax year 2017/2018. **(4)**

(ii) Using your answer from part (**b**)(**i**) above, calculate, **showing all your workings**, the annual allowance tax charge due as a result of Penny's tapered annual allowance. **(3)**

(c) Penny and Ian would like to reduce the amount of Income Tax and Annual Allowance Tax Charge payable in the tax year 2017/2018.

(i) Explain in detail how changing the ownership of the investments into Ian's sole name will accomplish these objectives. **(6)**

(ii) Explain why the charity donations should be made in Penny's sole name. **(4)**

QUESTIONS CONTINUE OVER THE PAGE

(d) Penny and Ian wish to ensure that, on first death, the deceased's pension fund is available to the survivor to provide an income for their lifetime. They then wish the remaining funds to pass to their respective children on second death.

(i) Explain why you would recommend they set up spousal bypass trusts to receive the pension fund on first death, rather than rely on a nomination form to direct the death benefits. **(8)**

(ii) Describe the tax treatment of the pension funds at the point they are paid into a spousal bypass trust, at whatever age the member may die. **(4)**

(e) Rosemary is considering selling her shares in the Enterprise Investment Scheme (EIS).

(i) Calculate, **showing all your workings**, the allowable loss available if Rosemary were to sell the shares in October 2017. **(4)**

(ii) Outline the factors that you would take into consideration before advising Rosemary on whether she should sell or retain her shares in the EIS. *You should cover both tax related and general planning factors in your answer.* **(8)**

(f) Emma has informed Ian and Rosemary that she may be declared bankrupt.

(i) Explain how her bankruptcy could affect, if at all, the Lasting Powers of Attorney Rosemary has already registered. **(5)**

(ii) Describe how any inheritance specified in Rosemary's Will as being for Emma's benefit may be treated by the Trustee in Bankruptcy. **(8)**

(g) Rosemary would like to make provision for Penny and Ben in her Will and also prevent any legacy to Emma being accessible by the Trustee in Bankruptcy, should Emma be declared bankrupt.

(i) Describe briefly the actions Rosemary should take to ensure her estate will be distributed as she wishes. **(6)**

(ii) Explain the options available to Ian to ensure Rosemary's wishes are met with regard to her intention to make provision for Penny and Ben, in the event that Rosemary dies before she can change her Will. **(6)**

Total marks 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.

Cara, aged 45, is single. She is UK domiciled and started working for YTP plc in January 2012. In 2013, she transferred to the company's Singapore office.

At the start of April 2017, Cara left her employment with YTP plc. At the start of May 2017, she gave up the lease on her home in Singapore and then spent some time travelling around the world. She returned to the UK to live in London on 30 September 2017. She has now accepted a position based in London with a new employer and her start date is 1 January 2018 at an annual salary of £120,000. Cara will be paid monthly in arrears on the 25^{th} of each month. Her employment income will be the only taxable income she receives in the tax year 2017/2018.

Following the death of her Uncle in 2014, Cara inherited a house situated in the north of England, the probate value of which was £450,000. The property had stood empty since her Uncle's death. Cara has recently exchanged contracts at an agreed sale price of £520,000 and will incur costs of £6,500 on the sale. The sale will complete before the end of October 2017.

In recent years Cara has purchased the following shares in YTP plc:

Date of purchase	Purchase price (£)	Number of shares
October 2014	4.90	14,000
June 2015	3.33	10,000
October 2016	3.57	11,000

These shares are currently trading at £2.79 per share.

Cara's only other investment was made in October 2012 when she purchased 5,000 shares, at a cost of £1 per share in XQZ Ltd, a start-up company listed on AIM. These shares are currently valued at £3.30 per share.

Cara intends to dispose of 10,000 of the shares in YTP plc and all 5,000 of the shares in XQZ Ltd in 2017/2018. She will use the funds realised, along with the funds from the sale of the property and a mortgage, to purchase two adjoining cottages, each costing £350,000. One cottage will be her primary residence in the UK and the other will be let. She will complete on the purchases before the end of November 2017.

Questions

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

(a) Explain why Cara will be treated as UK resident in 2017/2018. **(5)**

(b) Calculate, **showing all your workings**, Cara's Capital Gains Tax liability for the tax year 2017/2018. *You should assume that Cara arranges her affairs to limit, as much as possible, the Capital Gains Tax payable.* **(12)**

(c) Explain how the amount of Stamp Duty Land Tax payable by Cara in respect of the purchase of the two cottages will be determined. *You are not required to perform a calculation.* **(5)**

(d) Cara is intending to let the second cottage.

(i) State the requirements that must be met for the rental property to be considered a furnished holiday let. **(8)**

(ii) Explain in detail the potential benefits to Cara of letting the property as a furnished holiday let. **(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) and (d) which follow.

John, aged 75, has been divorced for over 15 years. He has a son, aged 45, and four grandchildren, the oldest of whom is 15. John is in excellent health for his age.

Over the years, John has made the following gifts:

- 1 February 2010: £200,000 into a discretionary trust for the benefit of his brother.
- 10 May 2013: £250,000 gift to his son.

John has made no other gifts.

John now wishes to set up a discretionary trust for the benefit of his grandchildren. His intention is that the trust will cover living expenses for his grandchildren who attend university and also help them purchase their first property. He will establish this trust on 1 November 2017 with a gift of equity based open-ended investment company (OEICs) from his investment portfolio valued at £350,000. The chargeable gain on disposal will be £110,000.

In 2012, John took out an index-linked whole of life policy with a sum assured sufficient to cover the Inheritance Tax liability payable by the executors of his estate on his death. The policy was placed in trust for benefit of the executors. The policy has never been reviewed.

Questions

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

(a) John will establish the discretionary trust for his grandchildren on 1 November 2017.

Calculate, **showing all your workings**, the Inheritance Tax payable on establishing this trust if the trustees pay the tax. **(5)**

(b) John will establish the discretionary trust with a gift of equity based OEICs from his existing portfolio.

(i) Explain the potential tax benefits, for both **trustees** and **beneficiaries**, if payments from the trust are made using the OEICs. **(7)**

(ii) Explain how the tax pool will operate within the discretionary trust. **(9)**

(c) Calculate, **showing all your workings**, the Inheritance Tax liabilities arising in respect of the various gifts John has made if he were to die in March 2018. *You should assume the discretionary trust from part (a) above is established on 1 November 2017.* **(10)**

(d) Explain to John why the sum assured on his whole of life policy may be **higher** than required to cover the Inheritance Tax liability that will arise in respect of **his estate** on his death. **(9)**

Total marks for this question: 40

The tax tables can be found on pages 13 – 21

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		
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.

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%

BLANK PAGE