

## AF7

# Advanced Diploma in Financial Planning

## Unit AF7 – Pension transfers

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 AF7 – Pension transfers

### Instructions to candidates

### Read the instructions below before answering any questions

**Two hours** are allowed for this paper which carries a total of 100 marks as follows:

Section A: 38 marks

Section B: 62 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.
- Additional information relevant to pension planning is also included 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

The following questions are compulsory and carry a total of 38 marks

1. A financial adviser has recommended that a defined benefit pension transfer does not proceed. However, the client wants to transfer to their personal pension plan against the advice received.
- (a) State the pension transfer suitability report requirements in relation to pension transfers that are contained in the Financial Conduct Authority's (FCA) Conduct of Business Rules (COBS). (4)
- (b) Outline the **three** key steps that the FCA expects a firm to take when advising an 'insistent client'. (3)
2. Jennifer's defined benefit pension scheme has provided her with a cash equivalent transfer value (CETV) of £565,000. She has received a transfer value analysis system (TVAS) report in relation to her deferred benefits. The critical yield is 9.5% based on her selected pension age of 63.
- (a) Describe to Jennifer how a CETV is calculated. (9)
- (b) Explain briefly how the assumptions used to calculate the critical yield in a TVAS differ from those used to calculate a CETV. (3)
3. An underfunded defined benefit pension scheme continues to offer unreduced cash equivalent transfer values to deferred members because of a strong employer covenant.
- Explain what is meant by the term employer covenant and its relevance to the scheme's ability to pay unreduced cash equivalent transfer values. (7)
4. Jonathan, aged 65, has been a member of his employer's Executive Pension Plan (EPP) since 1979 and is considering accessing his pension benefits flexibly. His current fund value is £675,000 and has a guaranteed annuity rate.
- (a) State the additional information that you would require in respect of the EPP before advising Jonathan in relation to drawing his pension benefits. (7)
- (b) State, giving your reasons, the steps that Jonathan must take before he would be able to transfer his fund into a suitable pension plan to allow him to access his pension benefits flexibly. (5)

Total marks available for this question: 38

**Section B questions can be found on pages 6 – 9**

## SECTION B

All questions in this section are compulsory and carry an overall total of 62 marks

## Case study 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.

Lizzie, aged 46, lives with her partner Jo, aged 43. Lizzie is divorced and has two children, aged 15 and 12, from her previous marriage. She wants all of her assets to pass to her children following her death as Jo is independently wealthy.

Lizzie is currently a self-employed accountant. She previously worked in a large firm and has the following deferred defined benefit pension:

Date of joining scheme	1 September 1992
Date of leaving scheme	30 June 2014
Total pension at date of leaving	£32,000 per annum
Spouse's pension	50% of member's pension
Children's pension	25% per child, payable to age 23
Revaluation and escalation	Statutory minimum
Normal pension age	65
Early retirement Available	From age 60 with an actuarial reduction of 4% per annum
Cash equivalent transfer value (CETV)	£925,000
Critical yield	8.5% per annum

Lizzie plans to grow her business for the next ten years and would then like to gradually reduce her working hours until retiring fully no later than age 60.

Lizzie has a low to medium attitude to risk and limited investment experience.

**Questions**

5. List the additional information you would require from Lizzie before advising on the suitability of transferring her defined benefit pension scheme. (8)
6. Based on the information provided in the case study, explain the factors that an adviser should consider before making a recommendation on the potential transfer of Lizzie's defined benefit pension scheme. (8)
7. Explain the limitations of the critical yield produced by the transfer value analysis system (TVAS) report assuming the fund value under a SIPP is likely to exceed the lifetime allowance. (6)
8. Assuming Lizzie transferred to a self-invested personal pension (SIPP) and nominated her children to receive any death benefits:
- (a) Outline the options available to the children, in the event of Lizzie's death before age 75. (5)
- (b) Explain why the completion of a nomination form does not guarantee the children will receive the death benefits. (4)

**Total marks available for this question: 31**

**QUESTIONS CONTINUE OVER THE PAGE**

**Case study 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.**

Billy, aged 61, is married to Candice, aged 42. They have two children, aged 8 and 6.

Billy has worked as a civil engineer at the same company since leaving university and has now decided to retire. Recently, his health has deteriorated and he is concerned about his life expectancy.

He has been a member of his employers defined benefit pension scheme and has been offered the following retirement options:

Full immediate pension	£49,750
<b>or</b>	
Pension Commencement Lump Sum	£147,250
Plus reduced pension of	£37,480
Spouse's pension	50% of pre-commutation pension
Children's pension	None
Increases to pension in payment	Statutory minimum
Cash equivalent transfer value (CETV)	£1,492,500

Having reviewed their income and expenditure requirements, Billy and Candice believe they need an ongoing income of £35,000 per annum. They have some capital spending requirements but these are covered by the pension commencement lump sum leaving a liquid emergency fund of £25,000.

Billy wants to ensure that Candice and the children are financially secure following his death.

Both Billy and Candice have a medium attitude to risk and some prior investment experience.

**Questions**

- 9.** List **six** benefits and **six** drawbacks of Billy transferring his defined benefit pension scheme to a personal pension plan to access benefits flexibly. **(12)**
- 10.** If Billy were to crystallise all of his pension benefits using flexi-access drawdown, he would exceed the lifetime allowance and be liable to tax charges.
- Explain to Billy why he is unable to apply for any currently available transitional protections to reduce these tax charges. **(7)**
- 11.** Explain what is meant by 'safe withdrawal rate' in relation to pension drawdown and the method of calculation. **(6)**
- 12.** As part of the advisory process, a lifetime cashflow model has been put in place for Billy and Candice.
- State **six** stress tests that could be undertaken as part of an annual review of the cashflow plan. **(6)**
- Total marks available for this question: 31**

**The tax tables can be found on pages 11 – 19**

## 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
<i>*not applicable if taxable non-savings income exceeds the starting rate band.</i>		
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%
<b>MAIN PERSONAL ALLOWANCES AND RELIEFS</b>		
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%
<i>§ the Personal Allowance reduces by £1 for every £2 of income above the income limit irrespective of age (under the income threshold).</i>		
<i>† where at least one spouse/civil partner was born before 6 April 1935.</i>		
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
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## 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.*

<b>Class 2 (self-employed)</b>	Flat rate per week £2.85 where profits exceed £6,025 per annum.
<b>Class 3 (voluntary)</b>	Flat rate per week £14.25.
<b>Class 4 (self-employed)</b>	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
<b>TAX RATES</b>		
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<sub>2</sub>) 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<sub>2</sub> emissions of 50g/km or less.
- For cars with CO<sub>2</sub> emissions of 51g/km to 75g/km the percentage is 13%.
- For cars with CO<sub>2</sub> emissions of 76g/km to 94g/km the percentage is 17%.
- Cars with CO<sub>2</sub> 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<sub>2</sub> 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
<b>Cars</b>		
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
<b>Motor Cycles</b>	24p per mile	24p per mile
<b>Bicycles</b>	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%
<b>Motor cars:</b> Expenditure on or after 01 April 2016 (Corporation Tax) or 06 April 2016 (Income Tax)				
CO <sub>2</sub> emissions of g/km:	75 or less*	76-130	131 or more	
Capital allowance:	100%	18%	8%	
	first year	reducing balance	reducing balance	

*\*If new*

## 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
<i>Only applicable where spouse or civil partner died on or after 6 April 2007*</i>			

**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%

The additional information for the pension papers can be found on pages 21 – 22

## Additional Information Pension Papers – AF7 2017/2018

### Revaluation

#### Guaranteed Minimum Pension – Fixed rate

Date of leaving service	Fixed rate of revaluation
Before 6 April 1988	8.5%
Between 6 April 1988 and 5 April 1993	7.5%
Between 6 April 1993 and 5 April 1997	7.0%
Between 6 April 1997 and 5 April 2002	6.25%
Between 6 April 2002 and 5 April 2007	4.5%
Between 6 April 2007 and 5 April 2012	4.0%
Between 6 April 2012 and 5 April 2017	4.75%
After 5 April 2017	3.5%

#### Non GMP benefits – statutory minimum rates

Date of leaving service	Statutory rate of revaluation
Before 1 January 1986	No requirement to revalue benefits
Between 1 January 1986 and 31 December 1990	CPI capped at 5% in respect of non GMP benefits accrued from 1 January 1985
Between 1 January 1991 and 5 April 2009	CPI capped at 5% in respect of all non GMP benefits
After 5 April 2009	CPI capped at 5% in respect of all non GMP benefits accrued before 6 April 2009 CPI capped at 2.5% in respect of all benefits accrued after 5 April 2009

NOTE: Statutory revaluation is based on RPI for revaluation prior to 2011

### Escalation

#### Statutory rates of escalation: Member reached State Pension age before 6 April 2016

Accrual	Statutory rate of escalation
GMP: Accrual prior to 6 April 1988	<b>Scheme:</b> No requirement to provide any increases in payment <b>State:</b> Fully in line with CPI
GMP: Accrual between 6 April 1988 and 5 April 1997	<b>Scheme:</b> CPI capped at 3% <b>State:</b> Any increases in CPI in excess of 3%
Non GMP: Accrual prior to 6 April 1997	<b>Scheme:</b> No requirement to increase in payment
Non GMP: Accrual between 6 April 1997 and 5 April 2005	<b>Scheme:</b> CPI capped at 5% (LPI)
Non GMP: Accrual from 6 April 2005	<b>Scheme:</b> CPI capped at 2.5%

NOTE: Statutory escalation was based on RPI prior to 2011

**Statutory rates of escalation: Member reaches State Pension age on or after 6 April 2016**

<b>Accrual</b>	<b>Statutory rate of escalation</b>
GMP: Accrual prior to 6 April 1988	<b>Scheme:</b> No requirement to provide any increases in payment
GMP: Accrual between 6 April 1988 and 5 April 1997	<b>Scheme:</b> CPI capped at 3%
Non GMP: Accrual prior to 6 April 1997	<b>Scheme:</b> No requirement to increase in payment
Non GMP: Accrual between 6 April 1997 and 5 April 2005	<b>Scheme:</b> CPI capped at 5% (LPI)
Non GMP: Accrual from 6 April 2005	<b>Scheme:</b> CPI capped at 2.5%

NOTE: No increase to GMP is made by the State (via the State Pension) for individuals who reach State Pension age on or after 6 April 2016

### Pension Protection Fund

Compensation cap at age 65 (2017/2018): £38,505.61

**Revaluation of deferred benefits within PPF**

<b>Service</b>	<b>Rate of revaluation</b>
All service before 6 April 2009	CPI capped at 5%
All service after 5 April 2009	CPI capped at 2.5%

**Escalation of benefits in payment from PPF**

<b>Service</b>	<b>Rate of revaluation</b>
All service before 6 April 1997	No increases
All service after 5 April 1997	CPI capped at 2.5%



