Chartered Insurance Institute

J05

Diploma in Financial Planning

Unit J05 – Pension income options

April 2018 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. Fran, who will reach the age of 75 next week, is retired. She is currently in receipt of a scheme pension of £48,000 per annum which commenced at the scheme's normal pension age of 60. Fran also has an uncrystallised personal pension plan valued at £450,000. She has not registered for any form of transitional protection.

(a) Calculate, **showing all your workings**, the lifetime allowance charge that will be payable when Fran reaches age 75. **(5)**

(b) State the transitional protections that Fran may be eligible for and outline the information you would require to determine her eligibility for these protections. **(6)**

2. Simon is a deferred member of his former employer's defined benefit pension scheme. He left the company several years ago and will reach the scheme's normal pension age of 65 next year. The scheme has been wound-up and has qualified for assistance from the Financial Assistance Scheme (FAS).

Outline the benefits that will be paid by FAS to Simon when he reaches the scheme's normal pension age of 65. **(6)**

3. Emily is currently drawing an income from her flexi-access drawdown plan using a performance driven withdrawal strategy.

Outline the factors that should be taken into account when carrying out an annual review of her flexi-access drawdown plan. **(10)**

4. David was an active member of his employer's defined benefit scheme when he died recently at the age of 45. David leaves a widow, Helen, aged 40, and three young children.

Describe the potential death benefits payable under David's defined benefit scheme, including the tax treatment. **(12)**

5. Ben, aged 58, is employed and is a higher-rate tax payer. He has an uncrystallised personal pension fund of £875,000. He plans to draw an uncrystallised funds pension lump sum (UFPLS) of £140,000 to repay his outstanding buy to let mortgage.

(a) Calculate, **showing all your workings**, the net lump sum that Ben will receive initially, assuming that the UFPLS is taxed on a 'month 1' basis. **(10)**

(b) Outline **five** drawbacks of this course of action. **(5)**

6. On 5 April 2006, Edward had an entitlement to £75,000 tax-free cash from his executive pension plan (EPP), which, at that time, was valued at £155,000. He crystallised the EPP on 5 April 2018 when it was valued at £245,000. Edward has not registered for any form of transitional protection and no partial transfers have been made.

Calculate, **showing all your workings**, the maximum pension commencement lump sum paid to Edward. **(7)**

7. Tessa died in March 2018, aged 68. She had nominated her husband, Phil as the beneficiary of her pension arrangements.

At the time of her death, Tessa had an uncrystallised group personal pension (GPP) valued at £835,000. She was also in receipt of income of £10,000 per annum from a lifetime annuity. This was purchased in 2013 and was set up on a single life basis including a ten-year guarantee.

Outline the death benefit options available to Phil in respect of Tessa's:

(a) uncrystallised GPP; **(4)**

(b) lifetime annuity. **(4)**

QUESTIONS CONTINUE OVER THE PAGE

8. Richard, aged 63, is about to retire and is considering drawing an income using flexi-access drawdown. Richard would like to assess his projected income and expenditure requirements before taking an income from his fund.

(a) Describe briefly how a cashflow model could be used to assist Richard in planning his future income needs. **(4)**

(b) Explain briefly the limitations of cashflow modelling. **(4)**

9. State the conditions that must be met when transferring a capped drawdown fund to a new capped drawdown fund, including any impact on the maximum permitted income withdrawal. **(5)**

10. Gurinder, aged 72, is in receipt of a scheme pension from her defined benefit pension scheme, which has been in payment since she retired in May 2005. She has been contacted by the pension scheme administrator regarding the potential option of exchanging her scheme pension for a trivial commutation lump sum.

(a) Explain briefly how Gurinder's pension benefits will be valued for trivial commutation purposes. **(2)**

(b) Outline the criteria that must be met before a trivial commutation lump sum can be paid to Gurinder. **(6)**

11. Don died in May 2017, aged 68. At the time of his death he was not in receipt of his State Pension as he chose to defer this when he reached his State Pension age in March 2014. His widow Melanie, aged 67, is retired and her only income is her State Pension of £6,500 per annum.

Explain briefly why Melanie is now able to claim a tax-free lump sum payment in respect of Don's deferred State Pension. **(5)**

12. Doreen, aged 58, is divorced and has a son aged 23, who is financially independent. She works part-time, earning £12,000 per annum. Doreen would like to gift her son £65,000 and also needs an additional annual income of £4,000 gross.

Doreen, who has no savings, has deferred benefits in a previous employer's defined benefit pension scheme. The scheme's normal pension age is 65. Doreen is entitled to an immediate early retirement pension of £7,680 per annum, plus a pension commencement lump sum (PCLS) of £45,893. Alternatively, she could take a cash equivalent transfer value (CETV) of £307,680 and utilise flexi-access drawdown.

Outline **six** potential benefits and **six** potential drawbacks for Doreen if she accepts the CETV and utilises flexi-access drawdown rather than the early retirement pension and PCLS offered by the scheme. **(12)**

QUESTIONS CONTINUE OVER THE PAGE

13. Section 9.3 of the Financial Conduct Authority's Conduct of Business Sourcebook (COBS) outlines the client relevant circumstances that should be considered when a firm is making a personal recommendation to a client regarding income withdrawals.

Outline the relevant circumstances that must be considered. **(8)**

14. Bernard, aged 63, is married to Joan, aged 58. He wishes to reduce his working hours as his health has started to deteriorate. Bernard has a personal pension plan valued at £750,000. He has no capital requirements and intends to draw an income via phased annuity purchase.

Outline the potential **benefits** to Bernard of using this approach rather than phased flexi-access drawdown. **(8)**

15. Natalie's husband, Gareth, died recently, aged 78. Natalie, aged 69, is in receipt of a State Pension of £98 per week and her own pension of £16,500 per annum from her previous employer's occupational pension scheme. She has inherited a dependant's flexi-access drawdown (FAD) plan valued at £560,000 from Gareth and she also has an ISA valued at £410,000. Her total estate is valued in excess of £1.5 million. Natalie's own pensions provide her with sufficient income to maintain her standard of living, however, she would like £20,000 to cover the cost of a holiday with her family.

Her primary financial aims are for her income to be tax efficient and to maximise the amount left to her non-dependant children.

Explain in detail why Natalie can best achieve her objectives by taking the £20,000 from her ISA rather than from her dependant's FAD. **(7)**

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	£4,000

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

	2016/2017	2017/2018
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*

	2016/2017	2017/2018
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%