Chartered Insurance Institute

AF2

Advanced Diploma in Financial Planning

Unit AF2 – Business financial planning

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

- 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 AF2 – Business financial 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.

Deleen Manufacturing Ltd is a private limited company with two directors, Geoffrey and Arthur, who are both nearing retirement. They are both equal shareholders. The business currently employs 15 staff.

Historically, the company relied on two major customers that accounted for most of its sales turnover.

During the last trading year the company lost one of its major customers and has been unable to find another large customer.

Chelsea, aged 36, and Dylan, aged 34, are the sales and marketing managers for the company. They have been frustrated by the directors' refusal to further expand the customer base as the directors' focus has been on maintaining and servicing their two major accounts. Both Chelsea and Dylan are single with no dependants and have no significant personal assets of their own.

The company does not own its own premises and the only major assets are its plant and machinery.

Based on the 2018 accounts the bank will not extend the company's overdraft and after analysing the company's financial ratios, Geoffrey and Arthur are considering closing down the company and selling off its assets. Should they continue to trade there is a real risk that the company would run out of money and become insolvent.

An extract of the company's profit and loss account and balance sheet is shown below:

Deleen Manufacturing Ltd Profit and Loss Accounts

	Year end 30 April 2017	Year end 30 April 2018
Sales revenue	720,000	430,000
Cost of goods sold	290,000	208,000
Gross profit	430,000	222,000
Expenses	290,600	314,700
Operating profit	139,400	(92,700)
Taxation	27,880	0
Profit after tax	111,520	0

Balance sheet

	As at 30 April 2017	As at 30 April 2018
Fixed assets		
Machinery	230,000	219,000
Total	230,000	219,000
Current assets		
Cash	84,000	4,000
Stock	21,000	8,000
Debtors	70,000	35,000
Total:	175,000	47,000
Current liabilities		
Bank overdraft	21,000	43,000
Creditors	40,000	31,000
Total:	61,000	74,000
Long-term liabilities		
6% Debenture loan	180,000	150,000
Net assets	164,000	42,000
Financed by:		
Share Capital	10,000	10,000
Shareholder retained profit	154,000	32,000
Total:	164,000	42,000

QUESTIONS CONTINUE OVER THE PAGE

Questions continue on pages 7 - 8

Questions

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

(a) In the analysis of financial statements:

(i) Outline **four** advantages of using financial ratios. **(4)**

(ii) Outline **six** limitations of using financial ratios. **(6)**

(b) Chelsea and Dylan, the sales and marketing managers, are considering a management buyout (MBO) of the company.

State **six** factors they would need to take into account to better understand the financial viability of the company. **(6)**

(c) **(i)** From the financial information provided, list the factors that should be taken into account when valuing the business for the MBO. **(5)**

(ii) State **three** methods of raising finance for the MBO, including **one** advantage and **one** drawback of each. *Exclude financing from friends and family.* **(9)**

(iii) Assuming the MBO goes ahead, and considering their current circumstances, briefly explain to Chelsea & Dylan their need for:

- Shareholder protection. **(3)**
- Key person protection. **(5)**

(d) From the accounts:

(i) Calculate, **showing all your workings**, how much Geoffrey could expect to realise from the sale of the business assets before any taxes and costs. **(2)**

(ii) Explain why the figure in your answer to **part (d)(i)** above may not be realised. **(3)**

QUESTIONS CONTINUE OVER THE PAGE

(e) Explain why a business owner should build up resources outside of the business which could be used as a retirement fund. **(8)**

(f) Geoffrey and Arthur are considering whether to wind up the company.

(i) Explain how Geoffrey and Arthur can utilise the loss in the 2018 trading year to the company's benefit if the company ceases trading. **(6)**

(ii) Outline, giving your reasons, why Geoffrey and Arthur would have the option of starting a members' voluntary wind up of the company. **(5)**

(iii) Explain the steps that the directors must take following the process in **part (f)(ii)** above, if they decide to voluntarily wind up the company. **(7)**

(g) **(i)** Explain the responsibilities of Geoffrey and Arthur to their employees should they close the business. **(7)**

(ii) Explain how statutory redundancy pay would be calculated for a 30-year-old employee with five years' service. *No calculations are required.* **(4)**

Total marks available for this question: 80

QUESTIONS CONTINUE OVER THE PAGE

Section B questions can be found on pages 10 - 13

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.

Sandra is a sole-trader providing compliance services to regulated firms. She has a number of regular clients. In the tax year 2017/2018 her net fee income is £80,000 after expenses. Sandra pays a pension contribution of £800 per month net and her intention is to continue with this.

Sandra is seeking advice on reducing her Tax and National Insurance liabilities. One of her clients has told her she should incorporate as a limited company without explaining why this might be advantageous.

Sandra works from the family home which she owns outright. She enjoys the flexibility of being self-employed and being able to choose for whom she works. Sandra is, however, considering an offer from one of her clients to work exclusively for them. This would be on the same contract terms as the current arrangement.

Questions

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

(a) Outline the main **drawbacks** that Sandra faces as a sole-trader. **(4)**

(b) Explain the main **disadvantages** to Sandra should she choose to trade as a limited company. **(4)**

(c) **(i)** Calculate, **showing all your workings**, the total Income Tax and National Insurance liability Sandra would have to pay for the tax year 2017/2018. **(10)**

(ii) Assume Sandra had incorporated the business on 6 April 2017. Turnover is £80,000 to 5 April 2018 and she takes a salary of £12,000 from this.

The company pays her gross pension contributions of £12,000 and the profits remaining are distributed to Sandra as dividends.

Calculate, **showing all your workings**, the net distributable profit from the company. **(4)**

(iii) Based on the calculation in **part (c)(ii)** above, calculate, **showing all your workings**, the total Income Tax and National Insurance payable by Sandra. **(10)**

(d) Explain to Sandra how income paid under contracts subject to IR35 rules would be treated if she worked for a single client through a limited company. **(8)**

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), (e) and (f) which follow.

Hannah and Jess are married, and are equal shareholding directors in a vegan restaurant, Club Greens Ltd. The company rents the premises from which it operates. The owner of the property has decided to sell and the asking price is £750,000. The rent for the property is £72,000 per annum. The business is highly profitable and has £400,000 cash in the bank.

Hannah and Jess own their home which is valued at £500,000 with no mortgage. They hold various personal cash deposits which total £100,000. Hannah has recently inherited a sum of £220,000 from her late mother's estate.

Hannah and Jess are both member trustees of the Club Greens Ltd small self-administered scheme (SSAS). The SSAS has a total value of £350,000 and is fully invested in a discretionary managed portfolio. The company has made contributions to the SSAS in March of each year of £10,000 for each of them for the last ten years. No contributions have been paid in the tax year 2017/2018.

They would like to buy the business property they rent and are looking at options to finance the purchase. They are considering either buying the property personally, via the limited company or via their SSAS.

The business employs several staff and it has missed its staging date for auto-enrolment as Hannah and Jess believe they do not need to comply as typically their workers are with them for three months or less.

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 Stamp Duty Land Tax (SDLT) which would be due should they purchase the property. *Assume VAT is not applicable.* **(4)**

(b) Calculate, **showing all your workings**, how Hannah and Jess could fund the purchase of the property via the SSAS with minimum borrowing, assuming total purchase costs of £40,000. Total costs figure includes the SDLT. **(8)**

(c) Hannah and Jess may wish to borrow funds personally, secured against their home, to fund the purchase.

(i) Explain the Income Tax and National Insurance implications assuming the business pays them full market rent. *No calculations are required.* **(5)**

(ii) Describe the Capital Gains Tax implications for Hannah and Jess should the property be sold at a later date. **(6)**

(d) Explain the potential financial implications to Club Greens Ltd, should it purchase the property. **(6)**

(e) State, giving your reasons, the **advantages** to Hannah and Jess of the SSAS buying the property as opposed to personal or business ownership. **(6)**

(f) State the actions the Pensions Regulator will take with regards to the business' failure to put in place an auto-enrolment scheme. **(5)**

Total marks available for this question: 40

The tax tables can be found on pages 15 - 23

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	£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

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

BLANK PAGE