

THE CHARTERED INSURANCE INSTITUTE

AF1

Advanced Diploma in Financial Planning

Unit AF1 – Personal tax and trust planning

October 2013 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2013/2014, 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**

Joseph, aged 62, is married to Susannah, aged 66. They have three children all of whom are financially independent.

Joseph has been employed as a carpenter and joiner at a small local firm for all of his working life. His annual salary is currently £29,500. Until recently there has always been the opportunity for Joseph to work overtime to improve his earnings. Due to a downturn in demand, this opportunity has not been available for the last two years. The company does not provide any employee benefits and there is no company pension scheme. Joseph has been contributing to a personal pension for the last twenty years, making monthly contributions of £50 for the last five years.

Susannah is retired and, in addition to the full State Basic Pension, she is in receipt of a company pension of £9,400 gross per annum.

The house Joseph and Susannah live in was inherited from Susannah's grandfather when he died in 1996 and is in Susannah's sole name. The current value of the house is £235,000. In addition to the house, Susannah's grandfather left her £25,000 which she initially put into their joint current account. Susannah decided to invest the full £25,000 into a single premium investment bond in August 2006. She has not taken any withdrawals and the bond is currently valued at £31,300.

Susannah is not happy with the performance of her single premium bond. She is considering encashing it and investing the proceeds into a real estate investment trust (REIT).

Joseph and Susannah also have the following savings and investments:

| | Ownership | Start date | Value (£) | Income per annum (£) |
|--------------------------------|-----------|------------|-----------|----------------------|
| Treebank current account | Joint | 1988 | 11,650 | 0 |
| Treebank deposit account | Susannah | 1980 | 12,200 | 124.80 |
| UK Equity stocks & shares ISA | Susannah | 2002 | 23,400 | 900 |
| Cash ISA | Susannah | 2003 | 9,325 | 120 |
| Upturn Equity Investment Trust | Susannah | 2009 | 45,000 | 4,725 |
| Cash ISA | Joseph | 2003 | 2,500 | 101 |

Over the last few months Joseph has been spread betting on various sporting events and currently owes three different online organisations a total of £14,500. He is concerned that one or more of his creditors will apply for him to be adjudged bankrupt.

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**, Susannah's Income Tax liability for the tax year 2013/2014, assuming she fully encashes the single premium investment bond in October 2013. (16)
- (b) Calculate, **showing all your workings**, the National Insurance Contributions paid on Joseph's earnings for the tax year 2013/2014 by:
- (i) Joseph; (4)
 - (ii) Joseph's employer. (3)
- (c) If Susannah decides to invest the proceeds from the single premium investment bond into a real estate investment trust (REIT), explain:
- (i) the internal tax treatment of a REIT; (4)
 - (ii) the conditions a REIT must satisfy in order to qualify for the tax treatment in part (c)(i) above; (6)
 - (iii) how any distributions Susannah receives from a REIT will be taxed. (6)
No calculations are required.
- (d) Susannah has been considering moving some of her investments into a Venture Capital Trust (VCT).

State the conditions that a VCT has to satisfy in order to be approved by HM Revenue & Customs. (10)
- (e) Joseph understands there are various arrangements open to him in order to avoid bankruptcy.
- (i) Explain the main points of a debt relief order (DRO). (9)
 - (ii) Explain the main points of an individual voluntary arrangement (IVA). (9)
 - (iii) State, with reasons, which of these two arrangements would be most suitable for Joseph. (4)
- (f) Joseph's personal pension plan is not in trust and he wants to arrange for it to be put in trust. Explain how HM Revenue & Customs will treat this action. (9)

Total marks available for this question: 80

Questions continue over the page

SECTION B

**Both questions in this section are compulsory
and carry an overall total of 80 marks**

Question 2

Alejandro and Melanie are both in their early fifties and have been married for ten years. Melanie is British and has three children, Sam, aged 26, Joe, aged 24 and Sally, aged 23, from her first marriage which ended in divorce. Alejandro and Melanie have no children of their own.

Alejandro, who is Maltese domiciled, runs a successful family business in Malta and spends April to November of every year there. Melanie has her own internet-based business and divides her time between Malta and the UK. Due to recent changes in the residency rules, she is now concerned that she might no longer be considered a UK resident for tax purposes.

Melanie's father died 19 years ago. On his death, his Will established a discretionary trust of £375,000 for the benefit of Sam, Joe and Sally. The trust is due to end when Sally reaches age 30. The trustees were Melanie and her mother. The trust has made distributions from income to assist with university fees and associated costs for all three children.

Melanie's mother died 18 months ago, leaving her estate divided equally between Melanie and her brother. Melanie has decided that in order to reduce her own potential Inheritance Tax position, she would now prefer her share of her mother's assets to pass to her children.

Melanie owns a property in Malta which she bought 12 years ago. Since her marriage to Alejandro, she has let it as a holiday apartment. The apartment is currently valued at £350,000 and she would now like to gift ownership to her three children.

Neither Alejandro nor Melanie have made any lifetime transfers.

Questions

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

- (a) (i) The discretionary trust was worth £430,000 when it reached its first ten-year anniversary. Calculate, **showing all your workings**, the periodic charge payable at that time. Assume a nil rate band of £263,000. (5)
- (ii) Explain how any exit charge will be calculated when the trust ends. No calculation is required. (7)
- (b) Recommend to Melanie the steps she would need to take in order to be considered a UK resident for tax purposes. (8)
- (c) Explain how Melanie could pass her share of the inheritance she received from her mother to her children without increasing her potential Inheritance Tax (IHT) liability, stating all the conditions she would need to fulfil to make this course of action effective. (8)
- (d) Recommend, giving your reasons, a course of action Melanie or her children could take to cover any potential IHT payable on the gift of the Maltese apartment without reducing Melanie's nil rate band on her death. (6)
- (e) Explain Alejandro's UK IHT position if he had died in September 2013. (6)

Total marks available for this question: 40

Questions continue over the page

Question 3

Robert, aged 46, and Karen, aged 44, live together in Nottingham and have two children, Clare, aged 12, and Bryan, aged 14. They have never married.

Robert works for a Software developer and earns £90,000 per annum. He is a member of the company group personal pension and his fund is currently valued at £195,000. He is also a member of the death in service scheme which pays three times his annual salary on death. Karen is the nominated beneficiary on both schemes. Karen is currently unemployed.

Robert and Karen own their own home equally as tenants in common. The property is worth £535,000 and they do not have a mortgage. They have a joint bank account with a current balance of £45,000. They each have a stocks and shares ISA, Robert's is valued at £75,000 and Karen's is valued at £68,000. Robert and Karen do not have Wills and would like advice on this given the early death of Robert's mother, Ann, last year.

Robert's father, Simon, aged 68, is a retired architect. Since the death of his wife Ann, Simon has become concerned about estate planning. He has £450,000 in savings and investments and owns two properties. Simon is now considering gifting, to Robert, either his main residence in Nottingham or his holiday home in Skegness.

Simon's main residence is worth £735,000 and there is no mortgage. Simon and Ann bought the property on 1 October 1983 for £172,250. They bought the property in Skegness with grounds of over one hectare, on the 1 March 1987, for £250,000. They moved into that property whilst they renovated their Nottingham house. Simon and Ann moved back to their Nottingham residence on 1 June 1994 and built an extension costing £61,300. Since then the Skegness property has only ever been used for holidays by the family. Simon has no other capital gains or losses from his investments.

Should Simon gift the Nottingham property to Robert, he would like to consider the option of continuing to live in the house for the next couple of years in order to be close to his grandchildren. He is prepared to pay a nominal rent if this were to happen. Simon understands that, if he disposes of his Nottingham property now by way of such gift, the associated legal costs would be £15,480.

Simon lives comfortably on his State and private pensions, which total £62,000 per annum, and he would now like to gift monies to his grandchildren. After legal advice he has decided to gift £250,000, split equally between two bare trusts, one for each of his grandchildren. The trusts are to be initially invested in equities only.

Questions

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

- (a) Ignoring Inheritance Tax, explain how Robert's estate would be distributed if he had died on 30 September 2013. (9)
- (b) If Simon gifts his Nottingham property to Robert on 1 November 2013:
- (i) With regard to Simon's Capital Gains Tax (CGT) liability in respect of the gift, explain briefly how HM Revenue & Customs rules relating to principal private residence relief will be applied. (5)
 - (ii) Calculate, **showing all your workings**, Simon's CGT liability for the tax year 2013/2014. (7)
- (c) Explain briefly the CGT implications of the land belonging to the Skegness property, if Simon decides to gift the Skegness property to Robert instead of the Nottingham property. (3)
- (d) Explain how the Pre-Owned Assets rules will apply to the gift of Simon's Nottingham property, should Simon remain living there whilst paying only a nominal rent. (8)
- (e) Explain the tax treatment of the bare trusts Simon intends to set up for his grandchildren in respect of:
- (i) Income Tax; (4)
 - (ii) Capital Gains Tax. (4)

Total marks available for this question: 40

Tax tables can be found on pages 11 – 15

INCOME TAX

| RATES OF TAX | 2012/2013 | 2013/2014 |
|--|-----------|-----------|
| Starting rate for savings* | 10% | 10% |
| Basic rate | 20% | 20% |
| Higher rate | 40% | 40% |
| Additional rate | 50% | 45% |
| Starting-rate limit | £2,710* | £2,790* |
| Threshold of taxable income above which higher rate applies | £34,370 | £32,010 |
| 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 |

*Restricted to savings income only and not available if taxable non-savings income exceeds starting rate band.

MAIN PERSONAL ALLOWANCES AND RELIEFS

| | | |
|--|----------|----------|
| Income limit for Personal Allowance § | £100,000 | £100,000 |
| Personal Allowance (basic if born after 5 April 1948) § | £8,105 | £9,440 |
| Personal Allowance (if born between 6 April 1938 and 5 April 1948) § | £10,500 | £10,500 |
| Personal Allowance (if born before 6 April 1938) § | £10,660 | £10,660 |
| Married/civil partners (minimum) (if born before 6 April 1935) at 10% † | £2,960 | £3,040 |
| Married/civil partners (if born before 6 April 1935) at 10% † | £7,705 | £7,915 |
| Income limit for age-related allowances | £25,400 | £26,100 |
| Blind Person's Allowance | £2,100 | £2,160 |
| Enterprise Investment Scheme relief limit on £1,000,000 max | 30% | 30% |
| Seed Enterprise Investment relief limit on £100,000 | 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) | £2,690 | £2,720 |
| - family element | £545 | £545 |
| Threshold for tapered withdrawal of CTC | £15,860 | £15,910 |

NATIONAL INSURANCE CONTRIBUTIONS

| Class 1 Employee | Weekly | Monthly | Yearly |
|----------------------------|--------|---------|---------|
| Lower Earnings Limit (LEL) | £109 | £473 | £5,668 |
| Primary threshold | £149 | £646 | £7,755 |
| Upper Accrual Point | £770 | £3,337 | £40,040 |
| Upper Earnings Limit (UEL) | £797 | £3,454 | £41,450 |

| Total earnings £ per week | CLASS 1 EMPLOYEE CONTRIBUTIONS | |
|---------------------------|--|------------------------------------|
| | Contracted-in rate/contracted-out (money purchase) | Contracted-out rate (final salary) |
| Up to 149.00* | Nil | Nil |
| 149.01 – 770.00 | 12% | 10.6% |
| 770.01 – 797.00 | 12% | 12% |
| Above 797.00 | 2% | 2% |

*This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £109 per week. This £109 to £149 band is a zero rate band introduced in order to protect lower earners' rights to contributory State benefits e.g. Basic State Pension.

| Total earnings £ per week | CLASS 1 EMPLOYER CONTRIBUTIONS | | |
|---------------------------|--------------------------------|---------------------|----------------|
| | Contracted-in rate | Contracted-out rate | |
| | | Final salary | Money purchase |
| Below 148.00** | Nil | Nil | Nil |
| 148.01 – 770.00 | 13.8% | 10.4% | 13.8% |
| 770.01 – 797.00 | 13.8% | 13.8% | 13.8% |
| Excess over 797.00 | 13.8% | 13.8% | 13.8% |

** Secondary earnings threshold.

| | |
|--------------------------------|--|
| Class 2 (self-employed) | Flat rate per week £2.70 where earnings exceed £5,725 per annum. |
| Class 3 (voluntary) | Flat rate per week £13.55. |
| Class 4 (self-employed) | 9% on profits between £7,755 - £41,450 |
| | 2% on profits above £41,450. |

PENSIONS

| TAX YEAR | LIFETIME ALLOWANCE | ANNUAL ALLOWANCE |
|-----------|--------------------|------------------|
| 2006/2007 | £1,500,000 | £215,000 |
| 2007/2008 | £1,600,000 | £225,000 |
| 2008/2009 | £1,650,000 | £235,000 |
| 2009/2010 | £1,750,000 | £245,000 |
| 2010/2011 | £1,800,000 | £255,000 |
| 2011/2012 | £1,800,000 | £50,000 |
| 2012/2013 | £1,500,000 | £50,000 |
| 2013/2014 | £1,500,000 | £50,000 |

ANNUAL ALLOWANCE CHARGE

20% - 45% member's tax charge on the amount of total pension input in excess of the annual allowance.

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.

INHERITANCE TAX

RATES OF TAX ON DEATH TRANSFERS

2012/2013 2013/2014

Transfers made after 5 April 2013

| | | |
|---|-----|-----|
| - Up to £325,000 | Nil | Nil |
| - Excess over £325,000 | 40% | 40% |
| - Lifetime transfers to and from certain trusts | 20% | 20% |

**For deaths after 5 April 2013, a lower rate of 36% applies where at least 10% of deceased's net estate is left to charity.*

MAIN EXEMPTIONS

Transfers to

| | | |
|--|----------|----------|
| - UK-domiciled spouse/civil partner | No limit | No limit |
| - non-UK-domiciled spouse/civil partner (from UK-domiciled spouse) | £55,000 | £325,000 |
| - UK-registered charities | No limit | No limit |

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 | £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% |

CAR BENEFIT FOR EMPLOYEES

The charge for company car benefits is based on the carbon dioxide (CO₂) emissions. There is no reduction for high business mileage users.

For 2013/2014:

- Cars that cannot emit CO₂ have a 0% charge.
- The percentage charge is 5% of the car's list price for CO₂ emissions of 75g/km or less.
- For cars with CO₂ emissions of 76g/km to 94g/km the percentage is 10%.
- For cars with CO₂ emissions of 95g/km to 99g/km the percentage is 11%.
- Cars with CO₂ emissions of 100g/km have a percentage charge of 12% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 35% (emissions of 215g/km and above).

There is an additional 3% supplement for diesel cars not meeting Euro IV emission standards. However, the maximum charge remains 35% of the car's list price.

Car fuel The benefit is calculated as the CO₂ emissions % relevant to the car and that % applied to a set figure (£21,100 for 2013/2014) e.g. car emission 100g/km = 12% on car benefit scale. 12% of £21,100 = £2,532.

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 Contributions (Class 1A) at 13.8%.

PRIVATE VEHICLES USED FOR WORK

| | 2012/2013 Rates | 2013/2014 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

| | 2012/2013 | 2013/2014 |
|---|-----------|-----------|
| Plant & machinery (excluding cars) 100% annual investment allowance (first year) | £25,000 | £250,000 |
| 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 2013 (Corporation Tax) or 06 April 2013 (Income Tax)

| | | | |
|------------------------------------|-------------|------------------|------------------|
| CO ₂ emissions of g/km: | 95 or less* | 96-130 | 131 or more |
| Capital allowance: | 100% | 18% | 8% |
| | first year | reducing balance | reducing balance |

*If new

Research & Development: Capital expenditure 100%

MAIN SOCIAL SECURITY BENEFITS

| | | 2012/2013 | 2013/2014 |
|----------------------------------|---|--------------|--------------|
| | | £ | £ |
| Child Benefit | First child | 20.30 | 20.30 |
| | Subsequent children | 13.40 | 13.40 |
| | Guardian's allowance | 15.55 | 15.90 |
| Employment and Support Allowance | Assessment Phase | | |
| | Age 16 – 24 | Up to 56.25 | Up to 56.80 |
| | Aged 25 or over | Up to 71.00 | Up to 71.70 |
| | Main Phase | | |
| | Work Related Activity Group | Up to 99.15 | Up to 100.15 |
| | Support Group | Up to 105.05 | Up to 106.50 |
| Attendance Allowance | Lower rate | 51.85 | 53.00 |
| | Higher rate | 77.45 | 79.15 |
| Retirement Pension | Single | 107.45 | 110.15 |
| | Married | 171.85 | 176.15 |
| Pension Credit | Single person standard minimum guarantee | 142.70 | 145.40 |
| | Married couple standard minimum guarantee | 217.90 | 222.05 |
| | Maximum savings ignored in calculating income | 10,000.00 | 10,000.00 |
| Bereavement Payment (lump sum) | | 2,000.00 | 2,000.00 |
| Widowed Parent's Allowance | | 105.95 | 108.30 |
| Jobseekers Allowance | Age 16 - 24 | 56.25 | 56.80 |
| | Age 25 or over | 71.00 | 71.70 |

Statutory Maternity, Paternity and

CAPITAL GAINS TAX

| EXEMPTIONS | 2012/2013 | 2013/2014 |
|---|-----------|-----------|
| Individuals, estates etc | £10,600 | £10,900 |
| Trusts generally | £5,300 | £5,450 |
| Chattels proceeds (restricted to five thirds of proceeds exceeding limit) | £6,000 | £6,000 |

TAX RATES

| | | |
|--|-------------|-------------|
| Individuals: | | |
| Up to basic rate limit | 18% | 18% |
| Above basic rate limit | 28% | 28% |
| Trustees and Personal Representatives | 28% | 28% |
| 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. | | |

CORPORATION TAX

| | 2012/2013 | 2013/2014 |
|-------------------------|------------|------------|
| Full rate | 24% | 23% |
| Small companies rate | 20% | 20% |
| Small companies limit | £300,000 | £300,000 |
| Effective marginal rate | 25% | 23.75% |
| Upper marginal limit | £1,500,000 | £1,500,000 |

VALUE ADDED TAX

| | 2012/2013 | 2013/2014 |
|-------------------------------|-----------|-----------|
| Standard rate | 20% | 20% |
| Annual registration threshold | £77,000 | £79,000 |
| Deregistration threshold | £75,000 | £77,000 |

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