THE CHARTERED INSURANCE INSTITUTE

AF1

Advanced Diploma in Financial Planning

Unit AF1 – Personal tax and trust planning

April 2014 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.

Candidates should answer based on the legislative position immediately BEFORE the 2014 budget.

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

George, aged 52 and Elizabeth, aged 46, have been married for the last 24 years. They have two children, Connor, aged 22 and Catherine, aged 17. George and Elizabeth own their home outright as joint tenants, which is valued at £850,000.

George has worked for a global logistics company for the past 20 years and was promoted from national sales manager on a salary of £76,000 per annum, to the role of international sales director at a salary of £126,000 on 1 August 2013. Prior to his promotion, George had not received a pay rise for the past four years.

He has been a member of the company's defined contribution pension scheme for the past six years. He contributes 5% of his gross salary and his company makes a contribution of 12.5% under the Net Pay Arrangement. In March 2014, George was paid a bonus of £60,000 from which he elected to sacrifice £30,000 to his pension.

Elizabeth is a self-employed illustrator. For the past few years, she has earned on average £6,000 per year after deductions, but the tax year 2014/2015 will provide her with profits of about £34,000 as one of her books has been optioned by a movie studio in California.

George and Elizabeth jointly hold cash on deposit of £100,000 at a rate of 1.2% net and a joint portfolio of unit trusts worth £80,000. In the 2013/2014 tax year the unit trusts paid a net dividend of £2,200.

Elizabeth was orphaned just before her second birthday, when her parents died in an accident. Their estate established a bare trust into which all of their combined assets were transferred. The trustees used the proceeds to purchase an onshore single premium investment bond in January 1970, with an initial premium of £100,000. On her 18th birthday, the bond was assigned directly to Elizabeth, at which time it was valued at £220,000. There has been only one withdrawal, which was made on Elizabeth's 22nd birthday for an amount of £40,000 which was used to help pay for her wedding and first house. The value of the bond on Elizabeth's 46th birthday was £580,000. It is Elizabeth's intention to use the majority of the proceeds of the bond to help her children and she intends to gift £250,000 outright to each of them.

Connor left home at age 17, and incorporated his own business developing applications for mobile phones. The business has grown quickly and he now employs 15 full time staff and expects his turnover to be close to £2,000,000 this financial year. He has reached the capacity of his current premises and is now seeking outside investment to take his company to the next level.

Catherine is just about to start University and has decided to use some of the gift from her mother to buy a flat that she can live in with her friends while she studies, and then either sell or maintain it as an investment when she leaves. Catherine has already been approached by two of her friends who have agreed to rent a room for £70 per week each. Catherine expects her expenses to be no more than £800 per year for her 'tenants' and will use the rest of the money to support her earnings whilst at University. Catherine works part time for her brother Connor and he currently

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**, for the 2013/2014 tax year, George's:

(i) Income Tax liability; **(13)**

(ii) liability to National Insurance. **(6)**

(b) Calculate, **showing all your workings**, the maximum additional contribution that George would be able to make to his pension without incurring an annual allowance charge in the 2014/2015 tax year.

Assume his salary and contribution level remain the same and his Pension Input Period runs from 6 April 2014. The annual allowance for the 2014/2015 tax year is £40,000. **(7)**

(c) Elizabeth has questioned how her profits for the 2014/2015 tax year will impact her liability to National Insurance.

(i) List the main State benefits that are dependent on her National Insurance contributions. **(6)**

(ii) Explain the impact the film deal will have on her eligibility for the small earnings exception. **(2)**

(d) Elizabeth decided to surrender the investment bond in full in January 2014 on her 46th birthday.

(i) Explain, in detail, how the chargeable gain on the bond will be calculated on surrender. *No calculations are required.* **(10)**

(ii) Explain to Elizabeth the Inheritance Tax (IHT) consequences of making a gift of £250,000 outright to each of the children, assuming she has made no previous lifetime gifts. **(7)**

(iii) Explain, in detail, how Elizabeth could provide for any IHT liability that might arise in relation to the gifts in part **(d)(ii)** above via suitable life policies. **(7)**

(e) Catherine understands that the income she will receive from her friends wil taxable in the event they live with her while they are at University.

(i) State the alternative options available to Catherine with regard to the taxation of the rental income. **(2)**

(ii) Calculate, **showing all your workings**, her net rental income for **each** option. **(7)**

(f) State the criteria that his company must meet to qualify as a suitable investment for Connor to obtain financing via an Enterprise Investment Scheme. **(6)**

(g) Explain to Connor the order in which his creditors would be paid, in the event that Connor's company was to fail and he becomes bankrupt. **(7)**

Total marks available for this question: 80

Section B questions can be found on pages 8 – 11

SECTION B

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

Question 2

Amanda, aged 55, is the Managing Director of Right On Research, a market research company based in London. She has lived with her partner, Pat, an artist, for 18 years. They have never married or entered a civil partnership and they have no children.

Amanda inherited £650,000 following the death of her father in September 2009, when his net estate was split equally between Amanda and her brother, Jake. The Inheritance Tax paid on the father's estate was £800,000. In March 2010, Amanda gave £250,000 of her inheritance as an outright gift to Pat to help him set up his own studio. She has made no other gifts.

Amanda's current assets are as follows:

Assets	**(£)**
House – joint tenant with Pat	350,000
Chattels	30,000
Current Account	8,000
Stocks and Shares ISA	50,260
Venture Capital Trust – effected 2010	49,000
Enterprise Investment Scheme – effected 2010	80,000
Inheritance – held in a 90 day building society account	538,989
Term assurance effected in 2010 - expires at age 65, monthly premium £50	Sum assured 250,000

Following a recent heart attack, Amanda has been diagnosed with type 2 diabetes. As a result Amanda has decided to take a sabbatical from her work and travel with Pat to stay with his sister in South Africa.

Neither Pat nor Amanda has made a Will and Amanda would like her best friend Charlotte to be able to make financial decisions on her behalf whilst she is away.

Questions

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

(a) Explain to Amanda how her estate would be distributed if she were to die today. *No calculation required.* **(3)**

(b) Calculate, **showing all your workings**, the amount of Inheritance Tax (IHT) that would be payable assuming Amanda had died on 2 April 2014. **(14)**

(c) Explain, in detail, the IHT implications of assigning the term assurance policy into a discretionary trust. **(11)**

(d) Explain the impact of Amanda's proposed trip to South Africa on her residence status in 2014/2015, assuming she leaves the UK on 15 April 2014 and returns to the UK on 1 May 2015. **(3)**

(e) State the type of Power of Attorney that Amanda should set up to allow Charlotte to manage her financial affairs whilst she is away and the requirements for Charlotte to be appointed. **(5)**

(f) If Amanda decides to remain in South Africa:

(i) State the actions she would need to take in order to establish a new domicile of choice. **(2)**

(ii) List the actions she could take in order to support her application for a new domicile of choice. **(7)**

Total marks available for this question: 45

Questions continue over the page

Question 3

David, aged 24, is working as a computer programmer for a global telecoms company. He h[illegible] no dependants.

His younger brother Russell, aged 16, is about to start higher education.

When their mother died eight years ago, the death in service grant from her occupational pension scheme was paid into a discretionary trust for their benefit, as per the expression of wish form she had completed.

The trust currently holds the following assets:

Asset	Original value (£)	Current value (£)
Rental property	80,000	90,000
Fixed interest unit trust	20,000	25,000
Equity OEIC	65,000	112,000
Cash	5,000	3,000

The trustees have now agreed to pay out half the value of the trust to David as he is looking to purchase his own home.

Questions

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

(a) Explain, in detail, the ongoing Income Tax treatment of the trust, prior to any distributions or payments to the beneficiaries. **(8)**

(b) The trustees have decided to sell the rental property and the unit trust to fund the distribution to David.

(i) Calculate, **showing all your workings**, any Capital Gains Tax (CGT) payable by the trustees on these disposals. **(6)**

(ii) Explain how the trustees would meet HM Revenue & Customs requirements for reporting and settling any CGT due. **(3)**

(c) Explain the actions the trustees should take in relation to the remaining trust assets. **(10)**

(d) Explain, in detail, the tax treatment of any payments from the trust, if the trustees decide to contribute towards Russell's further education costs, using income from the OEIC. **(8)**

Total marks available for this question: 35

The tax tables can be found on pages 13 – 19

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.

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.*

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

	2012/2013	2013/2014
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 (CO_2) emissions. There is no reduction for high business mileage users.

For 2013/2014:

- Cars that cannot emit CO_2 have a 0% charge.
- The percentage charge is 5% of the car's list price for CO_2 emissions of 75g/km or less.
- For cars with CO_2 emissions of 76g/km to 94g/km the percentage is 10%.
- For cars with CO_2 emissions of 95g/km to 99g/km the percentage is 11%.
- Cars with CO_2 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 CO_2 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) of 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% first year	18% reducing balance	8% reducing balance

*If new

Research & Development:	Capital expenditure	100%

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

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 Adoption Pay		135.45	136.78

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