THE CHARTERED INSURANCE INSTITUTE

AF3

Advanced Diploma in Financial Planning

Unit AF3 – Pension 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 AF3 – Pension 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

Paul, aged 48, lives with his partner, Christina, aged 40. Christina is expecting their first child in October 2014.

Paul was a professional golfer for 11 years but was forced to quit through injury at the age of 30. During his time as a professional golfer, he made contributions to a personal pension plan, currently valued at £280,000. Paul has a protected pension age of 40 in respect of these benefits.

Paul started working for XCEL Sports Ltd in 1996 and left in 2002 to take up his current position of Sales and Marketing Director at Briggstop Ltd.

In addition to his personal pension plan, Paul has the following benefits:

XCEL Sports Ltd Defined Benefit Pension Scheme	Estimated pension at normal retirement age of 65 Cash Equivalent Transfer Value	£28,000 £182,000
Briggstop Ltd Executive Pension Plan (EPP)	Current value Value at 5 April 2006 Tax-free cash at 5 April 2006	£380,000 £68,500 £23,760

Paul has recently been diagnosed with a mild form of multiple sclerosis and Briggstop Ltd has agreed to reduce his hours to help him manage his condition.

Paul recently obtained a Transfer Value Analysis report in respect of his preserved benefits within the XCEL Sports Ltd Defined Benefit Pension Scheme. This report showed a critical yield of 11.2% per annum based on an early retirement age of 55.

Christina is employed by Wartlidge & Co Ltd, a national firm of accountants, on an annual salary of £40,000 and has been a member of their non contributory contracted-out defined benefit pension scheme for 22 years. In order to control ongoing costs, Wartlidge & Co Ltd recently contacted scheme members to outline potential changes to future benefits. It is proposed that Christina will be able to choose either of the following two options:

Option One

- Retain membership of the defined benefit pension scheme, but with future accrual reduced from the current 1/60th to 1/80th of final salary and an employee contribution of 5% of salary.

Option Two

- Cease active membership of the defined benefit pension scheme and join a group personal pension (GPP) with an employer contribution rate of 12% of her salary. There is no compulsory requirement for employee contributions.
- In addition the employer will match voluntary employee contributions up to the first 5% of salary, which can be made via salary sacrifice.
- If the employee opts for salary sacrifice, the employer will also pay 50% of their National

Questions

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

(a) In respect of the two options being offered to Christina for future pension provision:

(i) Outline the process that Christina's employer is required to follow in order to satisfy consultation regulations. **(4)**

(ii) List the additional information that you would need to obtain from Christina prior to advising her on the proposed options. **(8)**

(iii) Explain the minimum level of pension provision under each option that must be maintained during her maternity leave. **(8)**

(b) Assuming Christina selects option two in respect of her future pension provision and elects to make a 5% contribution via salary sacrifice:

(i) State the statutory minimum revaluation rates that would be applied to the various tranches of benefit within her preserved defined benefit pension scheme. **(7)**

(ii) Explain the impact this decision will have on Christina's personal National Insurance contributions. *No calculation is required.* **(4)**

(iii) Calculate, **showing all your workings**, the total annual contribution that would be paid by the employer into the GPP. **(5)**

(iv) List **six** factors that would need to be taken into account when advising Christina on the selection of an appropriate investment fund for her pension contributions. **(6)**

(c) Describe the way in which Paul's maximum pension commencement lump sum entitlement would be calculated when he crystallises the benefits from his executive pension plan. *No calculation is required.* **(8)**

Questions continue over the page

(d) In order to supplement his reduced income, Paul is considering fully crystallising his personal pension plan and placing it into a capped drawdown arrangement.

(i) Outline **four** benefits and **four** drawbacks of Paul taking this course of action. **(8)**

(ii) Calculate, **showing all your workings**, the percentage of his lifetime allowance that would be used. *Use the 2013/2014 lifetime allowance in your calculation.* **(5)**

(e) In respect of Paul's recently received Transfer Value Analysis report relating to the XCEL Sports Ltd defined benefit pension scheme:

(i) Describe how the critical yield has been calculated. **(8)**

(ii) State the factors that you would take into consideration before advising Paul on the suitability of transferring his benefits to a personal pension plan. **(9)**

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

John, aged 58, and Susan, aged 53, have recently decided to commence divorce proceedings.

John and Susan's jointly owned assets comprise:

- their main residence, valued at £950,000
- a holiday home in Devon valued at £520,000
- savings and investments, valued at £560,000

John took early retirement in 2008 and is in receipt of a scheme pension of £63,000 per annum. In addition he has the following pension benefits:

- a deferred benefit under a previous employer's defined benefit pension scheme of £38,000 per annum, which is due to come into payment at age 65;
- an uncrystallised self-invested personal pension (SIPP), which has a current fund value of £652,000;
- a full entitlement to a Basic State Pension (BSP) and additional benefits under the State Earnings-Related Pension Scheme and State Second Pension.

John registered for primary protection at A-Day and has a primary protection factor of 0.27.

Susan, who has always been self-employed, currently has relevant UK earnings of £40,000 per annum and she contributes £2,000 per annum gross into a personal pension plan, which is currently valued at £72,000. She has also accrued 23 years of National Insurance contributions towards a BSP.

Once her divorce has been finalised, Susan intends to move abroad for the foreseeable future.

Questions

(a) Explain the potential impact of pension sharing on both John and Susan's lifetime allowance if Susan is awarded a share of John's pension benefits. **(12)**

(b) In respect of the divorce settlement, outline **three** potential benefits and **three** potential drawbacks to Susan for any pension benefits to be dealt with via off-setting rather than pension sharing. **(6)**

(c) Susan would like to continue to pay contributions to her personal pension plan for as long as possible.

(i) Explain the qualifying conditions that must be met in order for her contributions to be eligible for UK tax relief. **(4)**

(ii) State the maximum contributions that would qualify for UK tax relief in any given tax year where eligibility is met. **(3)**

(d) Susan is concerned about the relatively low level of Basic State Pension (BSP) she has accrued and the potential impact that moving abroad will have on these benefits.

(i) State the factors that you would take into account before advising Susan on whether to make Class 3 voluntary National Insurance contributions. **(8)**

(ii) State the criteria that must be met for Susan to qualify for increases to her BSP once in payment. **(3)**

Total marks available for this question: 36

Questions continue over the page

Question 3

Alice will be 73 on 1 May 2014. She has been in receipt of an index linked pension annuity since 2001 which currently pays her £9,500 per annum.

Following the death of her husband Brian in January 2009, Alice elected to continue his drawdown pension policy. She made this election on 15 June 2009. The fund is currently valued at £90,000 and Alice is taking an annual income of £6,560 which is 80% of the current maximum permitted withdrawal. This is next due for review on 15 June 2014, following the expiry of her current five year reference period.

Alice spends the vast majority of her time caring for her stepson, Michael, aged 53, who was paralysed in a motorbike accident ten years ago. Michael is Brian's eldest child from a previous relationship and he has been nominated by Alice as the recipient of any death benefits on the drawdown policy.

In addition to the above, Alice received the following gross taxable income in the tax year 2013/2014:

- State pension income of £9,200 per annum.
- Rental income of £28,000 per annum.
- Purchase life annuity income of £10,000 per annum.
- Income from a guaranteed income bond of £3,000 per annum.

Having enjoyed the flexibility of capped drawdown, Alice is considering crystallising some of her own personal pension plan in order to produce a net amount of £10,000. Alice's personal pension is currently valued at £260,000 and the applicable figure from the Government Actuary Department (GAD) drawdown table is £68 per £1,000.

Questions

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

(a) In respect of Alice's dependant's drawdown arrangement:

(i) State **five** reasons why the maximum level of withdrawal at the forthcoming review will be different from that calculated at the initial reference date. **(5)**

(ii) State, giving reasons, the first reference date that will apply after Alice reaches her 75th birthday. **(3)**

(b) Explain why the drawdown provider would agree that Michael meets the HM Revenue & Customs definition of dependant and outline the potential death benefit options available to him in the event of Alice's death. *You should cover the relevant tax treatment of each option in your answer.* **(10)**

(c) Assuming Alice decides to partially crystallise her personal pension plan using capped drawdown:

(i) State **four** reasons why it might be beneficial for Alice to utilise capped drawdown rather than annuity purchase to provide the £10,000 required. **(4)**

(ii) Calculate, **showing all your workings**, the minimum amount that needs to be crystallised in order to produce a net amount of £10,000. **(6)**

(iii) Calculate, **showing all your workings**, the percentage of Alice's lifetime allowance that will remain following the crystallisation in part **(c)(ii)** above. *Use the 2013/2014 lifetime allowance in your calculation.* **(4)**

(d) If Alice were to consider utilising flexible drawdown at some point in the future:

(i) Calculate, **showing all your workings**, the additional secured income Alice needs in order to meet the minimum income requirement, based on Alice's 2013/2014 income figures. **(3)**

(ii) Outline the options available to Alice to meet the shortfall identified in part **(d)(i)** above. **(3)**

(iii) State the factors you would need to consider before advising Alice on whether she should enter flexible drawdown. **(6)**

Total marks available for this question: 44

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	2012/2013	2013/2014
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	2013/20
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 (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	2013/20
		£	£
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

BLANK PAGE

BLANK PAGE

BLANK PAGE