THE CHARTERED INSURANCE INSTITUTE

AF3

Advanced Diploma in Financial Planning

Unit AF3 – Pension 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 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 section is compulsory and carries 80 marks

Question 1

Gwen, aged 60, and Sarah, aged 48, formed a civil partnership in September 2013. This is Gwen's second civil partnership and Sarah's first.

Gwen registered for primary protection in 2006, with a primary protection factor of 0.18. In 2010, at the dissolution of her previous civil partnership, she had a pension debit of £135,000 applied to her benefits. The funds in respect of this debit have been transferred to her ex-partner.

Gwen, who is a scientist in the oil industry, intends to stop working when she reaches her 61st birthday on 30 November 2013. Her current pension entitlement is:

Deferred membership of GH plc contracted-in defined benefit scheme	Pension entitlement at age 65: £38,000 per annum Early retirement factor 0.5% per month or part thereof
Personal pension plan fund value	£1,300,000
Retirement annuity plan fund value	£1,500
Retirement annuity plan fund value	£1,900

The trustees of the GH plc scheme have recently advised members that they have the option of taking Pension Increase Exchange. In Gwen's case, assuming she started taking her benefits in December 2013, she would receive an increase of 22% on her starting income.

Sarah, who is a lawyer, is employed with relevant earnings in the tax year 2013/2014 of £102,000. She has a son, Jack, aged 17, from a previous relationship. Sarah has opted to continue receiving Child Benefit and will pay any tax due via her self-assessment tax return.

Sarah received a large inheritance from her parents in 2011/2012. She has been using part of this to place the maximum possible tax relievable pension contributions into her personal pension plan as she wishes to stop working when she reaches age 55. She has no other pension plans. Her contribution history has been:

Tax year	Employer contribution (£)	Sarah's contribution (£)
2008/2009	10,000	5,000
2009/2010	10,000	6,000
2010/2011	11,000	6,000
2011/2012	12,000	78,000
2012/2013	12,000	80,000

Sarah's employer will pay a contribution of £14,000 in the tax year 2013/2014. Her personal pension plan has a pension input period aligned with the tax year.

Both Gwen and Sarah have previously received a forecast of their State Pension benefits. These show that Gwen will reach State Pension Age (SPA) on 6 July 2015 and that Sarah will reach SPA on her 66th birthday. Assuming Gwen ceases working in November 2013, she will have accrued 31 years of National Insurance Contributions (NICs). If Sarah stops working at age 55 she will have accrued 32 years of NICs.

Questions

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

(a) In respect of Gwen's two retirement annuity plans:

(i) Explain briefly why it is possible for her to commute these funds for lump sum payments. **(4)**

(ii) Outline the tax treatment of these payments when she commutes these funds in November 2013. **(2)**

(b) Gwen is very interested in the trustees offer of Pension Increase Exchange.

(i) Explain to Gwen how Pension Increase Exchange works. **(2)**

(ii) Calculate, **showing all of your workings**, Gwen's starting income if she elects for Pension Increase Exchange in December 2013.
You should assume she elects not to take any pension commencement lump sum (PCLS). **(2)**

(iii) Outline the factors that you would take into account when advising Gwen on whether or not to take up this offer. **(6)**

(c) Gwen would like to crystallise her GH plc pension in December 2013 and her personal pension plan in January 2014. She does not wish to take any PCLS from the GH plc scheme.

(i) Calculate, **showing all your workings**, Gwen's revised primary protection factor. **(4)**

(ii) Gwen intends to take up the offer of Pension Increase Exchange, as calculated in part **(b)(ii)** above.

Calculate, **showing all your workings**, the lifetime allowance tax charge payable once she has crystallised all of her pension arrangements, if she takes the excess over her personal lifetime allowance as income. **(8)**

(d) Gwen intends to use the PCLS she takes from her personal pension plan to purchase a holiday property and then place the balance of the funds into a drawdown arrangement from which she will draw an ad-hoc income.

State the additional information you would require from Gwen before you could advise her on a suitable investment strategy for these funds. **(8)**

Questions continue over the page

(e) Sarah would like to maximise her personal contribution to her personal pension plan the tax year 2013/2014.

(i) Calculate, **showing all your workings**, the maximum gross tax relievable contribution she can make in the tax year 2013/2014 without incurring an annual allowance tax charge. *Assume no changes are made to the pension input period.* **(10)**

(ii) Describe in detail, **using calculations to support your answer**, how the tax relief will be awarded in respect of the contribution calculated in part **(e)(i)** above and the impact on Sarah's overall tax situation. *You should assume she has no other taxable income.* **(11)**

(f) Gwen and Sarah would like to ensure that, on first death, the survivor can receive an income from the deceased's pension funds and then on second death, Jack will benefit from any remaining funds.

Explain how a spousal by-pass trust works, outlining any benefits or limitations that may apply. **(12)**

(g) **(i)** State why, based on their current circumstances, Gwen will receive a full Basic State Pension (BSP) and Sarah will not. **(3)**

(ii) Outline how Gwen's BSP will be taxed once in payment. **(4)**

(iii) Assuming Sarah does stop working at age 55, explain briefly how she can still ensure that she receives her full BSP. **(4)**

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

Jim, aged 42, established Aqua Supplies Ltd in 2002. The company has 93 full-time employees and 26 part-time employees. Jim has calculated that, on average, at least 20% of the employees take home pay is in respect of overtime.

Jim's only pension provision is a self-invested personal pension scheme (SIPP). This was established by a transfer in of £190,000, from a previous employer's scheme. The company has been making annual contributions of £10,000 since 2006.

The assets of the SIPP consist of £20,000 in cash and £265,000 in individual shares. In 2012 the SIPP borrowed £30,000 and currently £20,000 of this loan is outstanding.

The company operates from a commercial unit owned outright by Aqua Supplies Ltd. Jim believes the market value of this unit is around £220,000. Jim, who has an adventurous attitude to risk, would like to place this property into his SIPP. He would also like the SIPP to borrow additional funds so that he can take advantage of further investment opportunities.

Aqua Supplies Ltd currently offers employees membership of a group personal pension (GPP). The company contributes 5% of their basic salary and employees can contribute if they wish to do so.

The company's staging date for auto-enrolment is 1 May 2014. Jim would like to maintain the current scheme if possible, and has stated that he wishes to continue to pay an employer contribution of 5% of basic salary. He would prefer not to use the qualifying earnings definition when ensuring the minimum contribution requirements are met.

Questions

(a) **(i)** Outline the process that must be followed in order that the property can be placed into the SIPP as an in-specie contribution. **(5)**

(ii) Outline **five** benefits and **five** drawbacks to Jim of the SIPP owning the property, rather than it continuing to be owned by Aqua Supplies Ltd. **(10)**

(b) Jim believes that if the property is valued at £220,000, the maximum additional borrowing, the SIPP can undertake is £242,500. Explain, **using calculations to support your answer**, why this is not the case. **(6)**

(c) State the criteria that must be met so that Jim can maintain the current GPP for auto-enrolment purposes. **(5)**

(d) **(i)** Outline the contributions that must be paid under each of the **three** tiers available to an existing defined contribution scheme so that at least minimum contributions are being paid from October 2018. **(10)**

(ii) Recommend how the contributions to the Aqua Supplies Ltd GPP should be structured from October 2018. **(4)**

Total marks available for this question: 40

Questions continue over the page

Question 3

Robert, aged 45, is divorced with no dependants. After leaving university, he started working Ketterman Engineering Ltd and immediately joined their contracted-out defined benefit pension schem He was a member of this scheme until he left their employment after being made redundant. This is his only pension.

The details of his membership of the Ketterman Engineering defined benefit scheme are:

Date of joining	1 January 1991
Date of leaving	31 December 2011
Accrual rate	1/80th pension plus 3/80th pension commencement lump sum
Scheme pension age	65
Additional benefits	50% dependant's pension
Method of GMP revaluation	Fixed
Revaluation of non GMP benefits	Statutory minimum

Ketterman Engineering Ltd has now closed the defined benefit scheme both to new members and in respect of further accrual for existing members. The latest valuation shows the scheme is in deficit. Robert is concerned about Ketterman Engineering's financial strength.

When he left employment, Robert received a statement showing a cash equivalent transfer value (CETV) of £285,000. He recently received a revised statement showing a CETV of £310,000. Included with this was a note from the Trustees stating that the scheme's current underfunding had been ignored in arriving at this figure. A transfer value analysis report based on this latest CETV shows a critical yield of 5.9%.

Robert, who is in excellent health, has a cautious attitude to risk. He is currently working on a fixed term contract in the UK but has been offered work in Canada. If he makes the move Robert expects that he will remain there and plans to retire at age 60.

Questions

(a) In respect of Robert's CETV of £310,000:

(i) Describe, in detail, to Robert how his CETV was calculated. **(10)**

(ii) Explain why the scheme's current underfunding may have been ignored when Robert's CETV was calculated. **(4)**

(b) Explain to Robert how a change in the following assumptions may have led the trustees to increase his CETV.

(i) Consumer Prices Index. **(3)**

(ii) Life expectancy. **(3)**

(iii) Investment returns. **(2)**

(c) Based on the information available, state **six** reasons why Robert should consider:

(i) leaving his benefits within the Ketterman Engineering Ltd defined benefit scheme; **(6)**

(ii) transferring the benefits to a new scheme. **(6)**

(d) If Robert moves to Canada, he would consider transferring his benefits in the Ketterman Engineering Ltd scheme to a qualifying recognised overseas pension scheme (QROPS) in Canada.

Outline the reporting requirements of a QROPS. **(6)**

Total marks available for this question: 40

The tax tables can be found on pages 13 – 17

INCOME TAX

RATES OF TAX	2012/2013	2013/
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/
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%

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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