THE CHARTERED INSURANCE INSTITUTE

J05

Diploma in Financial Planning

Unit J05 – Pension income options

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

- Two 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 J05 – Pension income options

Instructions to candidates

Read the instructions below before answering any questions

- **Two hours** are allowed for this paper which consists of 15 short answer questions and carries a total of 130 marks.
- 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.

Attempt ALL questions

Time: 2 hours

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

1. Outline how each of the following factors may affect the income payable from a lifetime annuity:

(a) Gilt yields; **(3)**

(b) Longevity. **(3)**

2. Edward is planning to retire in January 2014 and would like to utilise flexible drawdown with his personal pension fund.

(a) List the relevant income sources that can be included when calculating whether Edward will satisfy the minimum income requirement. **(5)**

(b) Explain the rules and the tax treatment relating to any future contributions made by Edward. **(5)**

3. Susan received a scheme pension from her former employer's defined benefit scheme, until she died recently at the age of 58. Susan leaves behind her husband, Peter, and daughter, Claire, aged 20, who is in full time education. Susan also had uncrystallised funds in a personal pension.

Explain the potential death benefits available to Susan's husband and daughter and their tax treatment. **(15)**

4. Stuart, aged 62, retired six months ago after 18 years pensionable service and is in receipt of a scheme pension from his company's defined benefit scheme. Stuart did not retire due to ill health. The scheme pension includes a spouse's pension of 2/3rds of the member's pension at the date of retirement, and pensions in payment which escalate at 5% per annum. The scheme's normal retirement age is 65.

Explain how both Stuart's and his wife's entitlement would be affected if the scheme entered the Pension Protection Fund before Stuart reaches the scheme's normal retirement age. **(8)**

5. Alan is a member of an executive pension plan (EPP) with pension rights currently valued at £750,000. At A-Day, his pension rights were valued at £500,000, with a maximum pension commencement lump sum (PCLS) entitlement of £175,000. Alan has not registered for any form of transitional protection.

(a) Calculate, **showing all your workings**, the maximum PCLS available to Alan if he were to crystallise his EPP today. **(8)**

(b) Alan is considering a transfer to another registered pension scheme that allows income drawdown. State the conditions that must be satisfied to retain any protected PCLS on transfer. **(4)**

6. Heather reached her State Pension Age in October 2010 when she was entitled to a Basic State Pension (BSP) of £97.65 per week. At that time she deferred her BSP but she has now decided to take these benefits.

Calculate, **showing all your workings**, Heather's BSP entitlement if she decides to receive her deferred pension as increased income. *Assume a deferment of exactly three years and a current BSP entitlement of £110.15 per week.* **(5)**

7. Sam aged 63 and a higher rate tax payer, is utilising phased capped drawdown to supplement his earned income. The uncrystallised fund is currently valued at £475,000 and he does not plan to purchase an annuity in the foreseeable future.

Sam has decided he requires an additional net income of £15,000 in the tax year 2013/2014.

(a) State **two** ways in which the £15,000 could be provided by the current arrangement. *Calculations are not required.* **(2)**

(b) For each of the **two** ways of providing the £15,000 identified in part **(a)** above, outline **two** benefits and **one** drawback. **(6)**

8. List **five** circumstances when a registered pension scheme may pay an authorised lump sum to a member on or after retirement, but before the member's death. **(5)**

9. Yvonne, aged 63, commenced a phased drawdown arrangement in December 2010 and her annual review of the arrangement is now due.

State the factors that should be taken into account during a review of the following:

(a) income and pension commencement lump sum requirements; **(4)**

(b) fund performance. **(4)**

10. Owen, aged 59, and his wife Davina, aged 64, are both self-employed Barristers and additional rate tax payers. From 1 November 2013, Owen intends to start working part-time although Davina plans to continue working full-time.

Outline **six** potential benefits and **six** potential drawbacks of providing an income in retirement for Owen by way of phased drawdown. **(12)**

11. Keith retired in 2005 and has since drawn pension income from two pension arrangements as follows:

- Income withdrawals, which commenced in January 2005. He is currently drawing £7,200 per annum which is half of the maximum permitted withdrawal.
- A non-escalating lifetime annuity of £6,480 per annum, which commenced in March 2006.

Keith also has a retirement annuity contract. He now intends utilising the fund value of £210,000 to purchase a lifetime annuity in the tax year 2013/2014.

Calculate, **showing all your workings**, the percentage of Keith's lifetime allowance that will remain **after** he has crystallised his retirement annuity contract. **(11)**

12. John, aged 62, who earns £80,000 per annum, is due to be made redundant in December 2013. John has decided to take early retirement and take the benefits from his company's Group Personal Pension Plan (GPP) following his redundancy.

His redundancy payment is £100,000 and he can take this as a cash lump sum or have part of it paid into his GPP as an employer contribution.

Neither John nor his employer has made any pension contributions during the tax year 2013/2014. John's pension input period is aligned to the fiscal year and he does not intend altering this.

The pension contributions made in respect of John so far are as follows:

Tax Year	Employer Contribution (£)	Employee Contribution gross (£)
2010/2011	18,000	20,000
2011/2012	25,000	20,000
2012/2013	35,000	20,000

(a) Calculate, **showing all your workings**, the maximum pension contribution that could be made by John's employer for the tax year 2013/2014 without John incurring an annual allowance charge. *Assume John has no carried forward annual allowance available from 2009/2010.* **(4)**

(b) Outline **two** benefits and **two** drawbacks of John choosing to have part of his redundancy payment paid into his GPP as an employer's contribution. **(4)**

13. Christine, who is married, was a member of her previous employer's contracted-out defined benefit scheme between 1980 and 1996.

Outline the differences between Guaranteed Minimum Pension and excess benefits in respect of:

(a) a spouses' pension; **(4)**

(b) escalation of pensions in payment. **(8)**

14. The maximum Government Actuary's Department income level that can be taken from a drawdown pension arrangement changed on 26 March 2013.

Explain briefly how this change will affect existing drawdown pension arrangements. **(5)**

15. Jayne has been receiving an income from her drawdown pension plan for five years. The funds were originally invested in:

- 30% Cash.
- 15% Fixed Interest.
- 45% Equities.
- 10% Property.

Outline the circumstances which would result in a recommendation for the funds to be rebalanced. **(5)**

The tax tables can be found on pages 8 – 12

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
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

CAPITAL GAINS TAX

EXEMPTIONS	**2012/2013**	**2013/**
Individuals, estates etc	£10,600	£10,90
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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