THE CHARTERED INSURANCE INSTITUTE

CII

J04

Diploma in Financial Planning

Unit J04 – Pension funding options

July 2011 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2010/2011 unless stated otherwise in the question, and should be answered accordingly.

Assume all individuals are domiciled, resident and ordinarily resident in the UK unless stated otherwise.

Candidates should answer based on the legislative position immediately BEFORE the 2011 budget.

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 handing 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 J04 – Pension funding 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 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

1. State **four** advantages and **four** disadvantages of investing in buy-to-let property as an alternative to investing in a pension when saving for retirement. **(8)**

2. Beatrice, aged 52, has been a member of her employer's defined benefit scheme since 1 January 2003. The scheme provides pension benefits on a 1/80th basis with separate tax-free cash accrual of 3/80ths. At the start of the pension input period on 1 January 2011 her pensionable salary was £40,800. The increase in Consumer Prices Index for the current pension input period is 3.1%.

Assuming no changes to her salary during the year, calculate, **showing all of your workings,** the value of the benefits that will be tested against her annual allowance. **(12)**

3. In the tax year 2010/2011 Louis, an additional rate taxpayer, has inadvertently paid a pension contribution that will be subject to the special annual allowance charge. He would prefer to avoid this charge and has asked the scheme administrator to refund the excess pension contribution.

Outline briefly the factors the scheme administrator will take into account when considering Louis's request and the tax treatment of the refund should the refund occur. **(5)**

4. Jeremy, aged 46, has recently been diagnosed with terminal cancer and is in a civil partnership with Richard. Jeremy has a personal pension plan that contains both protected and non-protected rights and would like to be able to take these benefits as soon as possible.

State the conditions that must be met in order for his pension funds to be paid as a serious ill health lump sum, outlining any restrictions that may apply. **(7)**

5. Jenny, aged 17, is employed with earnings of £7,000 for the tax year 2010/2011.

(a) State the eligibility conditions that Jenny meets that enable her to accrue State Second Pension (S2P) benefits. **(2)**

(b) Explain how Jenny's S2P entitlement for the tax year 2010/2011 will be calculated. *No calculation is necessary.* **(3)**

6. A defined benefit scheme has recently commenced the assessment period for entry into the Pension Protection Fund.

Explain how this period of assessment will impact upon the scheme and its administration. **(8)**

7. Outline the responsibilities of the trustees of a defined benefit scheme. **(10)**

8. The company pension scheme of Laura's Lanterns Ltd has a funding deficit. The trustees and employer are considering the options available before submitting a formal recovery plan.

List **seven** options that would be available to help deal with the scheme deficit. **(7)**

9. Outline the HM Revenue & Customs (HMRC) requirements that must be satisfied in order to gain tax relief on an in-specie pension contribution. **(5)**

10. Holly, aged 28 and married, is a member of her employer's group personal pension. She has recently received a Statutory Money Purchase Illustration (SMPI) showing a projected pension income of £22,000 per annum at age 65.

(a) Outline the purpose of a SMPI. **(3)**

(b) Explain the annuity basis used in calculating Holly's projected pension income. **(6)**

11. Sanjita has deferred benefits in a previous employer's defined benefits scheme. She is considering transferring the benefits into her self-invested personal pension plan (SIPP). A transfer value analysis system has calculated the critical yield as 8.5% per annum to age 65.

(a) Explain the process that would have been used to calculate the critical yield. **(6)**

(b) Explain why the benefits Sanjita may receive from the SIPP in respect of the transfer could be less than her defined benefit entitlement at age 65, even if the critical yield of 8.5% is met. **(4)**

(c) Outline the reasons why Sanjita may choose to transfer her benefits to the SIPP, despite the relatively high critical yield. **(5)**

12. Explain, in detail, the potential disadvantages of lifestyling for a member of a money purchase scheme in respect of:

(a) the timing and method of taking benefits; **(5)**

(b) the automated switching of investments. **(5)**

Questions continue over the page

13. Jason wishes to investigate the possible transfer of his benefits under his former employer's contracted-in defined benefit pension scheme to his personal pension plan (PPP).

List the minimum information the FSA would require an adviser to obtain from the ceding scheme, in addition to a transfer value illustration, before advising Jason on the suitability or otherwise of the proposed transfer to the PPP. **(10)**

14. Vincent, aged 42, is considering using his self-invested personal pension (SIPP) to purchase a commercial property. The gross assets of the SIPP consist of shares valued at £250,000 plus cash holdings of £200,000.

In 2009, the SIPP took out a loan for £80,000 and the amount currently outstanding is £40,000.

Calculate**, showing all your workings,** the total amount the SIPP could use to purchase a commercial property assuming maximum additional borrowing is arranged. **(8)**

15. Amanda and her husband Steve are in the process of getting divorced. Whilst Amanda does not have any pension provision over and above her Basic State Pension entitlement, Steve is an active member of his employer's contracted-in occupational money purchase scheme (CIMPS) and has never been contracted-out.

(a) Explain the process that will be followed in establishing Amanda's entitlement to Steve's CIMPS and State Pension benefits under a pension sharing order. **(8)**

(b) State how any benefits Amanda is awarded as a result of a pension sharing order will be assessed against her lifetime allowance when the benefits are crystallised. **(3)**

The tax tables can be found on pages 8 – 12

INCOME TAX

RATES OF TAX	2009/2010	2010/2011
Starting rate for savings*	10%	10%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	N/A	50%
Starting-rate limit	£2,440*	£2,440*
Threshold of taxable income above which higher rate applies	£37,400	£37,400
Threshold of taxable income above which additional rate applies	N/A	£150,000

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

MAIN PERSONAL RELIEFS		
Income limit for Personal Allowance §	N/A	£100,000
Personal Allowance (basic) §	£6,475	£6,475
Personal Allowance (age 65-74) §	£9,490	£9,490
Personal Allowance (aged 75 and over) §	£9,640	£9,640
Married/civil partners (minimum) at 10% †	£2,670	£2,670
Married/civil partners (age 75 and over) at 10%	£6,965	£6,965
Income limit for age-related allowances	£22,900	£22,900
Blind person's allowance	£1,890	£1,890
Enterprise Investment Scheme relief limit at 20%	£500,000	£500,000
Venture Capital Trust relief limit at 30%	£200,000	£200,000

§ the Personal Allowance reduces by £1 for every £2 of income above the income limit irrespective of age from 2010/2011.
† where at least one spouse/civil partner was born before 6 April 1935.

Child Tax Credit (CTC)		
- family element	£545	£545
- family element baby addition	£545	£545
CTC usually reduced by 6.67% of joint income over	£50,000	£50,000

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	Weekly	Monthly	Yearly
Lower Earnings Limit (LEL)	£97	£421	£5,044
Primary threshold	£110	£477	£5,715
Upper Earnings Limit (UEL)	£844	£3,656	£43,875
Upper Accruals Point	£770	£3,337	£40,040

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS	
	Contracted-in rate	Contracted-out rate
Up to 110.00*	Nil	Nil
110.01 – 770.00	11%	9.4%
770.01 – 844.00	11%	11%
Above 844.00	1%	1%

Total earnings £ per week	CLASS 1 EMPLOYER CONTRIBUTIONS		
	Contracted-in rate	Contracted-out rate	
		Final salary	*Money purchase*
Below 110.00**	Nil	Nil	Nil
110.01 – 770.00	12.8%	9.1%	11.4%
770.01 – 844.00	12.8%	12.8%	12.8%
Excess over 844.00	12.8%	12.8%	12.8%

** This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £97 per week. This £97 to £110 band is a zero rate band introduced in order to protect lower earners' rights to contributory State benefits e.g. Basic State Pension.*
*** Secondary earnings threshold.*

Class 2 (self-employed)	Flat rate per week £2.40 where earnings exceed £5,075 per annum.
Class 3 (voluntary)	Flat rate per week £12.05
Class 4 (self-employed)	8% on profits between £5,715 - £43,875 plus 1% on profits above £43,875

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

NOTIONAL EARNINGS CAP
£123,600 – (For schemes that require post-1989 benefits to be still subject to a cap).

ANNUAL ALLOWANCE CHARGE
40% 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	2009/2010	2010/2011
Transfers made after 5 April 2010		
- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
- Lifetime transfers to and from certain trusts	20%	20%

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	£55,000
- UK-registered charities	No limit	No limit
Lifetime transfers		
- annual exemption per donor	£3,000	£3,000
- small gifts to same person	£250	£250
Wedding/civil partnership gifts by		
- parent	£5,000	£5,000
- grandparent/party to marriage/civil partnership	£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 2010/2011:
The percentage charge is 15% of the car's list price for CO_2 emissions at or below the qualifying level of 130g/km.
The base percentage charge of 15% increases in 1% steps for every additional full 5g/km over the 130g/km threshold, up to a maximum of 35% of the car's list price.
A lower percentage charge of 10% of the car's list price applies for emissions at or below 120g/km and 5% for emissions at or below 75g/km.

If price of car exceeds £80,000 then its price for tax purposes will be fixed at £80,000.

There is an additional 3% supplement for diesel cars not meeting Euro IV emission standards or registered after 31 December 2005. 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 (£18,000 for 2010/2011) e.g. car emission 160g/km = 21% on car benefit scale. 21% of £18,000 = £3,780.

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 12.8%.

PRIVATE VEHICLES USED FOR WORK

2010/2011 Rates

Cars	
On the first 10,000 business miles in tax year	40p per mile
Each business mile above 10,000 business miles	25p per mile
Motor Cycles	24p per mile
Bicycles	20p per mile

MAIN CAPITAL AND OTHER ALLOWANCES

	2010/2011
Plant & machinery 100% annual investment allowance (first year)	£100,000
Plant & machinery (reducing balance) per annum	20%
Patent rights & know-how (reducing balance) per annum	25%
Certain long-life assets, integral features of buildings (reducing balance) per annum	10%
Industrial & agricultural buildings (straight line)	1%
Energy & water-efficient equipment	100%
Zero emission goods vehicles (new)	100%
Qualifying flat conversions, business premises & renovations	100%

Motor cars: Expenditure on or after 01/04/09 (Corporation Tax) or 06/04/09 (Income Tax)

CO_2 emissions of g/km:	110 or less *	111-160	161 or more
Capital allowance:	100% first year	20% reducing balance	10% reducing balance

* If new

Research & Development:	Capital expenditure	100%
Revenue expenditure:	Small/medium companies:	175%
	Large companies:	130%

MAIN SOCIAL SECURITY BENEFITS

		2009/2010 £	2010/2011 £
Child Benefit	first child	20.00	20.30
	subsequent children	13.20	13.40
Incapacity Benefit	short-term lower rate*	67.75	68.95
	short-term higher rate*	80.15	81.60
	long-term rate	89.80	91.40
Attendance Allowance	lower rate	47.10	47.80
	higher rate	70.35	71.40
Retirement Pension	single	95.25	97.65
	married	152.30	156.15
Pension Credit	single person standard minimum guarantee	130.00	132.60
	married couple standard minimum guarantee	198.45	202.40
	maximum savings ignored in calculating income	6,000.00	10,000.00
Bereavement Benefit (lump sum)		2,000.00	2,000.00
Widowed Parent's allowance		95.25	97.65
Jobseekers Allowance		64.30	65.45

** under State Pension Age*

CAPITAL GAINS TAX

RATES OF TAX

Chargeable gains, less allowable losses, are charged to tax as follows from 23 June 2010:

- for individuals who are non-taxpayers or basic-rate taxpayers, the rate chargeable is 18%.
- for individuals who are higher-rate taxpayers or additional-rate taxpayers, the rate chargeable is 28%.
- for trustees of trusts and personal representatives the rate chargeable is 28%.
- Entrepreneurs' Relief reduces the rate to 10% on qualifying assets subject to a lifetime limit of £5,000,000.

ANNUAL EXEMPTION

- The annual exemption is £10,100.
- Most trusts have an annual exemption of £5,050.

CHATTELS EXEMPTION

- Gains on chattels are exempt if proceeds do not exceed £6,000 per item.

CORPORATION TAX

	2009/2010	2010/2011
Full rate	28%	28%
Small companies rate	21%	21%
Small companies limit	£300,000	£300,000
Effective marginal rate	29.75%	29.75%
Upper marginal limit	£1,500,000	£1,500,000

VALUE ADDED TAX

Standard rate to 03/01/11	17.5%
Standard rate from 04/01/11	20%
Annual Registration limit	£70,000

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