AF5 June 2021 case notes Version 1

As the fact find was completed on the 19 May, your answers should be based on the 21/22 tax year. This also impacts on any CGT on the transfer of assets between Peter to Julie

Julie Simmons is a 50 year old lady who has recently divorced her husband Peter. This was amicable and their two children, Oliver, 13 and Noah 11 live with her.

The main points of the divorce settlement are:

- The children live with Julie
- She owns the marital home which is mortgage free
- She receives monthly maintenance of £1,000 that will continue for the next seven years.
- She still owns 20% of the shares in her ex husband's business (£85,000) She has agreed that she will retain the shares and pass them to their sons when the youngest reaches 18.
- She agreed an offsetting arrangement for her ex-husbands pension receiving £200,000 in return.
- In addition she received a portfolio of AIM shares with a current value of £65,000. Peter would like her to retain these and pass them to their sons in her will.

What are the other implications of the divorce.

- Julie's will is still valid but Peter cannot inherit.
- Neither can he be the executor
- If Julie dies before writing a new will the rules of intestacy will apply and her sons will inherit. (as minors it will be held in trust until they are 18)
- If Peter was Julie's sole attorney the LPA will have lapsed. It cannot be revived so she must set up a new one.
- Peter was the nominee to receive the death benefits of her pension scheme and this hasn't been changed.
- Payment is at the trustees' discretion but they might still pay to Peter as the children's father.
- She will qualify for Child Benefit now she is the sole earner.

What additional information is required about her divorce settlement

- Is the maintenance indexed linked?
- Will it end if Julie remarries?
- Will it end if Peter dies?
- Can it continue if the children go inti Higher Education.

- Is he willing to have his life insured by Julie?
- Is the agreement to pass the business shares to the children a legally binding agreement.? Could this be considered a trust? (implied trust)
- The same consideration applies to the AIM shares.
- Was Peter her sole attorney of the LPA?
- Is Peter her executor
- Who does she want to benefit in the event of her death.
- Who would she like to be her executor?/Should Peter be the executor?
- When did they formally separate?
- What was the date of the divorce.
- When were Peter's assets transferred to her?

Technical notes: Julie's will and LPA

- Divorce does not invalidate a will but Peter cannot inherit nor be the executor.
- This means the assets will be distributed according to intestacy rules
- Which means her sons will inherit.
- If no new will is written they will inherit absolutely at 18.
- To give control she could consider writing an 18 to 25 trust in the will.
- This allows the executors the flexibility to advance the money at any time between each son's 18th and 25th birthday.

- If Peter is Julie's sole attorney for her LPA it would have lapsed on her divorce.
- She may have nominated a replacement attorney which means he or she could take over.

Technical notes Pension and DIS nominations

- The DIS has Peter as the nominated beneficiary
- This is not binding on the trustees but would probably pay the benefit to him since the children would live with him.
- The same would apply to the pension fund.
- An alternative would be for Julie to set up and nominate a discretionary trust to receive the benefits.
- This could have Peter and the two children as the beneficiaries
- Her parents could be the executors
- She could leave a letter of intent giving her wishes on how the money should be used.
- It means that the children could ultimately benefit which would not be guaranteed if Peter receives the money.
- Once the children are 18 she could nominate them as the direct beneficiaries
- One downside of nominating a trust is that it takes the money outside the pension regime and it would lose its tax free status

Recommendations

- Julie should write a new will
- She can appoint a new executor. (possibly her parents)
- Her will could be more bespoke in particular using an 18-25 trust so there is more control over the estate rather than giving them an absolute right at a18.
- She should set up a new LPA
- She could consider having a replacement attorney.
- The same applies to the DIS from her employer's scheme
- She could consider nominating a trust with the sons as the beneficiaries.

Technical note 18 to 25 trust

- She can set this up as she is the parent of the children.
- This would come into effect on Julie's death.
- The will would appoint trustees.
- They can forward money for maintenance whilst the children are minors.
- They have the discretion to advance capital between each child's 18th and 25th birthday.
- It becomes a Relevant Property Trust on the child's 18th birthday.
- There could be an exit charge but this would be a maximum of 4.2% on the property over the NRB.
- It would not invalidate the estate's ability to use Julie's NRB
- She could amend her will when the children come of age.

State the process for setting up a new LPA

- Must be done on the prescribed form
- Julie chooses her attorney/ies
- Must be signed, dated and witnessed.
- It must be countersigned by an independent person who certifies Julie knows what she is doing.
- It is sent to the OPG with the required fee and provided it has been completed correctly will register it.
- It then comes into force.

Have a look at

October 20 Q3

Protection needs

There is a stated objective that Julie wishes to make sure she has sufficient income to meet her needs and the needs of the children until they reach 18 (7 years)

Factors

- She earns £45,000 in her current job
- After tax and NI that is probably £34,500
- This is below her annual expenditure (£41,000)
- But she receives £12,000 a year in maintenance which is tax free
- ISA interest of £100
- Dividend ISA £2,160

- Taxable interest £1,200
- Taxable dividend £5,000
- No protection against long term sickness other than her employer's sick pay
- No Critical Illness
- Has the option of renewing PMI without any further underwriting

Bordering on being higher rate but pension contributions just keep her in basic rate.

It's a reasonable assumption that if Julie died then the boys would live with their father. In addition money will be available from her DIS and Pension. With trusts being used that could ensure the money would eventually go to he children in their own right.

Therefore no one would suffer financially if Julie were to die but Julie would suffer financially if Peter died as the maintenance would stop.

She has insurable interest in his life

Recommendation

- Julie should take out a FIB policy on his life
- For £1,000 a month
- With a term of seven years
- To ensure maintenance is paid for the agreed time if Peter dies.
- With indexation to maintain its value
- WOP to ensure premiums are paid in the event of sickness.
- Guaranteed costs to ease budgeting

As stated previously she should write a new will, inform trustees of pension and DIS to ensure money is paid to the children.

Her other need is protection against long term illness or injury.

- Recommend Income Protection
- Monthly benefit of c £2,500
- Term until 60
- Deferred period to match employer's sick pay to provide seamless cover.
- To maintain standard of living
- Avoids asking Peter to increase maintenance if she cannot work.
- Fixed premium to maintain affordability.
- With indexation to maintain its real value
- Own job to maintain widest cover
- Office based job so premium likely to be reasonable

The fact find states that she has the option to continue her PMI without further underwriting and wants your views on this. This could lead to a question on what information is required to give advice on this point:

- Costs/premium/
- Fixed or increasing
- Level of cover Affordability
- Excess
- Other options such as a more basic cover
- How are any pre-existing conditions dealt with?/Exclusions

Have a look at:

October 20 Q5 b Classic R & J question for FIB
October 19 Q 7 (a) and (c) The latter is a classic R & J question for IP

Investments

The fact find gives the question writer plenty of scope to write on different aspects of investment planning. Her holdings are as follows:

Current account	£15,000
Deposit account	£200,000 (received in lieu of pension offset)
Cash ISA	£40,000
S/S ISA	£120,000 (UK multi asset cautious management)
AIM shares	£65,000 (gifted from her ex husband)
WPQ shares	£85,000 (see notes below)

In addition we are told that:

- Julie wants advice on ensuring the monies she received from the divorce settlement are managed appropriately.
- She has a medium to high risk ATR but following her divorce a reduced capacity for loss
- She is interested in investing in an ethical manner but not at the expense of investment returns. She wants to know if her current investments follow any ethical guidelines so she can make an informed decision.

Appropriateness of her portfolio

On an assessment of her current portfolio:

- Her S/S ISA does not reflect her ATR
- Yield is 1.8%
- Lack of geographical diversification
- Neither do the AIM shares
- Tax efficient use of ISAs
- Excluding the £200,000 she received as the offsetting agreement she has £40,000 on deposit which may be too high but could be justified by her lower capacity for loss.

What additional information is required?

- Full details of her S/S ISA
- Asset split of the ISA
- Charges
- Whether held on a platform
- Base cost

We also need to establish her objectives.

The fact find states she has no spending plans in the next two years but she is only 10 years from retirement so it may be more emphasis should be on increasing her pension fund.

Ethical Investment

- Can't really answer this point on current information so would need to know individual holdings before any comment could be made.
- Presumably she's want to consider avoiding the classic four: Arms, Alcohol, Tobacco and Gambling.
- FTSE tracker fund will simply mirror shares in the index so no ethical consideration.

The usual theory with ethical investment is that it will produce lower returns than a non ethical approach on the grounds that you are restricting profitable sectors. On the other hand they could be investing in growth companies such as green energy. Also a classic non ethical sector is oil which some commentators argue is a declining industry

AIM shares

The Fact Find says that these were part of her divorce settlement and that Peter wants her to keep them and pass them to her children on her death "to maintain the IHT efficiency of these holdings".

Explain why this strategy is not appropriate.

- The AIM is a "nursery" market that provides capital to smaller companies.
- These companies hope to expand and either be taken over, bought by private equity or go for a full listing.
- They could also go bust.
- As Julie is 50 she could have a life expectancy of 30 + years it's unlikely that these companies will exist in their current form by then.
- There fore they may not qualify for Business Relief
- And legislation may be quite different by then
- She should view these on their own merits

- Peter cannot force Julie to keep these
- Probably too high for her ATR
- Whilst performance has been good there is a greater risk of total failure which does not match her CFL

Possible action.

- Identify the individual shares
- Identify the worst performers.
- Consider selling these, either to create a loss or to use up part of her CGT annual exemption
- Better performing ones could consider placing into an ISA

WPQ shares

Before their divorce Peter and Julie were the sole shareholders and Julie acted as company secretary.
This implies the shares are unlisted so there is no market to trade or value these.
Additional information needed is whether she retains this position.
In addition we have a semi formal agreement that she is to pass the shares to the children when they are 18

- This has some of the characteristics of a Bare Trust or possibly a Life Interest in that she has the right to the dividends but not the capital.
- Julie will have to retain them until 2028 then pass them to the children.
- If it is a Bare Trust then Julie is the settlor (she owns the shares) and trustee and cannot use the dividend for her own purposes.
- She must either use it for their benefit or maintenance of the children. If not she must accumulate it on behalf of the children
- As the income if over £100 he will be liable for paying income tax.
- On reaching 18 the children become the absolute owners. No CGT on transfer and the children will be taxed on their own circumstances when/if they are sold.
- If Julie dies whilst she is still the trustee they will not be part of her estate.

This may be overthinking the issue! If the arrangement is not considered to be a trust then Julie would be liable to pay CGT on disposal, This would qualify for Business Asset Relief if she was still the company secretary or a director.

Technical note CGT and divorce

- Having divorced Julie and Peter cannot benefit from intra spousal disposal
- However following separation/divorce they retain this until the end of the tax year in which the separation/divorce took place.
- The fact find is dated 19/5/21.
- If they formally separated prior to that date AND assets were transferred before 6/4/21 then Peter could benefit from intra spousal transfer
- This is detrimental to Julie as her acquisition cost would £30,000
- If these conditions don't apply then she would have acquired them at the value of date of transfer.

There is a wide range of past questions that could help you get familiar with the style. Wilst these don't reflect Julie's circumstances they are well worth a look.

March 21 Q 1(a). Good general fact finding question.
October 2020 Q 7 b Reinvestment of dividends
July 20 Q1 Additional information and capacity for loss
Oct 19 Q3 (a) Corporate Bonds (b) Reviewing performance
Oct 19 Q 4 (a) Use of a platform (b) ethical investments (c) using investments for retirement
Oct 18 Q1 Factors in determining capacity for loss
Oct 18 Q6 AIM

Retirement Planning

Her retirement planning objective is probably the most difficult one.

Factors

- Her fund is only £160,000
- She wants to retire close to 60 which is only 10 years away
- Total input is 10% of her salary
- She has potentially £200K to invest
- She can use carry forward
- Current fund allocation is unlikely to produce spectacular returns.
- No direct exposure to overseas markets
- CB fund tends to be cautious and could be hit if interest rates rise.
- State retirement age likely to be 67

Technical note State Pension

- She needs 35 years or credits to qualify for full pension.
- She may get a higher pension depending on whether she was contracted into SERPS/S2P
- She should get a state pension forecast
- She probably will have the potential to get 35 years (If she wasn't working whilst getting Child Benefit this would have got a credit

Additional information required

- Does her scheme allow increased contributions
- Will this be matched by her employer?
- Will they offer salary sacrifice?
- Is fund a default one offered by the scheme?
- Does it offer other funds?
- Is it on a lifestyle basis?
- Charges
- What income will she need in retirement?
- Lump sum required.
- Is she prepared to defer her retirement past 60.
- Willingness to use other assets?
- Any protected benefit from previous pension?
- Pension input from the last three years

What can be done?

In practice there are only three options:

- Save more
- Take more risk with her investments
- Retire later

- More diversified fund
- Reduce CB holding
- Investing the £200K is limited by the AA rules
- As she has NRE greater than £40,000 she could maximise this year's AA and carry forward unused amounts from three previous years
- However limited to her NRE of £45,000
- She could repeat this each year for the next three years
- She should also maximise her ISA holding each year and consider transferring that into the pension in the following year

Could be a general question on using a Pension v ISA

- Pension get immediate tax relief
- Likely to keep her in basic rate tax therefore get full child benefit
- Benefits could be taken in five years time
- 25% of the fund can be taken as PCLS
- Outside her estate if she dies

Have a look at:

Oct 20 Q 1(b) additional information pension planning
Oct 19 Q 1 additional information
Oct 19 Q2 (a) (c)
April 18 Q1 (a)

Estate Planning

- Current estate ex AIM shares £865,000
- Cannot use ex husband's NRB
- If house goes to children she could use her RNRB
- So potential liability £365,000 @ 40% = £146,000

- Usual methods such as gifting not practical in view of affordability
- Charitable legacy to reduce rate to 36%
- Would also mean setting up a trust as they are minors.
- To get RNRB she has to leave the house to the boys but practical issues when they are under 18.
- Could set up and 18-25 trust in her will
- Instruct the executor to sell the house and put the proceeds into the trust
- This retains the RNRB
- It would be lost if she were to set up a discretionary trust

Review question

Basic template

- Change in personal circumstances
- Change in financial circumstances
- Change in ATR/CFL
- Review performance
- Rebalance funds
- Any new money to invest
- Using annual allowances
- Economic conditions. Legislation changes
- New products

Go over all review questions, usually Q8