

AF5 September 2023 case notes (Revised)

These notes aim to cover all the key points arising from the September case study. I have aimed to be as accurate as possible but the odd error may have crept through. So please don't rely on this as your only guide, read other sources and carry out your own research.

Good luck

Overview

Alex has recently been bereaved. He has two children aged 13 and 9. He's currently on compassionate leave and his late wife's estate is currently being wound up.

Whilst emotionally this is a devastating event, Alex is in a reasonably strong position financially albeit that the household has lost £65,000 gross income.

It is an unusual case study because in real life an adviser's priority would be to help the executors wind up Tanya's financial affairs before reviewing his longer term needs. It may be that the majority of questions will focus on the immediate things that must be done and the final review question my focus on the priorities once he feels he can focus on longer term objectives.

Potential Objectives

These are normally split into short and long term objectives but because Alex should be classed as a vulnerable client it is likely that they will all be short term. The fact find does give us some possibilities.

- Wind up Tanya's estate including sorting out any tax liabilities.
- Make a new will to ensure his children are financially provided for in the event of his death.
- Make provision for Childcare
- Ensure his children are financially protected

Why is Alex a vulnerable client and what is the impact on how he should be treated?

- The death of his wife at 40 this is a significant life event
- Financially the family has lost £65,000 gross income.
- His two children are still financially dependent.
- He is currently off work on compassionate leave.

How to deal with his situation

- The fact that he has been classed as vulnerable should be noted on the client's file.
- He should be asked if he would like to have a family member or friend with him during any meetings
- He should be given ample time to make any decisions.
- Meetings should be kept short with frequent breaks
- Priority should be on sorting out any urgent issues arising from Tanya's death
- Avoid asking him to make long term commitments or signing up to products that are inflexible
- Deciding on a future investment strategy can be taken later.
- No undue influence or pressure.
- Avoid any special dates such as Tanya's birthday or their wedding anniversary.

Things that need immediate attention in view of Tanya's death

- Alex's will
- Alex's LPA
- Nominations for his DIS, Workplace pension.
- Trustee of his term policy
- Claiming any bereavement benefit
- Receiving Tanya's death in service.

Alex's will

- His will remains valid
- And his children will inherit
- But if they are minors when Alex dies it will be held in a **statutory** trust
- They will get an absolute right to the property at 18
- Which Alex may not want.
- There may be no provision for guardianship of the children.
- Tanya may be the executor of his will so if he dies before a new will is written and new executors appointed the beneficiaries will have to apply for "Letters of Administration with will annexed". If they are minors on Alex's death this will be complex

Additional information needed for his will.

- Who is the current executor of your will?/Is Tanya the executor?/is there a joint executor?
- Who would you like to be your executor?
- Are you comfortable that your children could inherit all the property at 18?
- Who would you like to be your children's legal guardian if you were to die before the children are 18?

- Would you like to make financial provision for the guardians?

Action

- Revoke the current will and write a new one.
- Appoint new executors.
- Appoint guardians for the children.
- An 18 to 25 trust to be used.

Technical Note 18-25 trust

- Should Alex die
- The executors/trustees would have the discretion to pass the legacy to the children between 18 and 25.
- They could decide if they were mature enough to receive all or part of the legacy between these ages.
- Separate trusts for each child
- This is preferable to a straight legacy/Bereaved minor's trust which would give them an absolute right to the share of the property at 18.
- It is preferable to a discretionary trust which does not guarantee the children will ever get the money.
- There would be no initial charge when the children reach 18.
- There cannot be a periodic charge as it can only run for 7 years.
- There could be an exit charge but a maximum of 4.2% above the NRB

Could the trustees make a claim for Vulnerable Persons election if Alex dies when the children are minors? This could give tax benefits in that the trust would essentially be taxed as the child's property. I've not been able to establish whether this would apply to an 18-25 trust.

However it may be academic as the trustees would probably be advised to use an Insurance Bond primarily because they do not need to pay or report tax until there is a chargeable event. Moreover, by assigning segment(s) to the beneficiaries there is no tax on the trustees as it's not a CE.

Probably better to use an offshore trust. When the beneficiary receives money they may be a non tax payer or have a low income. They could use their PA, and as a chargeable gain is classed as savings income, 0% starting rate and PSA. Non-taxpayers cannot reclaim the tax paid within an on shore bond.

Alex could write a letter of intent to accompany his will giving his preferences as to how the trustees should distribute the money.

Technical note Executors

- Could select a family member of his or Tanya's
- But may be better to use a professional executor.
- If he dies before the children reach 18 there are guardianship issues and investment considerations which may be difficult for a lay trustee.
- It would be advisable for the executor(s) and guardian to be different people. This would avoid any conflict of interest,
- In addition a decision would need to be made as to what is going to happen to the house if they are minors when Alex dies.
- This would be more expensive than using a lay trustee but Alex could write a new will when the children are of age appointing a lay executor

Lasting Power of Attorney

- His LPA will have been revoked as Tanya was his sole attorney
- A new one should be done.
- To avoid automatic revocation he should
- Appoint a sole attorney with a replacement one.
- Appoint attorneys who can act "jointly and severally".
- This is better than joint attorneys who must act unanimously and if one died or became disqualified the LPA would be revoked.
- A new LPA will allow Alex to give instructions or state preferences as to making gifts to the children on birthdays, Christmas and similar events.
- Whilst the prime duty of the attorney is to only use the assets for the donor's (Alex) benefits, they would be allowed to advance money for the maintenance and education of Thea and Cameron

Nominations

- Nominations make it clear what are his intentions.
- He needs to make new nominations for his DIS
- Probably for the children's guardian or into a trust. This could be a Bare Trust (absolute right to benefits at 18) or a Discretionary Trust (trustees can decide when they should get the money)
- If no nomination made the administrator could nominate the children but there could be issues if Alex were to form a new relationship in a few years time as the administrator may choose to prioritise the new spouse/partner,
- Similar action with his Pension

- If either child is a minor on Alex's death they cannot give instructions as to what they should do so the administrator will probably designate the fund as a Dependent's Flexible Drawdown Fund.
- This would keep its tax free status if it was redesignated within two years of Alex's death.
- The children would get control at 18.
- A further issue with no nominations is that once Thea is 24, Cameron will be 20.
- She will not be classed as a dependent but he will be. Therefore if no nominations made and Alex dies, then Thea can only be offered the cash option.
- ~~He presumably is the trustee of the DT attached to the life policy so a new trustee should be appointed to ensure the proceeds can be distributed quickly.~~
- Page 10 of the fact find states that Alex isn't a trustee but we should still establish who this is

Claiming Bereavement Support Allowance

Alex can claim this as:

- He and Tanya were married at the time of her death
- He is under state pension age.
- Is a UK resident.
- Tanya had paid National Insurance contributions for at least 25 weeks in a tax year.
- Alex must claim within 12 months of Tanya's death
- He can claim the higher rate as she was eligible for Child Benefit
- This is a first payment of £3,500 and 18 monthly payments of £350

Receiving Tanya's DIS

- This is £260,000 and will be paid directly to Alex.
- It will be protected by the FSCS Temporary High Balances protection of up to £1m for 6 months after the date of receipt.
- Or could use an NS&I product as this would be guaranteed by the Government
- In view of Alex's vulnerable status he should not be pressured into making a decision now but should be paid into an interest paying deposit

Paying for additional childcare

- Alex's net income is around £62,000 so he has a surplus income of £22,000.
- The expenses shown are purely his and the saving of Tanya's expenses has already been taken into account.

- The case study indicates he is likely to pay for more childcare. (He is already paying £400 a month.
- This could be either an additional information or factors type question.
- Possibly asking for the factors you would consider in drawing up a plan to provide childcare.

EXAM TIP!

The case study questions usually include these two commands:

- State the **additional information** you would need to make a recommendation
- State **the factors** you would need to take into account in making a recommendation

When asked for additional information **you must state any relevant information that is not in the fact find**. You will not get any marks for repeating what is in the fact find.

When asked for factors **you must write down all the facts given in the fact find that are relevant in coming to your recommendation**.

Additional information

- What childcare are you currently paying for?
- What type of childcare (live in nanny/au pair/part time help)
- How much childcare did Tanya provide.
- How much more help is required.
- Potential cost of increased childcare?
- For how long would the children need this childcare?
- How would working part time assist with the additional childcare?
- Will members of his family be able to assist?
- Can you fund this from income?
- Would you be prepared to use capital/savings?
- Would you want to “ring fence” capital to pay for on going childcare.
- Have you applied for the Government’s Tax Free childcare scheme?
- Has you used Childcare Vouchers?

Factors

- He has surplus income of around £20,000
- But this will reduce if he works part time
- They were already spending £400 a month on childcare.
- Once probate is concluded he will have assets of £298K excluding her DIS of £260,000
- His children will soon be old enough to look after themselves.

- He could take up the offer of working part time which will cut down the additional hours required for childcare
- There may be help from the wider family
- He qualifies for the government's tax free childcare scheme.
- He has no mortgage or debts

Tax free Childcare

This is a tax privileged savings vehicle.

- Alex would open an on-line account with HMRC
- For every £8 paid in the Government will add £2.
- The maximum amount that can be placed in the account is £500 every three months (£2,000 a year). This includes the government subsidy.
- The account is then used to pay the cost of childcare.
- This can be used for childminders and nannies, together with after school clubs.
- The provider must have signed up for the scheme before Alex can pay them and benefit from Tax Free Childcare.
- He will tell HMRC who is the provider and the payment is paid directly from the account

Alex qualifies as:

- Cameron is under 11. Thea will not qualify.
- He lives with Alex
- Alex is working and earns more than the minimum living wage.
- His adjusted net income (ANI) is less than £100,000.
- Although only Alex can open the account, anyone can pay in including grandparents.
- Money can be withdrawn from the plan for other reasons but the government subsidy will be removed.
- Quarterly submissions of eligibility will be required.

Protection for children

This is a stated objective

Comment of the current situation.

- The youngest child Cameron is likely to be financially dependent for another 9 to 12 years.
- This takes Alex to 52
- At present £658K of assets

- Plus potentially £360K DIS if Alex dies
- Plus £150k life policy that will run for another 11 years.
- It would appear that the children would have good financial provision should Alex die
- In his will Alex should appoint legal guardian(s)
- This will put an expense burden on them
- Alex may wish to set up a policy that would compensate them for these extra costs

The recommendation should be:

- Family income Benefit Policy
- Taken out by the nominated guardian on Alex's life
- To avoid probate and ensure speedy payment
- With a sufficient monthly benefit to pay childcare costs
- To ensure legacy for the children is not denuded
- Term to be 9 years to take Cameron to 18
- As he and Thea could benefit from the will trust once they are 18.
- With indexation to protect against inflation
- With WOP to ensure premiums are maintained if Alex is unable to work due to accident or sickness
- Fixed premiums (other than indexation)
- Low cost
- Tax free

Other State Benefits

- The guardians could claim GUARDIAN'S ALLOWANCE.
- They qualify as they would be bringing up children after their parents had died.
- Benefit is £20.40 a week per child and is tax free.
- The guardians could also claim Child Benefit for Thea and Cameron although this would be subject to the normal rules ANI over £60,000.
- If they get the full amount of CB the maximum that could be claimed would be £80.70 a week

Other protection issues

- Alex gets Income protection through his employer
- This provides 65% of basic salary with a deferred period of 6 months
- It is not a taxable benefit in kind but it would be subject to income tax if Alex has a valid claim.
- The comparison with his current net pay may be small as he will have less income charged at 40%
- He has no Critical Illness Cover

- He has no PMI

Winding up Tanya's tax affairs

- Tanya would have received salary from her employment until presumably her death.
- PAYE would have calculated her tax as if she had lived until the end of the 23/24 tax year so her estate is entitled to a refund of overpaid tax
- The tax situation on her share of the interest from the joint deposit will depend on when this was paid.
- If she had received it before her death she would be liable for income tax on her 50% share and she could use her PSA.
- As the ownership of the account would have passed to Alex on her death, he would be liable for any interest received after her death even if the estate has not been wound up.
- The case study implies that the dividend from the unit trust was paid after she died as it is in her estate.
- The executors are responsible for paying tax. They cannot use the DA and all is taxed at basic rate. Their liability will be £2,450 @ 8.75% = £214.38
- Dividends received once the unit trust has been transferred will be taxed on Alex's situation.
- There is a gain of £30,000 on Tanya's unit trusts
- This is all wiped out on death and she has no liability.
- If it is transferred directly to Alex the base cost for future disposals will be the value at date of transfer.
- The executors would be liable for any gain whilst in the trust but the acquisition price would be the value at date of death.
- Unlikely to be a significant gain but if there were then the executors could use Tanya's £6,000 allowance but the rate would be 20%.
- The executors of her estate should have applied for it to be a **Continuing ISA**. This means it keeps its tax-free status in the estate.
- This can continue until the earliest of
 - The ISA is transferred to Alex
 - The ISA is closed by the executor.
 - Three years after Tanya's death
- When Alex receives the ISA it will have been stripped of its ISA status.
- He will have an **Additional Permitted Subscription**
- This will be the greater of the value at date of Tanya's death and value when transferred to Alex has three years from Tanya's death to use this.

- If the provider allows an in specie transfer this must be done within 180 days of Alex becoming the owner.
- If this is not allowed he must use his own money which could be done by selling the inherited funds.
- The APS must be with one provider although this can be different to Tanya's and Alex can select his own funds.
- In the short term probably best to do this as soon as possible even putting the money in a cash fund and review it when Alex feels he is ready to do so.
- Alex will also have his annual allowance of £20,000.

Tanya's pension

As the nominated beneficiary Alex has three options:

Take the whole amount as cash.

- This takes it out of the pension regime and loses its tax advantages
- It gives him money to spend and this might be used to help provide childcare.
- It would form part of his estate on death.
- He could also use it to boost his own pension by using it as a contribution to his WPS or a new SIPP.
- This would restore the tax benefits of a pension.

Buy a dependent's annuity.

- This gives him a guaranteed income for life
- But at his age this would not produce a great deal of income.
- His children could not benefit from this when he dies.

Designate it as a dependant's Flexi Access Drawdown Fund

- The fund would remain in the pension regime and enjoy the tax benefits.
- He could make withdrawals as he wished.
- He could nominate the children as successors who could keep any remaining fund in the tax regime and have the same options as Alex
- All options would be income tax free as Tanya died under 75 but Alex must designate what he wants to do within two years of Tanya's death

IHT issues

- As things stand Alex can inherit 100% of Tanya's NRB and RNRB
- Once the DIS is paid out total assets will be £987K
- Assuming he does not remarry legacies to his children will use up some of his NRB.
- The RNRB will always be intact provided it is passed to his children or other direct descendants.
- This will still be available even if the house is sold and the proceeds passed to the children.
- Alex should not do a Deed of Variation as this would reduce or wipe out Tanya's NRB and it could never be recovered.

Should Alex take up the employers' offer of reduced salary and reduced hours?

This might seem initially attractive in the short term to help with his mental health but there are some other considerations.

- How significant would the extra non-working hours would have on his ability to care for his children?
- It would reduce his disposable income.
- It would reduce his DIS to £280,000
- It would reduce his employer's income protection benefits.

Longer term issues.

In view of his vulnerable client status it is not going to be appropriate to make long term decisions at this point. Rather than have a review question, it may ask what you would want to discuss when Alex feels he is ready to make longer term decisions. These could be:

- Review any change in his personal situation.
- Review whether his ATR and CFL needs to be changed.
- Identify his objectives.
- Check how he is paying for childcare and whether this needs to be reviewed.
- If he used his APS to open up a cash fund transfer this into a selection of Equity and Bond ISAs
- Recommend a new portfolio of both his and Tanya's assets.
- If no decision has been made on transferring Tanya's WPS this should be done otherwise its tax free status may be lost.
- Review his pension arrangements to assess whether they are meeting his objectives.
- Make use of any annual allowances, ISA, pension contributions.
- Review any changes in taxation or legislation.

Whilst in real life we would not want to ask Alex to take decisions on making a decision on his longer term investments a possible question might be, *“what additional information would you require to give advice on Alex’s longer term investment needs when he feels ready to do so”*

- What are his financial objectives?
- What is his ATR/CFL
- What emergency fund does he require?
- Does he have any planned spending needs in the next five years?
- What is his investment horizon?
- Does he have a preference for ESG investments?
- What is the total amount available to invest?
- Has Alex funded his ISA allowance for the current year?
- Has he used his CGT allowance.
- What has been the performance of his funds?
- What is their yield?
- Current charges.
- Are they on a platform.
- Details of the underlying investments in the funds

Probably a bit of a left field question but it has been asked a few times and has some relevance in this fact find. Difference between saving for the children with either a JISA or Personal Pension.

JISA

- Maximum contribution of £9K per child per tax year.
- Only Alex can open the account but grandparents etc can then contribute.
- Usual ISA benefits income tax and CGT free
- Does not come under £100 parental income rule.
- Child can take control at 16 and get full control (and take benefits) at 18.

PP

- Maximum contribution £3,600 gross, £2,880 net
- Usual Tax benefits.
- Children cannot access the fund until they are 57 (and probably later)