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Core Unit 4

Financing and Investing for Retirement Provision

Assignment 1

*(Part 1 – Funding and Taxation)*

*Recommended Time: 2 hours*

1. **What are “contract-based” pension arrangements and what types do employers typically operate?**

**15 marks**

Relevant section of the manual is Part 1 Chapter 1.2.2.

Format: descriptive prose in clear paragraphs

Answer should cover:

* Contract between the individual and the provider
* Governing documentation can be set up under irrevocable trusts or, if the provider is an authorised insurance company or friendly society, can be established by board resolution or deed poll. -
* Stakeholder pensions - a type of personal pension originally set up as a low-cost employee financed arrangement where the employer did not provide any alternative.
* SIPPs details to cover include that they are personal pensions that provide much greater investment flexibility than other types.

1. **There are two ways in which tax relief on employees’ pension contributions operate. Describe the following:**
2. **Each method and how the two methods differ**
3. **The advantages of operating a salary sacrifice arrangement**

**15 marks**

Relevant section of the manual is Part 1 Chapter 2.2.

Format: descriptive and comparative prose

Answer should cover:

* Relief at source- a contribution is paid out of net (post tax) pay to the provider who then reclaims tax at the basic rate from the government which is then allocated to the member’s pension fund account
* Net pay method - Under the net pay arrangement, contributions are deducted from an employee’s gross pay before the deduction of tax.
* How they operate, pointing out the differences
* Brief worked example demonstrating the difference
* Salary sacrifice enables both employee and employer to save NI contributions Under such an arrangement, the employee agrees in advance to give up, or ‘sacrifice’, part of their salary or bonus. In return, the employer provides additional pension benefits. This is more efficient from a National Insurance viewpoint, since the lower the salary/bonus that is paid, the lower will be the employer’s and employee’s NI cost.

1. **Payment of pension scheme benefits and other authorised payments are subject to tax. List the following:**
2. **The types of benefit payment where income tax is payable**
3. **3 examples of authorised payments which attract a tax levy on the scheme**

**10 marks**

Relevant section of the manual is Part 1 Chapter 2.4.

Format: bulleted list

Answer should cover:

* Pension in payment
* Trivial commutation lump sums
* Any 3 from:
  + Short service refunds
  + Benefits paid in excess of the Lifetime Allowance
  + Lump sum death benefits paid on the death of a member on/after age 75 or 2 years or more after the death
  + A transfer to a QROPS in a country out with the EEA and the member does not live in the QROPs country after the transfer

1. **Outline the key design features of the following occupational pension schemes and how each of these is funded:**
2. **DC scheme**
3. **DB scheme**
4. **Hybrid scheme**

**15 marks**

Relevant section of the manual is Part 1 Chapter 1.1.1.

Format: descriptive, clear paragraphs

Answer should cover, for each of a), b) and c):

* How benefits are accrued
* Variations in design
* How the type of scheme is funded

For example, in defined contribution (DC) schemes (also known as money purchase schemes) the employer promises to pay a defined level of contributions on behalf of the employee, which are invested and in due course used to purchase retirement benefits for the employee. It is essentially implicit for such schemes to be funded in advance.

1. **How do employee pension contribution levels vary between pension arrangements?**

**5 marks**

Relevant section of the manual is Part 1 Chapter 1.3.2.

Format: no preferred format – list or paragraph acceptable

Answer should cover:

* Contributory scheme
* Percentage of salary/fixed amount
* AVCs

1. **What were the main tax simplification changes that HMRC introduced from 6 April 2006?**

**5 marks**

Relevant section of the manual is Part 1 Chapter 2.1.

Format: no preferred format – list or paragraph acceptable

Answer should cover:

* Limits applicable to benefits and contributions replace by new limits
* Change from approved to registered scheme
* DC benefits could be taken in full as a cash lump sum
* Removal of requirement to annuitise on attaining age 75
* Schemes could maintain pre 2006 scheme rules, restricting the member options

1. **Compare and Contrast Tax Charges on Payments to Tax Charges on Investments.**

**20 marks**

Relevant section of the manual is Part 1 Chapters 2.3 and 2.4

Format: descriptive and comparative prose

* General principles of tax charges on investments
* Overseas investments
* Property
* Insurance Polices
* General principles of tax charges on payments
* Examples of tax due such as contribution refunds
* Tax charges for unauthorised payments
* Scheme Pays – Annual Allowance charge.
* When applicable
* How a member uses it.

1. **Explain why pensions are funded with particular reference to security, stability and cash flow, taxation, and Accounting Standards.**

**15 marks**

Relevant section of the Manual is Part 1 Chapters 1.1.2, 1.1.3 and 1.1.4

Format: descriptive and comparative prose

* Security – funds separate from employer.
* Level of security depends on the size of the fund.
* Stability and Cashflow – effects of not funding in advance
* Taxation-tax relief payable – changes the timing of the relief
* Accounting Standards – liabilities should be provided for as they fall due.