

Case: Roger

(Reference date: 1st April, 2017)

Roger, aged 29 years, is working with a multinational company since December 2010. He has approached you, a CFP^{CM} practitioner, for preparing his Financial Plan. He is staying in his own house at Ahmedabad. His wife Angela, aged 31 years, is a fashion designer. She has set up a boutique on rent and earned a net profit of Rs. 5.5 lakh in the previous financial year. They have a son, Mark of age 4 years, and a year old daughter, Stephanie. Roger is also supporting his parents to the extent of Rs. 20,000 per month. They stay at their ancestral house at Surat. The family's monthly household expenses are Rs. 40,000 p.m. (excluding insurance premium and EMIs). Roger normally gets 10% increase in his gross salary year-on-year in the beginning of every financial year, apart from bonus. The bonus for the previous financial year at Rs. 3.3 lakh (net of tax) shall be credited to his account at the end of this month. He has taken a family floater Health policy for Rs. 15 lakh (premium paid in the previous year is Rs. 16,268).

Roger's monthly salary (for FY2017-18):

Basic Salary	:	Rs. 60,000
DA (forming part of Salary)	:	50% of Basic salary
House Rent allowance	:	Rs. 18,000
Transport Allowance	:	Rs. 5,000
Medical Reimbursement	:	Actual expenses up to Rs. 1,250 per month
Executive Allowance	:	Rs. 10,000

Couple's Current Assets & Liabilities (As on 31st March, 2017)

Assets:

House	:	Rs. 75.00 lakh (Current market value, purchase cost Rs. 40 lakh)
Car	:	Rs. 4.00 lakh (Depreciated value)
Public Provident Fund - PPF ¹	:	Rs. 4.90 lakh
Insurance – Money Back policy ²	:	Rs. 3.00 lakh (Sum assured)
Child Plan – Life insurance ³	:	Rs. 12.00 lakh (Sum Assured)
Gold ornaments ⁴	:	Rs. 4.50 lakh
Equity Mutual Fund schemes ⁵	:	Rs. 7.85 lakh
Portfolio of Equity Shares ⁶	:	Rs. 3.95 lakh
Bank fixed deposits ⁷	:	Rs. 4.00 lakh (Principal, in Angela's name from her business income)
Bank account – Roger	:	Rs. 0.75 lakh
Bank account – Angela	:	Rs. 0.95 lakh

Liabilities:

Home loan ⁸	:	Rs. 17.85 lakh (Principal outstanding)
Car Loan ⁹	:	Rs. 3.05 lakh (Principal outstanding)

¹ Opened in December, 2011 in the name of Roger

² Purchased on 25th October, 2013; annual premium paid Rs. 14,798; 20-year policy with 20% of sum assured payable on survival on 5th, 10th and 15th years and the balance on maturity

³ Purchased when Mark was 2 year old; term of 15 years; annual premium Rs. 41,374

⁴ Gifted on marriage in November 2011 at then value Rs. 1.75 lakh.

⁵ Three schemes; current assets value in one scheme is Rs. 2.5 lakh, in second Rs. 3.5 lakh with monthly Systematic Investment Plan (SIP) of Rs. 10,000; the third is Equity Linked Saving scheme, invested Rs. 1 lakh in March 2015

⁶ The Demat account in which Roger and Angela are respectively first and second holders was started in 2013

⁷ Three deposits; Rs. 2 lakh made on 1-July-2014 for 3 years at 9.75% p.a., Rs. 1 lakh made on 1-July-2015 for 2 years at rate 9.25% p.a. and Rs. 1 lakh made on 1-July-2016 for 1 year and 1 day at 8.75% p.a. (interest is compounded quarterly and is cumulated to be received on respective maturities)

⁸ Home loan of Rs. 24 lakh for a 15-year term taken in April, 2011 at rate of interest fixed for first 3 years at 10% p.a., and floating thereafter at 1.5% above RBI Repo rate.

⁹ Car loan of Rs. 5.5 lakh taken in April, 2015 at a fixed interest of 11% p.a. for a 4-year term; Car cost Rs. 8 lakh.

Goals:

1. Accumulate in a fund, higher education expenses of Mark and Stephanie. Expenses at their respective age of 18 years are Rs. 4 lakh p.a. (current cost) required for four years, cost escalation 8% p.a.
2. Marriage expenses of Rs. 10 lakh (current cost) for each child at around their respective age of 25 years, cost escalation 9% p.a.
3. Retirement corpus at Roger's age of 58 years to sustain 70% of pre-retirement household expenses, inflation adjusted, till his lifetime and 70% of then expenses till Angela's expected life.
4. A bigger house valued at Rs. 1 crore today, 5 years from now by disposing of the current house and foreclosing the loan.
5. Build a separate fund for vacation expenses of Rs. 1.5 lakh p.a. (current cost), first expenses to be drawn after 5 years and thereafter every year continuing up to the year of Roger's retirement, cost escalation 7% p.a. A suitable lump sum is to be invested immediately followed by an investment regime.

Life Parameters:

Roger's expected life	:	75 years
Angela's expected life	:	80 years

Assumptions regarding pre-tax returns in various asset classes:

- 1) Equity & Equity MF schemes/ Index ETFs : 11.00% p.a.
- 2) Balanced MF schemes : 9.50% p.a.
- 3) Bonds/Govt. Securities/ Debt MF schemes : 7.50% p.a.
- 4) Liquid MF schemes : 6.00% p.a.
- 5) Gold and linked investments : 6.00% p.a.
- 6) Real Estate appreciation : 6.50% p.a.
- 7) Bank/Post Office Term Deposits (> 1 year) : 7.25% p.a.
- 8) Public Provident Fund/EPFO : 7.75% p.a.

Assumptions regarding economic factors:

- 1) Inflation : 5.00% p.a.
- 2) Expected return in Risk free instruments : 5.50% p.a.

Cost Inflation Index:

FY	CII	FY	CII	FY	CII	FY	CII	FY	CII
2001-02	100	2005-06	117	2009-10	148	2013-14	220	2017-18	272
2002-03	105	2006-07	122	2010-11	167	2014-15	240		
2003-04	109	2007-08	129	2011-12	184	2015-16	254		
2004-05	113	2008-09	137	2012-13	200	2016-17	264		

Questions:

- 1) Before beginning work on Roger's Financial Plan, you have drafted a document outlining the "Scope of Engagement" and sought Roger to mutually define and determine the activities that may be necessary to pursue. Roger asked you about relevance of such a document. In the context of Financial Planning Profession, you explain about the "Letter of Engagement" as a _____.

[2 marks]

- A. professional requirement under Code of Ethics of FPSB India
- B. professional requirement under Practice Guidelines of FPSB India
- C. necessary legal requirement as per Contract Act 1872
- D. document for his personal record

- 2) You have finished analysis of Roger's financial situation and risk profile. Which of the following is the next appropriate step in the financial planning?

[2 marks]

- A. Specify financial goals which can be achieved within Roger's financial situation based on the information collected
- B. Fix the scope of engagement based on the available information already collected
- C. Consider such assumptions of investment returns, inflation, tax rates, etc as to maximize the chances of achieving Roger's goals
- D. Identify other issues that may potentially impact Roger's ability to achieve financial goals

- 3) Roger wants to estimate the amount of finance needed to buy the proposed new house after 5 years. This could be arrived at by utilizing the net amount from the sale proceeds of his existing house after 5 years. The outgoings from such proceeds would be the outstanding loan amount and a sum of Rs. 10 lakh towards meeting capital gains tax liability on existing house and the statutory charges, etc. You expect the average Repo rate of 6.5% to be maintained by RBI over the next 5 years. The quantum of loan required could be _____.

[3 marks]

- A. Rs.75 lakh
- B. Rs. 60 lakh
- C. Rs. 54 lakh
- D. Rs. 37 lakh

- 4) You give a quick look at the assets and liabilities of the couple, and before drawing a comprehensive picture of adequate insurance protection and a strategy to achieve the same, you suggest to take cover on an immediate basis, which is _____.

[2 marks]

- A. They must take Mortgage Redemption Insurance or an equivalent term insurance to cover outstanding loans
- B. They must take Accident Insurance
- C. They must take Critical illness insurance
- D. They must take Unit Linked Insurance Policies for their financial goals

- 5) You compute the value of additional life cover for Roger by considering 80% of the current household expenses, (inflation adjusted) up to Angela's age of 55 years and further 80% of then expenses inflation-linked for the remaining period of her expected life by considering investment in debt MF schemes. This cover required to be taken as term insurance exclusive of the sum assured under current insurance policies comes to _____.

[3 marks]

- A. Rs. 120 lakh
B. Rs. 135 lakh
C. Rs. 220 lakh
D. Rs. 105 lakh
- 6) Roger's ideal life cover has to be estimated which in case of any exigency will first repay the outstanding loans and the remaining would be invested along with the couple's existing financial assets. Such combined corpus would be invested in a 7.5% p.a. return instrument to sustain the family's living expenses and the specific financial goals of higher education of their children. The living expenses need to be taken as inflation-adjusted to the extent of 80% of their present household expenses for 50 years. What should be this ideal cover?

[4 marks]

- A. Rs. 147 lakh
B. Rs. 165 lakh
C. Rs. 180 lakh
D. Rs. 230 lakh
- 7) Roger and Angela wish their retirement corpus, as per proposed goal, to also have a provision of gifting Rs. 50 lakh to each of their children and an additional Rs. 25 lakh towards charity to an Old Age Home at Roger's age of 70 years. The sums are at absolute values then. They also wish to provide in the corpus an additional Rs. 10,000 per month (current costs) towards healthcare after Roger's age of 70 years. You estimate the required corpus, considering the same shall be invested in investment yielding 6.5% p.a., to be _____.

[3 marks]

- A. Rs. 3.53 crore
B. Rs. 3.20 crore
C. Rs. 3.78 crore
D. Rs. 3.67 crore
- 8) You sensitize on the post-retirement parameters considered as: investment return 6.5% p.a., inflation 5% p.a., and the specified longevity as you work out retirement corpus. You stress test the same as: investment return 6% p.a., inflation 5.5% p.a., increased longevity of Roger by 5 years and of Angela by 2 years, and no further curtailment after Roger's death. You work out the revised corpus. What additional funds need to be accumulated by Roger's retirement age? Alternately, by what percentage the retirement expenses should be curtailed to retain this cushion?

[5 marks]

- A. Rs. 57 lakh; 44% curtailment
B. Rs. 14 lakh; 33% curtailment
C. Rs. 129 lakh; 55% curtailment
D. Rs. 26 lakh; 36% curtailment

9) You inform Roger and Angela about the recent vehicle of taking exposure to Gold, which is Sovereign Gold Bonds (SGB). Which of the attributes about the SGB is CORRECT?

[2 marks]

- A. The Capital Gains on redeeming these bonds on maturity are exempt from income tax
- B. They work like zero-coupon bonds
- C. The quoted prices of SGBs currently are very close to ruling Gold prices
- D. The redemption price on maturity is guaranteed not to be below the issue price of the respective SGB

10) Towards the marriage goal of the children, you suggest Roger to make maximum permissible subscriptions to his PPF account towards the end of every financial year and extend the account twice beyond initial maturity for terms of 5 years each with similar subscriptions. The third term of 5 years is continued without further contribution. Roger shall withdraw about 50% of accumulation for the marriage expenses of Mark and the remaining for the marriage expenses of Stephanie. What are the expected individual withdrawals and shortfalls in meeting the marriage expenses?

[4 marks]

- A. Mark Rs. 51.5 lakh, 16% shortfall; Stephanie Rs. 64.8 lakh, 18% shortfall
- B. Mark Rs. 47.7 lakh, 22% shortfall; Stephanie Rs. 59.7 lakh, 24.5% shortfall
- C. Mark Rs. 52.3 lakh, 14% shortfall; Stephanie Rs. 65.9 lakh, 17% shortfall
- D. Mark Rs. 45 lakh, 26% shortfall; Stephanie Rs. 56.7 lakh, 28% shortfall

11) Roger and Angela will set aside immediately a sum of Rs. 10 lakh towards setting up a fund for vacation. They will start contributing annual investments beginning April 2018 till Roger's age of 55. The annual investment will be doubled after 14 such investments. You devise an asset allocation for the vacation fund to yield 11% p.a. for the first 15 years and 9.5% p.a. thereafter. What should be the amount of initial annual investment?

[5 marks]

- A. Rs. 1,75,500
- B. Rs. 123,600
- C. Rs. 97,900
- D. Rs. 115,300

12) For the higher education expenses for Mark and Stephanie, Roger starts accumulating funds with monthly investment of Rs. 20,000 in an aggressive asset allocation yielding 12% p.a. After 7 years the allocation is moderated to yield 10% p.a. and while the investment is raised to Rs. 40,000 p.m. After 12 years, the funds accumulated are shifted to suitable debt instruments from which distribution towards higher education is made as proposed. What excess/shortfall of funds you expect after 12 years by following this investment strategy?

[5 marks]

- A. Shortfall Rs. 28.16 lakh
- B. Shortfall Rs. 10.12 lakh
- C. Excess Rs. 7.60 lakh
- D. Excess Rs. 12.48 lakh

13) Roger asks for your guidance regarding different modes of tax efficient estate planning which can help in creating and distributing family assets. You opine that a Trust would be a more appropriate option because_____.

[2 marks]

- A. there is no taxation applicable on trust income
- B. they have fixed rate of tax which is far lower than tax rates for individual assesseees
- C. future capital gains tax on assets transferred to trust could be lower
- D. all future earnings from assets transferred to trust are exempt

14) Roger invested Rs. 4 lakh on 20th September 2016 in an Equity Mutual Fund scheme at NAV of Rs. 28.273 per unit. The scheme declared dividend of Rs. 5 per unit, the Record Date being 4th December 2016. The prevailing NAV of the scheme is Rs. 22.367 per unit. If he sells all the units of the scheme today, what would be the implication of this transaction in his IT return of AY 2018-19?

[3 marks]

- A. Rs. 12,818 short term capital loss to be set off against capital gains in AY 2018-19 or carried in 8 subsequent years
- B. Rs. 83,557 short term capital loss to be set off against capital gains in AY 2018-19 only
- C. Rs. 83,557 short term capital loss to be set off against capital gains in AY 2018-19 or carried in 8 subsequent years
- D. Rs. 12,818 short term capital loss to be set off against capital gains in AY 2018-19 only

15) Roger wants to invest the maturity proceeds of all his fixed deposit investments in the 2.50 %-SGB (Sovereign Gold Bonds) of a series quoted at Rs. 2,660 per bond, at a discount of 7.3% to their issue price (issue date: 18-July-2016). Roger wishes to hold SGBs till maturity. Calculate the impact of taxation in the AY2018-19 in respect of these transactions if the SGBs could be bought at the quoted rate when FDs mature. Also evaluate capital gains on maturity in the 8-year tenure of these SGBs, if on maturity Gold price in its purest form is expected at Rs. 4,000 per gram. (CII expected in the year of maturity may be considered as 348).

[5 marks]

- A. Rs. 1,31,556 "Income from Other Sources" in AY2018-19; Capital gains of 1,14,030 on maturity
- B. Rs. 1,31,556 "Income from Other Sources" in AY2018-19; Capital gains on maturity shall be tax-exempt
- C. Rs. 24,745 "Income from Other Sources" in AY2018-19; Capital gains on maturity shall be tax-exempt
- D. Rs. 29,477 "Income from Other Sources" in AY2018-19; Capital gains of 1,37,853 on maturity