The Investment COACH

NICs – a tax by any other name?

The new National Insurance Contributions (NICs) scales for 2020/21 were announced ahead of March's Budget, with one slight surprise hidden in the numbers.

Are NICs a tax?

Over many years, Chancellors have tried to convince the public that they are not. It has always seemed easier to say that NICs are going up by 1% than to announce the same increase in income tax rates, even if the net effect for the working population is virtually the same. NICs are still vaguely associated with the NHS and social security benefits in the public's mind, partly because qualification for some benefit entitlements depends upon NIC payments. However, from the Treasury's viewpoint, NICs are just another source of revenue.

This year the Treasury seems to have decided – at least temporarily – that NICs are a tax. At the end of January, it ran a news story with the headline '31 million taxpayers to get April tax cut'. It sounded like an official Budget leak, but it wasn't.

The announcement referred to an increase in the level at which employees and the self-employed start to pay NICs. As trailed in the Conservative party election manifesto, this trigger point will rise from £8,632 in 2019/20 to £9,500 in 2020/21. In practice the limit would have risen to £8,788 anyway, as it is automatically inflation-proofed unless the Chancellor decides otherwise.

The net result is a maximum saving of around £104 a year if you are employed and pay class 1 NICs and £78 if you are self-employed paying class 4 NICs. The Treasury's new release says that "…the government has set out an ambition to raise the National Insurance thresholds to £12,500", but that aspiration – worth up to another £360 a year – has no timescale attached to it.

If you are an employer, you may be surprised to learn that the threshold at which employer class 1 NICs for an employee start to be charged in 2020/21 will not rise to £9,500 but benefits only from the inflationary uplift to £8,788.

The maximum combined employer/employee rate of NICs is 25.8% (13.8% + 12%), so NIC planning can be as important as other tax planning. For the options available to you – as an employer, employee or self-employed – you need expert advice.

New state pension rates keep UK last in the league tables

The government has published the revised level of state pensions and other benefits for 2020/21. But Britain remains last in the state pension league table.

In April 2020, the new state pension will increase by 3.9% to £175.20 a week – £9,110 a year. The old state pension, which is payable to anyone who reached state pension age before 6 April 2016, also increases by 3.9% to £134.25 a week. Other state pension benefits, such as additional state pension, will rise by 1.7%, in line with Consumer Price Index (CPI) inflation to last September. The higher increase for the two main pension benefits is the result of the 'triple lock', which means that both increase in 2020/21 in line with earnings rather than prices or a 2.5% floor.

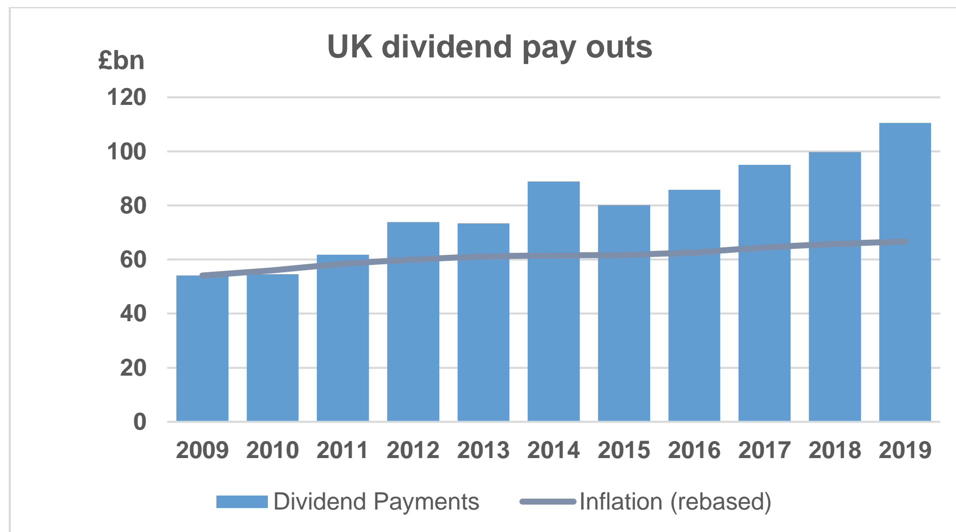
At £9,110 a year, the new state pension is nearly £3,400 below the personal allowance and even below the newly increased level at which individuals start to pay national insurance contributions. The latest global annual survey by the Organisation for Economic Development (OECD), published in November 2019, showed that in terms of mandatory pensions for those on average earnings, the UK was at the bottom of the pile. The OECD average for state pensions is 49.0% for men and 48.2% for women of average earnings. The figure for the UK state pension represented only 21.7% of average earnings. At the top of the OECD league, Austria, Italy and Luxembourg all offer pensions that exceed 75% of average earnings.

The UK has regularly appeared at or very near the bottom of the OECD pension league table, often swapping the wooden spoon ranking with Mexico. It seems unlikely that this situation is going to change any time soon. The last major change to UK state pensions took effect four years ago, when the single tier new state pension replaced the combination of the basic state pensions and, for employees, state second pension scheme (formerly the State Earnings Related Pension Scheme). The underlying aims of the reform were to raise retirement income for low earners while simultaneously reducing the long-term cost to the Treasury.

The October 2012 introduction of pension automatic enrolment added a second tier of private pension provision, but minimum contributions are at modest levels and the self-employed are not included. If you want to enjoy your retirement, the message from the latest state pension increases is to make sure your plans are not relying on state provision.

A good year for UK company dividends

UK shares produced a double digit increase in dividends over 2019.



Over the year, the total paid out in dividends by UK listed companies rose by 10.7% according to the Link Group, a leading firm of registrars. Inflation in 2019 was 1.3%, as measured by the Consumer Price Index (CPI) to December 2019, and 2.2% on the still widely quoted Retail Prices Index (RPI) yardstick.

As the graph shows, the inflation-beating increase follows a broad trend over the last ten years. In 2019, however, the gap between inflation and dividend growth was much larger than the average for the last ten years, of 5.3%. To understand why, look at the two components in Link's total dividend calculation:

- *Regular dividends* are typically paid twice or four times a year from the bulk of the total. Companies generally aim to maintain or increase their regular dividends. Investors do not take kindly to regular dividends being cut, so companies wield the axe only when they have no alternative (for example, some of the major banks stopped dividend payments entirely in the wake of the financial crisis). Regular dividends rose by 2.8% in 2019.

- *Special dividends,* as their name suggests, are one-off payments. These are often associated with corporate reorganisations (for example, the over 20% jump in dividend payments in 2014 was due to Vodafone selling its interest in a US mobile operator and returning part of the proceeds to shareholders as a special dividend). By their nature, special dividends vary more year-by-year and 2019 was a bumper year for them – at £12bn, they were three times 2018's level. The big payers included mining companies such as Rio Tinto.

Link does not foresee a repeat of 2019's special dividend boom in 2020, so it expects overall dividend payments to fall, including a 0.7% exchange rate driven decline in regular dividends. Nevertheless, Link notes that "Compared to other asset classes, equities continue to provide the most attractive income", a point worth bearing in mind when deposit rates are around all-time lows.

National Savings takes the axe to interest rates

National Savings & Investments (NS&I) has announced interest rate cuts to most of its products.

If NS&I did not exist, it is hard to imagine that it would be invented now. Once upon a time it was a useful way for the government to raise cheap money from the general public, whereas today it is exactly the opposite.

If HM Treasury needs to borrow – as it always does – it can raise billions by selling government bonds (gilts) to institutional investors at an interest rate of under 1%. For example, at the time of writing, the yield on ten-year gilts was just 0.47% – less than one third of January's 1.8% inflation rate.

With such low-cost money available in wholesale amounts, it was not surprising that in February NS&I announced a raft of interest rate cuts, all to take effect from 1 May 2020:

Product	Current rate	New rate from 1/5/2020
Direct Saver	1.00% gross/AER	0.70% gross/AER
Income Bonds	1.15% gross/1.16% AER	0.70% gross/AER
Investment A/C	0.80% gross/AER	0.60% gross/AER
Premium Bonds	1.40% 24,500:1 monthly odds of winning	1.30% 26,000:1 monthly odds of winning

The premium bond changes mean that from May, 98.95% of all winning draws will be for the minimum prize of £25. However, as the table shows, the underlying prize interest rate for premium bonds is markedly better than what NS&I is offering on its other variable rate products. Indeed, if your interest income exceeds your available personal savings allowance (£1,000 for basic rate taxpayers, £500 for higher rate taxpayers) and you have used your £20,000 ISA allowance, the likely meagre returns on premiums bonds are relatively attractive.

NS&I also lowered the rates on their fixed rate products – Guaranteed Growth Bonds, Guaranteed Income Bonds and Fixed Interest Savings Certificates. These are not on general sale and are only available for reinvestment of maturing plans.

NS&I's move can be expected to encourage another round of cuts among deposit-taking institutions, even though the Bank of England rate has remained unchanged since July 2018. If you need income from your savings, then you must either resign yourself to these ultra-low rates or accept some risk to capital. For example, the average yield on UK shares is now about 4.3%.

The regulator identifies potential 'areas of harm' for investors

With individual investors now exposed to direct marketing of some products, the UK financial regulator has spelled out which parts of the personal investment market it is most worried about.

"Sustained low interest rates have suppressed returns in safer asset classes, resulting in many consumers deciding to take on more risk in the search for yield. It has led to some being tempted by promised returns from high risk, and sometimes fraudulent, investments."

So says the Financial Conduct Authority (FCA) in its document 'Sector Views: Key areas of harm identified', published mid-February. What the FCA is describing in formal terms is how private investors looking for an income from their capital are being forced to look beyond deposit accounts and opening themselves up to more risk in doing so. The extent of that additional risk is not always evident to investors who haven't sought professional advice, as has been evident in the fall out from London Capital & Finance (LC&F).

LC&F promoted 'mini-bonds', which themselves are not directly regulated by the FCA. In the wake of LC&F's demise in December 2018 amid investor losses, the FCA introduced new rules to prevent the mass-marketing of such products to the general public. However, the ban did not come into effect until the start of 2020 and is only for 12 months while the FCA consults on permanent rules. According to the FCA, by the end of 2018, "1.2% of British adults held retail or mini-bonds – many with little regulatory protection."

The regulator recognises that "…risky investments have been directly targeted at consumers, leaving them more directly exposed to risk". The direct approach means that the 'consumer' is not offered any regulated advice and will not receive any unless they talk to a financial adviser. Without advice, the adage that 'if it looks too good to be true, it probably is' does not seem as be as effective as it once was. That is probably another consequence of ultra-low interest rates.

If you find yourself considering an investment that offers higher returns than normal, especially if it is being directly promoted, remember that adage. Then, if you are still tempted, make sure to take independent advice before acting (*not* the other way around).