The Investment COACH

The state of retirement in 2022

An annual survey from major investment manager Abrdn has provided a snapshot of people who have or plan to retire in 2022. Wherever you are in your retirement planning, the research offers an interesting insight.

When do you plan to stop working? Whatever answer you give, the recent survey of 2,000 people who were either due to retire in the next 12 months or have retired in the past 12 month suggests the odds are that your plans may not reach fruition.

No fewer than 55% of respondents said they had or would be retiring earlier than planned, a jump from 37% in the previous survey. Another 20% said their retirement was deferred, with one in five retirees saying the reason being that they had not saved enough. That leaves only 25% who retired as planned, a reminder that building flexibility into your planning is not optional.

Only 25% of the retirees surveyed felt ‘very confident’ that they had enough funds to finance their retirement, down from 30% in 2021. The fall is related to the rising cost of living, which was flagged as a concern by many. It may also explain why two thirds of the retirees said they would carry on with some form of work, including starting their own business.

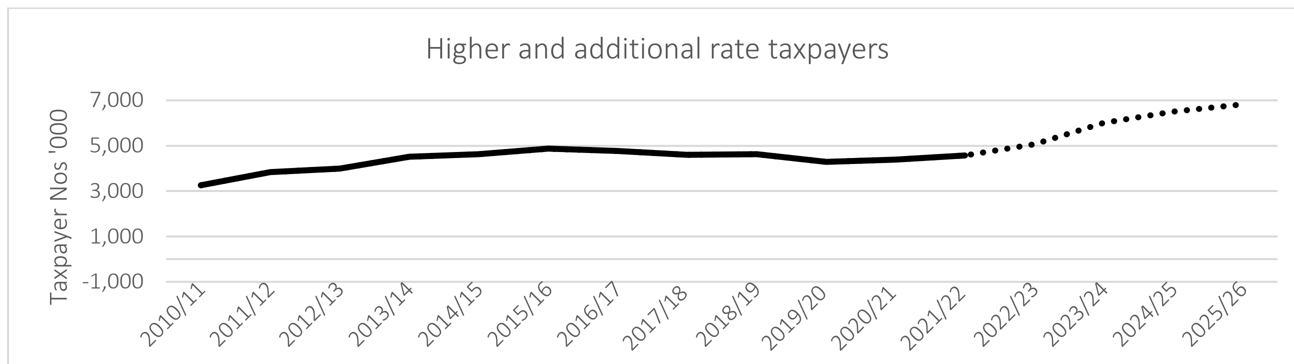
Continuation of work may be an optimistic assumption: the latest data from the Office of National Statistics shows that only 10.6% of those aged 65 and over are in employment. Of the 2021 retirees who were still doing some work, a third said they have or will take ad-hoc jobs in the gig economy. Surprisingly, less than one in seven of the 2021 retirees had mapped out how much they could afford to spend each year, so the number looking for gig employment may well be going up.

A little over half of the 2022 retirees hoped to pass on wealth to their children or grandchildren, but fewer than one in four felt very confident about how to do so. The 2021 retirees could give them a clue. Of the 40% of 2021 retirees who said they were spending more than anticipated, the most common reason was supporting family members in financial difficulty – it seems the Bank of Mum and Dad never retires…

If any of the survey’s results sound uncomfortably familiar to you, take the time to do what only 18% of the 2022 retirees did and seek professional advice about your retirement plans.

Higher rate taxpayers: no longer a select club

Higher rate taxpayer numbers are rising sharply, and if that's you, then independent financial advice is now more important than ever.



Source: ONS data, OBR projections.

There was once a time when paying tax at more than the basic rate made you a member of a somewhat select club. In 2010/11, the first year in which additional rate tax was introduced, the proportion of taxpayers who were taxed at more than the basic rate was 10.4%. Five years later, a dose of austerity pushed the figure close to 16%. Then it began to drop as higher rate thresholds were raised, so that by 2019/20 it was down to 13.6%. From that low, the upward path was resumed.

Alongside the Chancellor's Spring Statement in March, the Office for Budget Responsibility (OBR) issued estimates that the freeze in the personal allowance and, outside Scotland, basic rate bands through to 2025/26 will mean by that year almost 19% of taxpayers will be liable for higher rate tax. The number of taxpayers will also be increasing too because of the personal allowance remaining at £12,570. The rising taxpayer numbers explain why the Chancellor could announce a 1p cut in basic rate tax for 2024/25 at the same time as the OBR calculated that income tax revenue for the year would increase by £12 billion. Scotland already has a starter rate of 19%.

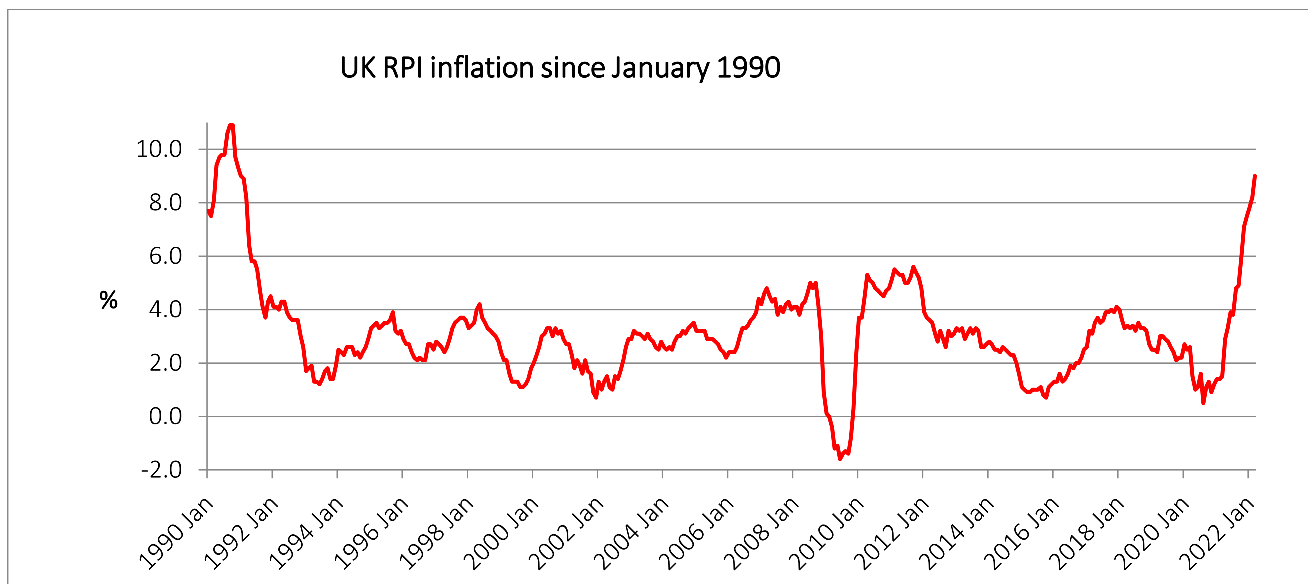
If your head is spinning from all the numbers, there is a simple message: you are likely to pass more of your income to HMRC in the coming years. To limit just how much extra the Exchequer gains and you lose, there are a few actions to consider wherever you are in the UK:

- If you are married or in a civil partnership, make sure you are maximising the benefits of independent tax and, if you are eligible, claiming the transferable marriage allowance.
- Check your PAYE code – it could be wrong.
- Ensure you are claiming full tax relief on the pension contributions you make. Do not assume this will be given automatically, especially if you pay higher rate tax.
- Consider an ISA first for any investment as it is free from UK income tax and capital gains tax.
- Choose any employee perks with care. Some are highly tax efficient, while others carry a heavy tax burden.

Remember that if you are or likely to become a member of the ever-expanding higher rate taxpayer club, the value of financial advice rises with your tax rate.

12% interest on student loans? Not so simple

In theory, high inflation should mean high interest rates for student loans. But it is not that simple.



Source: ONS.

The Retail Prices Index (RPI) is no longer used as a National Statistic, but the government still finds uses for the index when the results work in its favour (because it is usually higher than the Consumer Price Index (CPI)). One good example is that the RPI forms the basis for calculating interest on student loans throughout the UK. The starting point for interest rates for each academic year is the annual RPI in March of the previous academic year. For the coming 2022/23 academic year, the RPI reading that matters the most is the one for March 2022.

The bad news is that, as the graph shows, the RPI was at its highest level for over 30 years – 9.0% (compared with CPI of 7.0%). Cue headlines that some students would be paying 12% interest on their student loans, because many loans are subject to RPI plus a variable amount of up to 3%.

The good news is that the 12% headline is an example of overstatement by oversimplification. The student loan regimes differ throughout the UK and although each start with the RPI as a base figure, all apply some market-related cap to the interest charged. For example, the Plan 2 loans of students (and graduates) in England and Wales who started their course since 2012 have their interest capped at a level derived from Bank of England commercial lending data.

Until recently, that cap has been largely irrelevant because inflation has been so low. In 2022/23, it will become a significant factor. However, the story does not quite end there. The way in which student loans are administered means there is an effective six-month lag between the market cap being triggered and its coming into operation, and a corresponding delay before the benefit of the cap is withdrawn.

If you are now thinking you need a mathematics degree to understand what is going on, you are not alone. The upshot is that when it comes to student finance, as in many other areas of personal finance, expert advice is essential.

Inflation: getting real about returns

With inflation edging ever closer to double digits, the way you think about investment returns may need to change.

From January 2000 to the start of this year, inflation, as measured by the Consumer Price Index (CPI), averaged 2.3%. Over that period, it had briefly risen above 5% three times – in 2008, 2011 and, most recently in late 2021. The last time CPI inflation was above 7% was in March 1992, over 30 years ago.

That means that if you were born after about 1980, you have not experienced the sort of economic environment we are now experiencing. When inflation is around 2% – the Bank of England's government-given target – it goes virtually unnoticed. Economists reckon some inflation is necessary to keep the wheels of the economy moving and that 2% is about the right level. Prices still increase, but they do so slowly and are balanced to a degree by other prices falling. At 2%, the phrase 'cost of living' is not automatically followed by the word 'crisis'.

With inflation at today's high rate, the picture is radically different. Inflation is suddenly no longer something running under the surface. When it comes to investment, the professionals have always taken inflation into account by considering 'real' returns. These are calculated by deducting the inflation rate from the investment rate of return (the nominal return). For example, if an investment return is 8% and inflation is 6%, the real return is +2% (8% – 6%), but when inflation is 2%, the real rate of return is 6% – three times as much. Real returns, like their nominal counterparts, can also be negative.

A negative real rate of return means that your investment's buying power is shrinking. The higher inflation, the more important it is to think in terms of real rather than nominal rates. A good current example is the savings market, where the top rates have risen in response to the Bank of England's base rate increases. You can now earn over 1% on an instant access account – the best nominal rate for several years, but the worst real rate for many years because of inflation.

To stand any chance of obtaining real returns, you must take advice, look beyond deposits and accept some investment risk.

Time to take AIM with your ISA?

The tax benefits of ISAs can extend to inheritance tax.

Individual Savings Accounts (ISAs) have three major tax advantages:

1. No UK income tax liability on UK dividends and interest. With frozen tax bands and allowances plus an increase in dividend tax rates for this tax year, that tax freedom is more valuable than ever.
2. No UK tax on capital gains. Relatively few people pay capital gains tax (CGT) – fewer than 300,000 in 2019/20 – but for those who do, the ISA CGT exemption not only saves tax, but also what can be complex calculations and record keeping.
3. There is nothing to report on your tax return.

One tax disadvantage sometimes attributed to ISAs is that they cannot be placed into trust or given away in lifetime, meaning at death, they potentially attract inheritance tax (IHT). At up to 40% of the entire ISA value, IHT can more than wipe out the income tax and CGT savings.

While it is true that your ISA will be part of your estate, it is possible to sidestep any IHT liability on its value. To achieve this, your ISA needs to have been invested for at least two years in shares which qualify for IHT business relief, which effectively removes them from any IHT charge. In practice, that means your ISA needs to be directly invested in shares in 'qualifying' companies listed on the AIM market.

The 'qualifying' is important: not all AIM-listed companies will meet the requirements for business relief. For example, property investment companies will not qualify, but property development companies usually will. Companies listed on foreign stock exchanges as well as AIM may also not be eligible for relief.

The need to select AIM companies and monitor their continued eligibility has encouraged investment managers to develop specific IHT AIM portfolios for ISAs (and direct investment). The market has grown as IHT liability has increased and there is now a good choice of managers, many with track records.

If you want this tax year's ISA to save income tax, capital gains tax *and* inheritance tax, why not consider an AIM ISA?