The rising cost of retirement

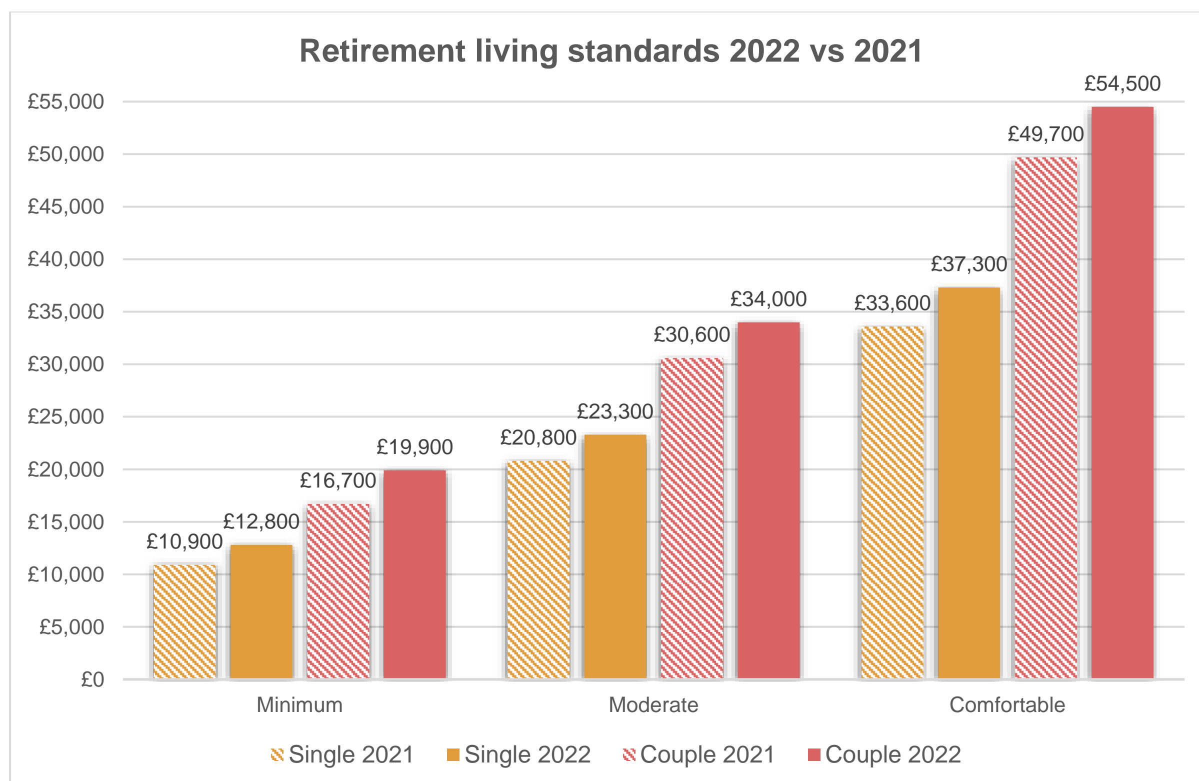
How much income do you actually need in retirement? New research shows an increase that might surprise you.

In 2019, the Pensions and Lifetime Savings Association (PLSA) published research examining how much three different levels of retirement living standards would cost for couples and those living on their own. The three standards were summarised as:

Minimum: Covers all your needs, with some left over for fun
Moderate: More financial security and flexibility
Comfortable: More financial freedom and some luxuries.

To get a sense of the difference across these living standards, the transport category provides a useful benchmark. For a couple, the minimum level assumes no car, the moderate level has one three-year-old car replaced every ten years, while the comfortable pair have two cars, each replaced every five years.

The trio of living standards is updated for changes in spending patterns and the revised costs calculated by Loughborough University. The latest results for people living outside London were published in January, based on April 2022 prices. They showed a sharp rise in the income needed at all three levels, as the graph indicates.



Source: PLSA January 2023.

Not all of the rise was due to inflation, which was 9.0% on a CPI basis in April 2022. Some of the higher income requirement was due to revision to the mix of spending that "saw the amount of food included within the budget increasing to bring it into line with the up-to-date nutritional research on a healthy diet". The disproportionate rise to the minimum figures (18% for singles and 19% for couples) also reflected where spending was concentrated. At the minimum level, 34% was applied to two categories with fast-rising inflation – food and fuel.

Inflation in 2022 has been such that the retirement living standard income levels would need another 5.3% added to them, just to bring them into line the CPI increase from April 2022 to January 2023. State pensions will rise by 10.1% in April 2023, taking the new state pension up to £203.85 a week (£10,600 a year), which will help counter rising retirement costs, but a better comparison is the increase in state pensions in April 2022 – just 3.1%.

If you feel that your future retirement income is not on track to deliver your chosen standard of living, then the sooner you review matters, the better.

Bereavement benefits extended to unmarried couples

The eligibility for some bereavement payments has now been extended to unmarried couples, but there are two major caveats.

In 2021, just over one in five couples living together were cohabiting but not married or in a civil partnership. Despite the growth in cohabitation, the UK tax and benefit systems have an ambivalent approach to those individuals outside the two legal frameworks. For example, an unmarried couple's joint income is taken into account when considering Universal Credit claims, but they are unrelated individuals when it comes to inheritance tax.

Two challenges to an example of this differential treatment made it to the courts several years ago. Both cases concerned bereavement benefits, which the law at the time restricted to surviving spouses and civil partners. In both instances, the government lost, but not because it was discriminating against unmarried couples. The courts' decision hinged on the unequal treatment of each couple's children, which fell foul of the European Convention of Human Rights.

Now three years after the second defeat, legislation is finally going to 'rectify' the original law. The revisions will mean that if one individual in an unmarried couple with dependent children were to die, the survivor would be entitled to the same higher rate of Bereavement Support Payment (BSP) as would be available to a surviving spouse or civil partner. The change will be backdated to 30 August 2018, when the Supreme Court gave the first ruling. The backdating will also cover entitlement to Widowed Parent's Allowance, which was replaced by the BSP for new claimants from 6 April 2017.

While the inclusion of some unmarried couples of BSP is welcome, it comes with two major caveats:

- It applies *only* to unmarried couples with dependent children, which includes cases in which the survivor is pregnant at the time of their partner's death. Unmarried couples who do not have dependent children remain excluded from BSP.
- The amount of BSP is far from generous. The higher rate of BSP was set in 2017 as a lump sum of £3,500, plus up to 18 monthly payments of £350. Unlike most other benefits, it has been unchanged since, so inflation has cut its value by nearly a fifth.

If you are cohabiting – or even if you are not – the BSP rules are a reminder of the inadequacy of the 'safety net' provided by the state in 2023. With this in mind, it's important to build your own safety net and protect your future financial circumstances.

A new tax regime for pensions?

A national think tank has proposed a new blueprint for taxing pensions, which might appeal to a future government.

Tax and pensions. This combination is enough to give most people a reason for their eyes to glaze over. However, the duo is one with a price tag of nearly £55bn in terms of relief from income tax and National Insurance contributions (NICs).

The last major overhaul to the tax and pensions framework took effect in 2006. At the time, it was labelled "simplification". However, 17 years of tweaks – many designed to reduce those reliefs – have resulted in what has been described as "complification". As seems to be the case with many of the UK tax regimes, a design that conceived as a sleek racehorse has ended up as a camel in need of major surgery.

The Institute for Fiscal Studies (IFS) is the latest organisation to put forward proposals to bring some rationality back into the world of tax and pensions. Among its proposals are:

- **Tax-free cash:** As a broad rule you can draw 25% of your pension pot as a lump sum, free of tax, provided your pot does not exceed £1,073,100 – so a maximum tax-free sum of £268,275. The IFS thinks this represents too much of a tax subsidy to higher earners and proposes that the figure should fall to £100,000.
- **NICs:** If your employer contributes to your pension, neither you nor your employer pays NICs on the contribution. However, if you make a pension contribution *personally* from your pay, then your employer pays NICs on that pay (at up to 13.8%) and so do you (at up to 12.0%). The IFS suggests that the NICs relief on employer's contributions should be replaced by a subsidy, the level of which does not have to match the employer NICs rate. For employees (and the self-employed), the IFS goes in the opposite direction and says full NICs relief should be given.
- **Pensions in payment:** There is a sting in the tail that comes with NICs relief for personal contributions – the IFS wants pension payments to gradually become subject to NICs, just as earnings are now.

It would be a brave politician that put some of the IFS's proposals in their 2024 manifesto, but that does not mean they might not appear sometime after the election. In the meantime, maximising your pension contributions in the most tax-efficient way remains a priority.

Looking forward to a Happy New Tax Year?

The new tax year starts on 6 April, heralding a raft of changes that will make an early tax review of the year ahead a wise move.

There is always plenty of attention given to planning for the *end* of the tax year, making use of allowances that are otherwise lost at midnight on 5 April. A March Budget normally adds to the focus as speculation mounts about what might change even before the tax year ends. Much less attention is paid to planning for the *start* of the new tax year, but that can be just as valuable an exercise.

In 2023/24, there will be important personal tax changes – and, in the face of double-digit inflation, non-changes – taking place:

- The personal allowance and higher rate threshold will be frozen again (and will remain so until April 2028). In Scotland, the higher rate threshold will also rise by 1% to 42%.
- The income thresholds for child benefit tax (£50,000) and personal allowance taper (£100,000) will also be frozen, as they have been since they were first introduced.
- The additional/top rate threshold will be reduced from £150,000 (originally introduced at that level in 2010/11) to £125,140. At this lower figure, in theory the rate kicks in immediately until the personal allowance has been tapered away to nil. In Scotland, the top rate will also rise from 46% to 47%.
- The dividend allowance will be halved to £1,000 (and halved again in 2024/25).
- The annual exempt amount for capital gains tax will be cut from £12,300 to £6,000 (again ahead of another halving in 2024/25).

As a result, personal tax bills could increase in 2023/24, even if income does not. For example, if you are a higher rate taxpayer, the halving of the dividend allowance could cost you an extra £337.50 in tax (and £506.25 in 2024/25). Worse still, you might find that you have been 'promoted' from higher rate to additional/top rate. HMRC estimates that nearly a quarter of a million taxpayers will fall into this unhappy category.

There are a variety of actions to ease the increasing tax burden if taken early in the tax year. For example, investing in an ISA in April 2023 rather than March 2024 removes the income that would be generated from the investment from your 2023/24 tax calculation. Some other strategies are more complex, so advice is essential.

The Investment COACH

The UK dividend recovery continues

New research shows that UK companies continued to increase their dividend payments to investors in 2022, albeit at a much slower pace than in 2019.

As memories of the Covid-19 pandemic begin to fade, it is easy to forget the damage that was done to dividend payments from UK-listed companies. Early on in 2020, the Bank of England put a block on dividend payments from the major banks, a sector of the market that had always been a big provider of dividends. Then two other major dividend payers – Shell and BP – reacted to falling oil prices by slashing their dividends by 66% and 50% respectively.

Many more companies followed, either cutting their dividends or suspending them completely to preserve capital. By the end of 2020, the total dividend payout from UK companies was 42.7% down on 2019. Viewed another way, over £45bn of investors' income disappeared in the space of 12 months. Even the global financial crisis of 2007/08 did not have as much impact.

In 2021, as the pandemic was brought under control, the dividend picture reversed almost as sharply. The total dividend payout rose by 42.9%. However, do not be fooled into thinking that meant all the lost income was recovered. Simple maths says that to recover from a 42.7% fall, we would need to see a rise of 74.5% (0.573 x 1.745 = 1.00). The total payout was still £19.4bn below 2019.

The latest data shows that in 2022, total payouts grew again but at a slower pace of 8.0%. That shrunk the gap with 2019 to £12.4bn. Most importantly for many investors, regular dividends (as opposed to the volatile one-off kind) rose by 16.5%.

At the time of writing, an investment in the UK stock market offers an average dividend yield of 3.4%. Many funds in the UK Equity Income sector, which focus on the higher dividend paying shares, have a yield of over 4.5%. The gap between equity yields and deposit rates has shrunk significantly since the start of 2022 as the Bank of England has consistently raised interest rates. That has tempted some income-seekers to keep their cash in savings accounts for the time being, rather than invest it. If that is you, make sure you take advice before making that your long-term strategy.