Private Banking

Would extra income enrich your retirement?

I dare say it might!

You work and save hard so that one day, maybe not too far from now, you'll have the freedom to do all those things you've looked forward to over the years.

That might be time away with family and friends, a home in the sun, or that classic car you've had your eye on.

Your investments are a means to an end. It's important to think about what you want out of retirement and where you want to spend your money and your time.

That said, there are things you need to factor in when planning for your future. And if you're thinking about retirement or have retired already, you may want to consider finding a way to generate an income to enhance your living.

People are living longer, and there's even talk of the **100-year life** and beyond.

You might spend 20 or 30 years in retirement, so it's worth considering how your income will keep up with rising prices and maintain the lifestyle you're used to.

This is where investing for income could come in. Depending on what you've invested in, this regular income can be paid monthly, quarterly, or annually and is usually in the form of dividends or interest payments. You might also use investing for income alongside your other investments, to help you do the nicer things in life.

While it's not too late to start investing for income if you've already retired, it could help to start thinking about this ahead of stopping work.

What is investing for income?

There are two aspects to investing for income

- Income that is paid out to you to spend. Depending on what you've invested in, this regular income can paid monthly, quarterly wor annually and is usually in the form of **dividends** or **interest payments**
- Income you reinvest to grow your money for the longer term.

What are dividends?

These are a portion of company profits paid out to shareholders in the form of cash. Dividends vary with the success of a company, but many big businesses have a long history of reliable payouts to investors.

What are interest payments?

Government or corporate bonds pay out interest throughout the life of your investment. They then repay the money originally invested at the end. Interest payments are generally viewed as a more secure option to dividends due to the nature of how they are invested.

Essentially, investing for income is money in the pocket.

If you're switching from building wealth to taking an income from your investments, it's worth making sure you hold the right type of investments. Most investments have two options – 'income' shares which pass on any income, and what's called 'accumulation' shares which are designed for future growth.

With investing for income you also benefit from a 'snowball effect' known as **compounding**.

What is compounding?

You can receive income on the amount you've invested. If you reinvest your income, the amount you've invested increases. This means the next income payment will be based on your new larger investment amount. This is compounding.

The compounding effect of reinvesting income over time can be powerful. Data shows that from 2012 to 2022 the return of the FTSE 100, the top 100 companies listed on the London Stock Exchange, was just over 23%. That return climbed to over 84% when dividends were reinvested.

Certain types of investment income such as dividends can also be useful to help protect against rising costs.

What about bonds?

Dividends from company shares are only one part of income investing. Bonds can also generate an income.

Bonds were a good go-to option in retirement. They paid a reliable income, and people got their money back at the end of the term. The only way this wouldn't happen is if the government or company behind the bond went bust, which is rare.

Low interest rates made bond investing more difficult as the income available was low. But with interest rates rising since last year, bonds are back. Corporate bonds – bonds issued by companies – have also seen payouts rise.

In general, stock market investments can be a good defence against inflation. Conventional bonds don't offer protection against higher costs, but it's possible to buy 'index-linked' bonds, which rise in line with inflation expectations.

Cutting your tax bill

There are ways to reduce the tax paid on investment income. This can be through using the right products or 'wrappers' and making use of tax-free limits or 'allowances'.

Tax planning can require specialist advice where big sums are involved, but there are some points to note as a start:

Tax allowances and income investing

- You may have income from more than one place. For example, if you are still in part-time work and you have extra income from your pensions and investments. Make sure HMRC knows so you pay the right amount of tax
- The personal allowance is £12,570 for the 2023/24 tax year. This is the amount of income you don't have to pay any income tax on. Your Personal Allowance may be bigger if you claim Marriage Allowance or Blind Person's Allowance. It may be smaller if your income is over £100,000
- The personal savings allowance for the 2023/24 tax year:
  - £1,000 for basic rate taxpayers
  - £500 for higher rate taxpayers
  - £0 for additional rate taxpayers
- The dividend allowance is £1,000 for the 2023/24 tax year
- Income generated in an Individual Savings Account or ISA is tax-free. The ISA allowance for this tax year is £20,000.

Investing for income might be used to fund the lifestyle you're used to, or as a way of reinvesting returns to build wealth. However you do it, it could help unlock a happy, wealthy retirement.

Helpful resources

You can find out more about tax in retirement from Money Helper and current tax allowances from the government's website

If you'd like to chat through your options for investing in your future, you may find it helpful to speak to your Private Banker.

Tax rules, rates and allowances can change at any time and could affect how much you get back. The value of any tax relief depends on your individual circumstances.

The value of investments and any income from them can go down as well as up and you may get back less than the full amount you invested. Investments should be held for the medium to long term (5+ years), unless there is a fixed term that applies.

The content in this article doesn't constitute financial or tax advice, if in any doubt, please speak to an adviser or tax specialist.

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