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NATIONAL INSURANCE AND TAX ON DIVIDENDS TO RISE

The Prime Minister announced last month that National Insurance contributions (NICs) and the three dividend tax rates will all increase by 1.25% from April 2022 to pay for the social care system in England.

From 6 April 2022, the basic rate of dividend tax increases to 8.75% (up from 7.5%), the higher rate rises to 33.75% (up from 32.5%) and the additional rate becomes 39.35% (up from 38.1%). These rates apply on dividends received above the £2,000 tax-free dividend allowance.

National Insurance contributions (NICs) are to rise 1.25% for employers, employees, and the self-employed for the 2022/23 tax year. It will then become a separate health and social care tax on earned income from April 2023 - appearing on employees' payslips.

This will be paid by all working adults, including older workers over the age of 66, and is expected to raise around £12 billion a year. The proceeds raised from 2023 onwards will be legally set aside to pay for reforms to the care sector and NHS funding in England. The move goes against a Conservative manifesto vow not to raise the rates of income tax, VAT or NICs for the duration of Parliament. However, this pledge was made in 2019 before the pandemic and before state spending hit more than £300 billion on COVID-19 support measures.

What does the NICs increase mean for employers, employees and the self-employed from April 2022?

For Employers

Employers currently pay secondary Class 1 NICs at a flat rate of 13.8% for all employees who earn more than £8,840 a year. From 6 April 2022, the rate of employers' NICs will increase to 15.05% on qualifying earnings above this threshold. This rate will revert back to 13.8% from April 2023, but the additional 1.25% will apply separately as the new health and social care tax.

For Employees

Employees have Class 1 NICs deducted from their pay packets at source by their employer if they earn more than £9,568 a year in 2021/22. They currently pay a main rate of Class 1 NICs at 12% on qualifying earnings up to £50,270, with an additional 2% applying on earnings above this.

From April 2022, these main and higher rates of Class 1 NICs that apply to employees will increase to 13.25% and 3.25% respectively. This means an employee who earns the median basic-rate taxpayer's income of £24,100 a year in 2022/23 would contribute an additional £180 a year, while higher-rate taxpayers earning the median higher-rate taxpayer's income of £67,100 a year in 2022/23 would pay an additional £720 a year.

For the Self-Employed

Like employees, the self-employed also pay a main and higher rate of NICs. The difference is they pay Class 4 NICs, which have rates of 9% and 2% respectively. For 2022/23, sole traders and business partners who are registered as self-employed and pay Class 4 NICs will see these two rates increase to 10.25% and 3.25% respectively.

The increase will not apply to Class 2 NICs - the flat rate paid by the self-employed with profits above the small-profits threshold, currently £6,515 a year. Neither will the increase apply to Class 3 NICs (voluntary contributions for taxpayers to fill in gaps in their contribution records to qualify for state benefits).

What about the increased tax on dividends?

As mentioned, from the 2022/23 tax year onwards, the basic rate of dividend tax increases to 8.75%, the higher rate rises to 33.75% and the additional rate becomes 39.35%.

The current rates of tax on dividends are 7.5%, 32.5% and 38.1% respectively. These rates have remained unchanged for more than a decade, since April 2010 in fact, although the dividends tax regime has undergone significant change during that time. Most recently, in April 2018, the annual dividend allowance was reduced from £5,000 to £2,000.

Around 40% of savers who hold dividend-paying investments outside of ISAs can expect to be hit with higher taxes from 2022/23, according to Government forecasts. Higher-rate taxpayers are expected to pay £403 more in dividend tax in 2022/23, while the bill for those paying basic-rate income tax will rise by £150 on average next year.

Tax Planning Options

Two options to try to mitigate the impact of the dividend tax hike, particularly for those who have money in dealing accounts, is to consider putting as much as possible into an ISA or a pension scheme before next April.

ISAs continue to offer a tax-efficient way to save, allowing individuals to put up to £20,000 a year into a tax-free wrapper. This means there is no income tax or capital gains tax liability if the investments grow. Some customers might rush to use up their £20,000 ISA allowance before the higher dividend tax rates kick in from 6 April 2022, driven by the tax benefits of ISAs, enabling them to shelter dividends from the tax hike.

Alternatively, utilising the annual pension allowance - worth up to £40,000 in 2021/22 - is another tax-efficient option, although it does of course involve setting the money aside in the pension scheme, which may not be accessible again for some time, depending on your age.

However, when the time comes to take benefits after the age of 55 (rising to 57 in 2028), 25% is normally tax-free with the rest of the retirement income that exceeds the personal allowance taxed at an individual's marginal rate of income tax.

The above is for general guidance only and no action should be taken without obtaining specific advice.

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