Information

Family Investment Companies

What is a Family Investment Company?

A Family Investment Company (FIC) is a bespoke private company, which can be used as a tax efficient alternative to family trusts. A FIC is a flexible structure, allowing families to define how specific family members benefit through varying rights attaching to shares, or the number of shares in issue. The directors and shareholders of the FIC are normally family members. As with trusts, the structure of the FIC can enable parents/grandparents to retain control over assets, whilst accumulating wealth in a tax efficient environment and facilitating future succession planning.

It is preferable to set up FICs with cash (by gift and/or loan), as the transfer of property or shares is likely to trigger capital gains tax, stamp duty and inheritance tax (IHT).

The set up costs and ongoing administration of a FIC make it unattractive unless sums in excess of £1m are available to establish the FIC. For sums less than £1m the use of trusts or outright gifts may be a more suitable means of estate planning.

Inheritance tax planning and Family Investment Companies

A FIC can help families manage their exposure to IHT in several ways:

- When the FIC is formed, shares can be given to family members without incurring any immediate tax charges and after seven years the full value of what has been given away will pass out of the estates of the founders, so avoiding any IHT;
- If founders lend initial capital to the FIC, any growth in the value of investments held by the FIC will be outside the founders' estates;
- The founders can retain distinct classes of shares, so enabling them to retain income (and capital if the company is ever wound up);
- If shareholders have a minority interest in the FIC, the value of their shareholding will be discounted on death for IHT purposes, taking into account the size of their holding and their inability to sell the shares or demand income from the company;
- Unlike trusts, the FIC will not pay IHT periodic charges, which apply to trusts at up to 6% every 10 years, or exit charges if and when capital is distributed.

Asset Protection

A FIC may provide useful protection in the event of a shareholder's divorce. The FIC can be structured so that shares can only be held by direct family members (excluding spouses). The assets of the FIC are generally beyond the reach of the family courts. The value of shares held by a divorcing shareholder will be taken into account on divorce, but given the restricted rights their value may be low or negligible.

Wealth accumulation

A FIC is a tax-efficient vehicle for accumulating wealth, particularly dividend income, which is received by the FIC tax free. Other income and capital gains are subject to corporation tax at 19% (rising to 25% in April 2023), which is significantly lower than the top rates of tax for individuals and trustees (45% for savings income and

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39.35% for dividend income). This means the FIC is able to reinvest more of its income, which if accumulated within the FIC should generate greater future growth.

Funds are normally extracted from the FIC via dividend payments. No additional tax is payable on dividends received by individual shareholders up to £2,000 per annum. Above this amount, in the tax year 2022/23, dividends paid to basic rate tax payers will attract tax at 8.75%. Dividends paid to higher rate tax payers will attract tax at 33.75% and additional rate taxpayers will pay tax on dividends at 39.35%. The payment of any additional tax by the recipient shareholders only arises when profits are distributed out of the FIC to them. It is, therefore, advantageous to roll up income at the lower rates of tax, reinvest it in the FIC and only distribute it to use individual dividend allowances or if the family need it.

Who controls a FIC?

Day to day control of the FIC rests with the board of directors, who are often the founders. The board determines what investments the company makes and when dividends are paid to shareholders.

The constitution of the FIC will often include additional measures to ensure either the board, or a particular class of shareholder, must approve changes to the structure and management of the FIC, such as the appointment of directors or the transfer of shares.

Management expenses

Expenses incurred by the FIC in managing investments and running the business will be eligible for corporation tax relief. This will include investment managers' fees and remuneration paid to employees/directors. By contrast, an individual investor cannot obtain tax relief on the expenses of managing a share portfolio.

Example of a FIC structure

The parents, as founders, provide funds to the FIC in the form of either loans or by subscribing for preference shares. This will not be regarded as a transfer of value for IHT purposes. Repayment of loan capital can be extracted tax free from the FIC at a later date.

The parents also subscribe for voting shares in the FIC, which gives them control of the FIC at shareholder and at board level.

The parents might also subscribe for a class (or classes) of voting or non-voting shares. The parents can then give those shares to their children (preferably before significant value accrues to those shares, so as to avoid a CGT charge). The gift will not be subject to IHT, provided the parents survive seven years. There can be a different class of share for each child, so allowing future flexibility concerning dividend payments to some but not all.

The children's shares may pay dividends in future.

Parents could also put cash into a discretionary trust for the benefit of their children/grandchildren without triggering an IHT charge, to the extent that their IHT nil rate bands are available (maximum £650,000).

The parents (and minor children) should be irrevocably excluded from benefiting from this trust, although children can benefit once

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they reach 18. The trustees can then subscribe for a class of shares in the FIC at market value, (i.e. at nominal value if the company is newly formed).

Disclaimer

This information sheet is written as a general guide. As any course of action must depend on your individual circumstances, you are strongly recommended to obtain specific professional advice before you proceed. We do not accept any responsibility for action which may be taken as a result of having read this information sheet.

NOTE: The law is stated as at 6 April 2022.

If you require further information, please contact Nicola Plant or Mark Politz on 01892 510000 or by email at:

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