Cantab
ASSET MANAGEMENT

Family Investment Companies

A family investment company (FIC) is a UK-resident private limited company whose shareholders are family members. This vehicle can be extremely tax-efficient where an individual transfers significant sums of cash into a company. This cash could be invested to generate income for the family.

Family Investment Companies versus Trusts

Trusts are the standard way to pass down family wealth to future generations. However, recent tax changes mean that family investment companies may offer a more tax-efficient option. The Finance Act 2006 introduced significant changes in the UK's tax regime for trusts. Most new trusts now enter into the relevant property regime which results in:

- An immediate charge to inheritance tax (IHT) at 20% for transfers made in excess of a donor's available nil rate band (currently £325,000)
- 10-yearly IHT anniversary charges (capped at a rate of 6%)
- A further charge to IHT if assets 'exit' the trust (also capped as above)

With these drawbacks, individuals wishing to pass down substantial wealth need to consider alternative vehicles, which may be more tax-efficient. However, rates of corporation tax available in the UK (19% from 1 April 2017, rise to 25% from 1 April 2023).

Advantages of a Family Investment Company

1. Assuming an individual has available cash to transfer into a company, the transfer into the FIC would be tax-free.
2. There would be no immediate charge to IHT on the gift of shares from the donor to another individual as this is deemed to be a potentially exempt transfer (PET). There will be no further IHT implications on the donor if they survive for seven years following the date of gift.
3. The donor can still retain some element of control in the FIC providing the articles of association are carefully drafted. They can own the voting shares while the investment growth goes to the shares held by the younger generations. Preference shares can also be used to guarantee the donor receives sufficient income from the company.
4. The FIC would pay corporation tax on the profits that it generates and 0% on the receipt of dividends. Investment management fees are tax deductible from profits.
5. Shareholders only pay tax to the extent the FIC distributes income. If the profits are retained within the FIC therefore, no further tax would be payable. Children who are shareholders can draw income and dividends up to the relevant allowances. Income flows can be turned on and off 'like a tap' to maximise tax efficiency.

Disadvantages of a Family Investment Company

1. If non-cash assets are transferred into the FIC, the donor may incur a capital gains tax (or stamp duty land tax on property transfers) charge based on the market value of assets that are transferred into the FIC at the date of transfer. Unlike a trust, the FIC does not benefit from an annual capital gains tax allowance.

2. Trust structures continue to be tax-efficient if you can transfer assets in without incurring an IHT charge. This is achievable when assets qualify for some sort of relief such as business property relief or agricultural property relief. If an individual has these assets therefore, a trust structure may be more suitable.

3. As mentioned above, there is an element of double taxation in using the FIC structure. The profits are first subject to corporation tax and then are subject to income tax when they are subsequently distributed to the shareholders, albeit accessing capital through a purchase of own shares can be highly tax-efficient in some circumstances.

4. The FIC will have to comply with company filing regulations if set up as a limited company – there are costs however to consider when setting up and running a trust.

The FIC is a potential vehicle that should be seriously considered as an alternative to a trust. The FIC still allows the donor to retain control over their investments while avoiding an immediate charge to IHT. Care does need to be taken, however, if assets other than cash are to be transferred into the FIC.

Conclusion

It is important to enunciate objectives as fully as possible before making decisions on potential structures to be used in planning family finances. Once objectives are agreed, the possible options for structuring investments can be laid out and discussed with pros and cons compared. It may be that continued personal ownership and gifting may suit many families. Good preparation should enable good decision making in this potentially complex area.

January 2023

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