Broadcast

Nunn Hayward

FACTSHEET: FAMILY INVESTMENT COMPANIES

SPECIAL ISSUE

01753 888211
www.nhllp.com

FAMILY INVESTMENT COMPANIES (FIC's)

Since 2006 when HMRC imposed some significant taxation changes on Trusts, Family Investment Companies (FICs) have been seen by many as the natural success to Trusts in the context of succession and (IHT) planning. Whilst there are certain tax and succession planning issues that can be achieved using solely a FIC, it has become clear that the careful use of Trusts can complement and benefit FIC planning, providing flexible wealth preservation, control and protection of the family wealth as well as tax mitigation.

Family Investment Company as a Standalone Succession Planning Vehicle

Typically, cash investments or other assets with low inherent Capital Gains can be transferred into a FIC without any significant taxation charges. Whilst assets can be transferred in exchange for shares, typically they would be sold to the FIC and the proceeds initially left as a debt in the form of a loan due from the company to those selling the assets into the FIC. Normally, two classes of shares will have been issued to a married couple on incorporation of the FIC. These would have exactly the same rights to dividends, assets and voting.

Subsequently, but importantly, before the assets have been sold into the company in exchange for the loan, a new class or classes of share(s) are issued to the next generation. These would be separate shares for each individual involved but here, those shares would typically have rights to dividends at the Directors' discretion, for capital growth rights in the future, but no voting rights.

At this stage the tax implications can be summarised as follows:

1. If stocks and shares are purchased by the FIC that yield dividends, the FIC will not pay any corporate tax on those dividends. Other income such as rental from property or interest may well attract Corporate Tax but at corporate not personal tax rates. This may therefore be a significant tax saving compared to tax suffered on personal investment income.
2. Should income be required by the founders, they can vote themselves dividends out of the reserves of the company as and when they choose. However, as they have a significant loan account, they can choose to limit these dividends to keep personal taxation to a particular threshold whether that be 20% or 40%, for example, and pay the balance as a tax-free repayment of loan. In this way, personal allowances and/or lower tax rates can be managed for each founder dependent upon their own circumstances thus optimising each year's taxation position.
3. The next generation can be paid dividends to utilise their own lower tax rates, tax free dividend allowance of currently £2,000 per annum, entirely at the Directors' discretion. These dividends do require reserves and thus income or Capital Gains to have been generated in the company.
4. At day one it should be noted that as the entire value of the company is represented by the loan due to the founders, no IHT saving has been made.

There are usually two ways to achieve IHT mitigation as follows:

1. At the commencement of the company, it is possible to add in extra rights to the shares given to the next generation such that their shares receive all future growth of the company's value.
2. Independently, or in conjunction with the above, assuming the founders are content with their future financial security they could choose to gift some, or all of the loan owed to them by the company to the next generation. This gift of a debt is a Potentially Exempt Transfer (PET). Therefore, after 7 years from the date of the PET, as long as the founders have not died, the gift will be entirely outside of the founder's estate. This saves 40% IHT. In addition, as the next generation now have loan accounts owed to them by the company, their personal tax positions can also include a mix of dividend and loan repayments to better improve the income tax efficiency of any payments made to them.

If it is assumed that the loan is either fully repaid or gifted before the founders have died, the result will be that the full value of the initial investment, plus all growth will have passed to the next generation without IHT.

Family Investment Companies in Conjunction with Trusts

The biggest practical issues with founders giving shares to the next generation are concerns over:

i. Giving too much wealth too soon and impacting negatively on the next generation's motivation and drive to achieve their full potential; and
ii. Concerns over failed relationships of the next generation and/or general financial naivety/ mismanagement leading to others gaining ownership of the FIC shares.

This is where a Trust owning some FIC shares assists with both the above issues. Generally, a Trust gives the following:

Control – As the founders can also be trustees and write the rules of the Trust.

Protection – As the beneficiaries can only benefit at the behest of the trustees, which is entirely discretionary, therefore there is no right to any income or asset for any other third party to attack.

Flexibility – As the family dynamic evolves, it's possible to vary who gets what and when at different times to suit the different family circumstances.

Taxation – If implemented and managed correctly, the high headline income tax rates for a Trust (45% income tax) can be managed and mitigated in full, or to match beneficiaries' tax rates.

In addition to the above, if the shares that go into the Trust have the ability to capture all future growth entirely, or over a certain hurdle, then that value will be outside of the founders and indeed the next generation's and future generation's estates for IHT purposes.

Discretionary Trusts are subject to a special IHT regime of their own. This broadly subjects the value in the Trust to a 10 yearly IHT charge on the excess over the nil rate band used to set up the Trust, but at a maximum of only 6%.

In summary, family investment companies either as a stand-alone vehicle or in conjunction with a Trust have become a popular Estate and Succession planning vehicle for families to hold investment assets intended for inter-generational succession.

If you would like further information on this, please call us on **01753888211** or email **info@nhllp.com**

Disclosure: This article is intended as a general introduction to the main concepts. No liability can attach to the firm as a result of any actions taken, or refrained from as a result of this article.