Family Investment Companies

Family Investment Companies (FICs) have become an alternative to trusts, following recent falls in the rate of corporation tax and the historic trust tax changes made in 2006, as an efficient means of retaining control over assets and passing them on to the next generation.

Overview

A FIC is a private company whose shareholders are members of the same family. Typically the parents of a family will fund the company by way of equity and loans, and the funds are then used to acquire assets in order to generate a return. They may also gift cash to family members to enable them to participate. The company's Articles of Association may be used to tailor the company to meet the family's needs.

Key advantages of FICs

- They are useful as a long-term investment vehicle for those with common investment approaches.
- They allow the founder to retain significant control of the assets, usually via a director role.
- They are often less complicated than trusts.
- Dividend income received by a FIC is not normally subject to tax.
- Certain expenses may be deducted from the company's income, to a greater extent than is possible for an individual or trust.
- Other income and gains are taxed at the corporation tax (CT) rate (currently 19%).
- By combining a FIC with the operation of a family trading business it may be possible to invest surplus profits from the business in a tax-efficient environment.
- They can reduce a family's exposure to inheritance tax (IHT).
- They may provide some protection to assets in the event of divorce.

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Succession planning

FICs can be an efficient alternative to trusts for use in succession planning. Shares in the FIC may be gifted to family members free from any immediate IHT charge and after seven years the full value will pass out of the estate of the founders. FICs are also not subject to the 20% IHT entry charge or the 10-yearly IHT charge suffered by trusts.

Where founders still have a shareholding in the FIC on their death, the value of the shareholding will often be significantly discounted for IHT purposes by comparison with the value of the underlying assets, after taking into account the size of the holding, restrictions on sale and lack of access to underlying income.

Taxation of FICs

FICs will usually be funded by a mixture of equity and loans from the founder shareholders; however, in the instances where non-cash assets are transferred into the company, these are likely to give rise to a capital gains tax (CGT) liability on the founder (who is making a disposal of the assets).

Dividend income returns generated by the FIC are not normally subject to CT, whilst other income and chargeable gains are taxed at the CT rate of curently 19%. A FIC also benefits from indexation allowance on chargeable gains (frozen at December 2017), providing a further tax reduction. These relatively low tax rates compared to those applicable to trusts can make FICs an ideal long-term investment vehicle, allowing a greater portion of returns to be reinvested.

Profits may be extracted from the company by the shareholders by way of dividends subject to income tax (IT) at the prevailing dividend tax rate. A dividend allowance (£2,000, from 6 April 2018) has the effect that the first £2,000 will not suffer any further tax. Dividends exceeding this allowance are then taxed at 7.5% for basic rate tax payers, 32.5% for higher rate tax payers and 38.1% for additional rate tax payers. As distributions give rise to this tax charge, and given the benefits of retaining income in the company and reinvesting it to produce returns taxable at the CT rate, care is needed to ensure that dividends are extracted in the most tax-efficient manner.

Sometimes it may be possible, as an alternative, to make loan repayments without a tax charge.

Tailoring a FIC to the specific circumstances

FICs can be set up relatively quickly in the same way as any company; however, care should be taken when preparing the Articles of Association and any shareholders' agreements. These documents can be used to tailor the FIC to specific family needs. This may include restrictions on the transferability of shares, mechanisms for making decisions on the distributions of profits and investment decisions, and provisions relating to voting rights. FICs may also provide some protection in cases of a divorce, as normally a family court will be able to make an order as regards the disposition of an individual's shares in the FIC, but not as regards the disposition of the assets held by the FIC.

Additionally an unlimited company may provide a greater degree of confidentiality.

Onshore v offshore

Traditionally FICs take the form of UK tax resident private limited companies, incorporated either in the UK or incorporated offshore but managed and controlled in the UK, and therefore receiving the same tax treatment as a UK-incorporated company. An offshore FIC (i.e. one that is incorporated overseas) may however serve in some cases to prevent confidential information about the family from entering the UK public domain as such companies are not required to file accounts or details of key persons with Companies House unless they have a place of business in the UK. They will instead be subject to the filing requirements of the country in which they are based. However, set-up and running costs tend to be higher for overseas companies.

Key considerations

- If assets other than cash are transferred into the company, these are likely to give rise to a CGT liability on the donor.
- There are costs associated with setting up and maintaining a company, including: accounts preparation, corporation tax returns and annual returns to Companies House.
- There may be an element of double taxation on distribution of income or gains of the company.
- If the donor holds shares on death, IHT will be payable, but the value of the shareholding may be discounted to reflect its size and lack of access to distributions.
- It is important to seek IHT advice on the incorporation of an FIC as if the company is not structured correctly, the donors may be caught by the 'gift with reservation of benefit' and settlement rules.

How can Moore Stephens assist?

Moore Stephens can help by:

- considering whether a FIC will be beneficial in any particular case, and comparing its effects with those of other structures such as family trusts;
- liaising with solicitors, who will draft the articles and shareholders agreement
- advising on IHT implications;
- submitting tax returns to HMRC, both for the FIC itself and for individual shareholders;
- assisting with accounts preparation and submission of returns to Companies House.

If you would like further information on any item within this brochure, or information on our services please contact your usual Moore Stephens adviser.

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