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Family Investment Company

When looking to structure your wealth and pass assets to younger generations, there are various options to consider. One method is the use of a Family Investment Company (FIC), which have become more popular in light of the significant changes in 2006 concerning the taxation of trusts.

These changes had the effect of ensuring that all lifetime transfers into trusts (with a few exceptions) are subject to a lifetime inheritance tax (IHT) charge of 20% on any value in excess of the transferor's available nil-rate band (which has been £325,000 since 2009). Consequently, as the popularity of trusts has declined, FICs have become a preferable vehicle through which wealth can be invested and passed onto future generations.

What is a Family Investment Company?

A FIC is merely a private company, incorporated under the Companies Act 2006, which is created for the purposes of holding investments for a family. The process of incorporating the FIC is relatively painless, and it will be registered at Companies House, as for any private company.

A FIC is normally created with limited liability due to the advantages this can present for shareholders, however, it is possible for a FIC to be established with unlimited liability. The advantages of this are largely to do with increased privacy for shareholders since unlimited companies are not required to file annual accounts at Companies House, so the financial position of the company is not available viewing for third parties.

Creating and structuring a Family Investment Company

A FIC is usually incorporated with subscriber shares issued at nominal value to individual family members, usually the parents. Subject to the rights assigned to shareholders in the company's legal documents, they are entitled to receive income by way of dividends and/or a return of capital on disposal of their shares.

Often, the share capital of a FIC is established to ensure that control and economic entitlement are kept separate, which allows the control to be vested in a small number of individuals whilst the economic interests can be held by a key number of family members. Whilst FICs do not offer the same amount of flexibility as a discretionary trust with regards to income streams and asset protection, some restrictions can be written into the constitution of the FIC.

As well as contributing share capital to the FIC, it may also be possible to lend funds. One advantage of this is the flexibility to extract funds from the structure without needing to take a dividend (which requires the FIC to have distributable reserves). However, if using a loan and making gifts of shares, care should be taken in case anti-avoidance provisions apply.

What are the tax benefits of a Family Investment Company?

Inheritance tax

A gift of shares to children would be a potentially exempt transfer for IHT, meaning the value of the gift would fall out of the donor's estate for IHT purposes, provided they survived the gift by at least seven years.

In contrast, a gift to a trust will give rise to an immediate IHT charge at 20% (to the extent it exceeds the donor's nil rate band).

Corporate taxation v personal taxation

One of the main benefits of making investments through a FIC is that the FIC will generally pay tax at a lower rate on its investment returns.

1. Rates

The company will pay corporation tax at 25%, as the small profits rate of 19% does not apply to 'close investment holding companies' which by definition will include many FICs. This is significantly lower than the top rates of income tax (currently 45%) and therefore may result in higher post-tax profits being available for reinvestment.

2. Dividends

Most dividends received by a UK company (including foreign dividends) are exempt from corporation tax.

There are general and specific anti-avoidance measures, but in general, unless a distribution is paid as a contrived means of avoiding tax on what would otherwise be taxable income for the company, the anti-avoidance provisions should not be applicable.

3. Capital gains

Capital gains realised by the company are chargeable to corporation tax at 25%. At present, this is higher than the current main rate of capital gains tax (CGT) of 20% that would be payable by an individual.

Where the asset disposed of is shares in a subsidiary company, Substantial Shareholdings Exemption may be available to exempt the gain. Detailed conditions apply, but broadly the FIC would need to hold at least 10% of the company being disposed of, which would itself need to be a trading company.

4. Tax relief on interest

The company will be able to claim a corporation tax deduction for interest on loans taken out against the value of its investments, where the loans are used for the purposes of the company's business (eg acquiring new shares or generally managing its business). Loan interest deductions may be restricted where the total interest payable exceeds £2 million per annum (on a group basis).

By contrast, individuals are not eligible to claim tax relief on interest on loans to acquire a portfolio of shares.

5. Management expenses

Expenses incurred by the company in managing its investments and running its business will be eligible for corporation tax relief. This will include investment managers' fees and remuneration paid to employees/directors. Certain items are not eligible for tax relief, such as entertaining.

By contrast, an individual investor cannot obtain tax relief on the expenses of managing his share portfolio.

It is necessary to consider the tax cost of extracting profits from the FIC. Shareholders will be subject to tax on profits extracted from the company:

- Income tax on dividends: the highest rate is 39.35%. For lower rate taxpayers (eg children once aged 18), the amount in excess of the combined personal allowance and dividend allowance (a combined £13,570 for 2023-24) will be taxed at 8.75% at the basic rate and 33.75% at the higher rate,
- Income tax on salaries (if the shareholder is also an employee): up to 47% or 49% for Scottish taxpayers (including employee's National Insurance contributions), and
- CGT on capital distributions on the liquidation of the company at 20%. Capital distributions on liquidation are, however, treated as income for tax purposes in certain circumstances (essentially where the recipient, or someone connected with them, carries on a similar business to that of the liquidated company in the two years following the distribution). In such cases the distribution will be subject to the relevant marginal rate of income tax (up to 39.35%).

The tax implications of extracting profits may therefore result in a similar or higher rate of tax than if an individual invested directly. FICs are therefore best used as a long-term planning tool where the aim is the accumulate and grow wealth for future generations, rather than where investment returns will be extracted and spent in the short term.

When is a Family Investment Company not suitable?

When investing in property, care must be taken to ensure that the FIC does not fall foul of the Annual Tax on Enveloped Dwellings (ATED) regime. This tax applies to residential properties worth over £500,000 held by a corporate entity, where an annual tax charge is levied based on the value of the property, although reliefs are available against this tax.

In addition, investments benefitting from tax incentives and reliefs such as the Business Asset Disposal Relief (BADR), Business Property Relief (BPR) or the Enterprise Investment Scheme (EIS), may be better off being made personally as the FIC would not be able to get the tax advantages available to individuals.

Establishment and annual running costs will be due on the creation and running of the company. Due to the likely costs involved, they are, therefore, only really viable for people wishing to invest significant sums.

HM Revenue & Customs (HMRC) have, in the past, carried out some work to understand the use of FICs as an IHT planning vehicle.

To date, this has not led to any changes in the legislation affecting FICs, but it remains possible that, as with other vehicles used to transfer wealth, we could see changes in the future. Because of this, and also because of the complexities involved (including the mix of personal and corporate tax issues that need to be taken into account), appropriate advice should be taken before setting-up a FIC.

Additionally, if you are thinking of changing the structure or operation of an existing FIC, we would always recommend taking additional professional advice before doing so.

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This information is based on law and HMRC practice at 1 October 2023.