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FAMILY INVESTMENT COMPANY BULLETIN

Phil Pellegrini, Private Client Partner at Dains Accountants, looks at the role a Family Investment Company could play in protecting and building your family's wealth for the future.

For most of our clients, when it comes to securing their wealth for their children, grandchildren and beyond, and reducing their liability to Inheritance Tax (IHT) on their deaths, their first thought is a family trust.

Trusts do still have a place in modern tax planning and can work extremely well in the right circumstances. However, many clients are now looking for an alternative.

2006 Not A Good Year For Trusts

After Finance Act 2006 was enacted, it became very difficult to transfer assets into trust without incurring a charge to IHT.

The Act also brought most trusts within an IHT regime that imposes tax charges every ten years on the value of the trust fund, plus whenever assets are distributed to beneficiaries.

Despite growing inflation, the value that can be put into trust without creating an immediate 20% charge to Inheritance Tax has remained the same for several years: £325,000 for an individual or £650,000 for a couple.

If my clients - let's call them Mr & Mrs Floyd - wish to transfer say £1m into trust e.g. sufficient to generate enough income to pay school fees for their grandchildren, and then to help with future property purchases, they could be looking at an immediate Inheritance Tax bill of £70,000.

In addition, clients often feel uncomfortable relinquishing control of assets they have built up over many years of hard work to third party trustees. They can put a 'letter of wishes' in place, and can include or exclude certain individuals, but once that deed is signed, and the assets transferred, it is the trustees who make all the decisions. For many entrepreneurial clients in particular, this loss of control can be an issue.

Also, crucially, it is almost always necessary to completely exclude the creator ("the settlor") of a trust and their spouse or civil partner from ever being able to benefit from the trust. If the settlor (or the spouse or civil partner) does retain use of, or benefit from, those assets, the tax benefits that a trust can bring will be lost. Our clients are wealthy enough to be considering estate planning, but many are not ready to say goodbye forever to a large chunk of their assets.

So, what is the alternative, if a trust isn't the right choice for you?

Setting Up A FIC

Dains have successfully set up many Family Investment Companies for our clients, with each structure being as unique as the family it is created for.

In its most basic form a FIC is, quite simply, a private company owned by shareholders who are family members.

Often a limited company will be used but unlimited companies can be used instead. These preserve privacy, as unlimited companies do not need to file publicly available accounts with Companies House. However, advice and care is needed as unlimited companies do not offer protection from personal liability of the shareholders for the company's losses. In addition, unlimited companies are not suitable for FICs intending to carry on certain activities, for example consulting contracts with public sector bodies.

The company can be incorporated with several different classes of shares to enable flexibility over the payment of dividends. Shares can be subscribed for by, or immediately gifted to, different family members. In addition, a trust can be a shareholder to hold shares for younger family members, or those not born yet.

Let's go back to Mr & Mrs Floyd. They can subscribe for shares that have built into them all the voting rights in the company. They can also be the directors, so that they can retain complete control over the activities and management of the FIC and the payments of any dividends or salaries.

The Floyds can loan cash into the FIC, so that if they do require access to funds, this can be achieved via tax-free loan repayments as and when the FIC has available cash, rather than taxable dividends or salaries.

The Key Tax Benefits Of Using A FIC:

1. Non-dividend income earned in the FIC is subject to Corporation Tax at 25%, as opposed to being taxed in the hands of Mr & Mrs Floyd, or a trust, at up to 45%.
2. UK and most non-UK dividends received by the FIC are exempt from tax. If Mr & Mrs Floyd receive those dividends they will be taxed at up to 39.35%.
3. Any capital gains in the FIC are also subject to Corporation Tax at 25% , as opposed to Capital Gains Tax at up to 28% (for residential property disposals) or 20% for other gains.
4. With regards IHT, the future growth in the value of the assets transferred into the FIC will be immediately outside of Mr & Mrs Floyd's estates, saving IHT at 40% on that growth. If shares are gifted by Mr & Mrs Floyd to their children etc, then the value of those gifts will be outside their estates provided they survive seven years.
5. Dividends and salaries can be paid to the various shareholders to make use of their available personal allowances and basic rate bands.

Points To Consider:

- We normally advise that to be cost and tax efficient, at least £1m-£2m is transferred into the FIC initially.
- If non-cash assets, such as share portfolios, are transferred into the FIC, care is needed as this may trigger CGT. If assets have recently been inherited this can be a great time to transfer them into a FIC as they will have benefitted from an uplift in base cost, minimising any CGT on transfer.
- It is sensible that if shares are to be given to children, grandchildren or a trust, this is done on the creation of the FIC and before it holds any assets. This is because if shares are gifted later, they may have significant value and this could again trigger CGT.
- A FIC is most efficient when the bulk of the income generated in it can be left in the company for reinvestment if it is not immediately required by the family
- The initial value of any cash (or assets) lent to the FIC will continue to be included in Mr & Mrs Floyd's IHT estates. It is the growth on those assets that can be successfully removed from their estates. However, (some of) the loans themselves can be gifted to family members and will cease to be included in their estates for IHT after seven years.
- If the shareholders die, their shares in the FIC will be subject to IHT. However, if they hold less than 50% of the FIC's shares, the value will be heavily discounted as a "minority shareholding".
- There will be initial set-up costs and advice costs, as well as ongoing running costs.

Asset Protection

This is a tricky subject but is often a very important consideration for clients. Many of them wish to protect their family's wealth from future divorces (or even bankruptcy) of their children or grandchildren.

Trusts can offer this if tightly worded and properly drafted, but a number of cases heard in recent years have weakened this security.

In relation to FICs, the Supreme Court decision in Prest v Petrodel [2013] is helpful. The judgement was that the family courts cannot "pierce the corporate veil", i.e. look through a company that a party to the divorce holds share in, to seize its assets in a settlement.

The shares themselves can be part of a divorce settlement, but the Articles of Association and Shareholders' Agreement of the FIC can be structured to restrict any transfers or ownership of shares to any non-family members and/or spouses.

What Investments Can A FIC Invest In

FIC's are able to own most assets, although we find most FIC's tend to either hold stock market based investment portfolios or rental property.

Recent changes to income tax relief for private landlords has made private ownership less attractive. Those looking to invest in rental property may prefer to do so via a company, which they can set up as a FIC to benefit their families long-term.

There are many things to consider here, such as the attitude of lenders to lending to companies rather than individuals, Stamp Duty Land Tax, and the Annual Tax on Enveloped Dwellings. However, it can work very well and Dains can advise in more detail on this if required.

As well as those just embarking on property investment, or those wishing to acquire several new properties, we have many clients who already hold several investment properties, and who assume that the charges to CGT and Stamp Duty Land Tax preclude them from moving those properties into a company. This is not always the case. It is worth taking specialist tax advice in these scenarios, as the long-term tax and succession benefits that can be achieved can be surprising.

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