TRIDENT TAX

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Guides

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Income Tax and Capital Gains Tax Planning with Life Bonds and Family Investment Companies

This guide offers an introductory overview of using Life Bonds and Family Investment Companies (FICs) for income tax and capital gains tax planning. It highlights the benefits these structures can provide in terms of tax reduction and investment yield enhancement for UK residents.

Given the complexity of tax regulations and individual circumstances, we strongly recommend seeking personalised advice from a qualified UK tax adviser for detailed guidance and strategy optimisation.

Overview of Family Investment Companies

Glossary

- IT: Income Tax
- CGT: Capital Gains Tax
- FIC: Family Investment Company
- PIC: Personal Investment Company
- Non-dom: Non-UK domiciled individual
- Life Bond: a policy of life insurance written by a non-UK resident life insurance company

As a result of the withdrawal of the remittance basis regime for non-UK domiciled individuals (“non-doms”) from 6 April 2025 and the immediate increase in CGT rates both of which were announced in the Chancellor’s Autumn Statement on 30 October 2024, the scope for and the tax advantages of UK resident individuals in holding investments indirectly via a Life Bond or a FIC/PIC have increased.

This guide aims to provide a broad understanding of how investing via a Life Bond or a FIC/PIC can reduce the amount of IT and CGT payable and thereby increase the net investment returns of UK resident individuals.

Overview of the IT and CGT regime

Subject to the remittance basis regime that applies to certain non-doms, UK resident individuals are subject to IT and CGT on their worldwide income and gains.

- IT is chargeable at an individual’s marginal rate which currently rises to a top rate of 45% for non-dividend income.
- Income from dividends is subject to a top rate of 39.35% (on taxable income above £125,140).
- The higher rate of CGT is now 24% following a 4% increase with effect from 30 October 2024.

With the abolition of non-dom status most UK resident individuals will be subject to IT and CGT on their worldwide income and gains from 6 April 2025.

From 6 April 2025 individuals arriving in the UK from overseas will be able to claim exemption from IT and CGT for their first 4 years of tax residence in the UK, provided they have not been tax resident in the UK in any of the 10 years prior to their arrival (“New Arrivers”). Such individuals will include those who arrived in the UK between 6 April 2022 and 5 April 2025, but their 4-year exemption period will be reduced by the number of years before the 2025/26 tax year in which they have already been resident in the UK.

THERE ARE SEPARATE IT AND CGT REGIMES FOR NON-UK RESIDENT INDIVIDUALS WHICH ARE NOT COVERED BY THIS GUIDE.

Key Features:

- IT is chargeable on UK resident individuals at progressive rates, up to a current top rate of 45% and 39.35% for dividends.
- Other than residential property and carried interests in private equity funds, CGT is generally chargeable on UK resident individuals at a top rate of 24%. Butin certain circumstances involving overseas trusts, the top rate can be increased to 38.4%.
- New Arrivers can claim exemption from IT and CGT on foreign income and gains in their first 4 years of tax residence in the UK, even if the income and gains are brought to the UK.

UK Tax Planning with an overseas Life Bond

An overseas life bond is a policy issued by a non-UK resident life insurance company that does not trade in the UK.

Typically, the policy will be the subject of a single initial premium which is invested by the insurance company such that the "**surrender value**" of the policy increases over time. Although there is an insurance element, in practical terms it operates as a kind of "**investment wrapper**" allowing investment returns to roll-up on a **largely tax-free basis** (the only tax suffered being any withholding tax on income in the source country).

The policy, which is usually written on the lives of multiple family members allowing the policy to continue after the death of the policyholder, can be transferred **by way of gift** of the policy or specific segments or sub-policies without any tax charges and therefore also provide an opportunity for **inheritance tax** ("**IHT**") planning, subject to the 7 year survivorship rule for **Potentially Exempt Transfers** ("**PETs**").

An attractive feature of the life bond is the **ability to draw a tax-free income of 5% of the premium each year** for 20 years. The ability to draw such a tax-free income attaches to the policy segments or sub-policies and any unused balance (at the time of a gift) transfers from the policyholder to the recipient of the gift.

To avoid annual tax charges under the penal regime that applies to a specific type of policy, a **Personal Portfolio Bond** ("**PPB**"), the investment portfolio must be subject to **discretionary management** by the life company and preclude control or any influence over investment selection by the policyholder or any connected person.

The main tax disadvantage of a life bond is the ultimate conversion of a gain into income, for tax purposes, on the surrender of the policy or sub-policies once the 5% tax-free allowances have been exhausted.

It is also important, in avoiding excessive tax charges, that any surrender of sub-policies generating proceeds above the 5% tax-free allowances is made by a "**complete surrender**" of a number of segments rather than a "**partial surrender**" of all the segments. In certain circumstances this can allow the policyholder to secure a lower rate of income tax due to the availability of top slicing relief.

Key Features:

- The return on investments in the insurer's underlying portfolio can roll-up on a tax-free basis.
- A 5% tax-free income can be taken by the policyholder each year, for 20 years.
- Gifts can be made by the policyholder to future generations of their family without any tax charges, subject to the 7-year IHT survivorship rule for PETs.
- Insuring the lives of multiple family members allow the policy to continue after the death of the policyholder.

UK Tax Planning with a Family Investment Company or Personal Investment Company ("PIC" or "FIC")

We have produced an earlier guide, "***Securing the Future: A Comprehensive Guide to Family Investment Companies***" which is available to read or download on our website. This guide therefore provides only an overview of investing via a FIC in the context of the changes in the 30 October 2024 Autumn Statement affecting IT and CGT.

What is a FIC?

A FIC is simply a UK tax-resident company which holds and manages investments on behalf of its shareholders who are members of the same family.

A FIC which is essentially a shared ownership structure, can be a flexible and tax-efficient way of transferring wealth down the generations within a family through the issue of different classes of shares under the company's articles for each generation. Governance of the company and ownership of the company's share capital is also typically subject to the terms of a Shareholders Agreement. It can be capitalised by a combination of share capital and debt provided by the FIC's founding shareholder.

The only distinction between a PIC and a FIC is that a PIC is owned for the benefit of one person rather than a family.

How is a FIC or PIC taxed in the UK?

- A FIC is an investment company for corporation tax purposes and is therefore able to deduct fees incurred in managing its investments, unlike investments held directly by an individual.
- UK dividends and dividends from most overseas companies or territories with which the UK has a double tax treaty are exempt from tax, unlike dividends received directly by an individual which would be subject to income tax at progressive rates up to 39.35%.
- Gains realised on the disposal of shares in "trading companies" may be exempt under the rules for "substantial shareholdings", unlike gain made by individuals which are subject to CGT at a higher rate of 24%.
- FICs are subject to corporation tax on their chargeable profits (comprising both non-exempt income and gains) currently at a rate of 25%.

Who can benefit from a FIC?

Prior to the abolition of the non-dom regime in the 30 October 2024 Autumn Statement, FICs **were almost exclusively used by UK resident and domiciled individuals** as they were **unable to benefit from the "Protected Trust" regime** that was open to non-doms.

However, **the loss of the protection on foreign income and gains for non-doms** with effect from 6 April 2025, and the **limited 4-year exemption** for foreign income and gains of New Arrivers to the UK, could **now make FICs fiscally attractive** to a much wider pool of UK resident individuals.

Typically, a FIC or PIC will be funded primarily by way of a loan from the founding shareholder which can be repaid on a tax-free basis out of future investment returns of the FIC.

New Arrivers in the UK should be able to transfer existing assets to the FIC after 5 April 2025 **without any CGT charge**, by claiming exemption under the new FIC regime during their first 4 years of residence in the UK. The important proviso to this is that if they have already claimed the remittance basis for overseas income and gains in earlier years, they must be careful to ensure they do not remit any of those income and gains.

Because inheritance tax on non-UK assets will be chargeable when the individual has been UK resident for at least 10 out of 20 years, **in some cases it may be appropriate to incorporate a non-UK company to preserve IHT protection**, although the company will be UK tax resident and pay corporation tax.

Where the initial funding is provided by way of a loan, shares in the FIC will initially be of low value allowing the founding shareholder to make gifts of shares in the FIC to children and/or grandchildren without incurring any IHT liabilities.

If the founding shareholder wishes to protect their family's wealth, shares in the FIC could be settled on a family discretionary trust (of which the founding shareholder may be a trustee), again at an early stage when the shares may have a low value due to the loan that is owed.

Finally, privacy is often a consideration and for that reason it may be appropriate to use an unlimited company as the vehicle as less information is publicly available and the protection of limited liability is generally not required as the company will be a passive investor.

Key Features:

- A 25% rate of tax on chargeable profits (income and gains), compared with top rate of income tax of 45% for individuals.
- A tax-free roll-up of the income return (on dividends) from most UK and overseas equity investments, and exemption from tax on certain gains from the sale of "substantial shareholdings" in trading companies.
- Opportunity for the founding shareholder in gifting value to later generations of the family free of tax.

Further details in relation to the steps in setting up a FIC, and case studies of how a FIC might be used for a family's succession planning and/or asset protection purposes are provided in our separate guide, *"Securing the Future: A Comprehensive Guide to Family Investment Companies"*.

Optimise and protect your family's financial legacy with Trident Tax.

Our expertise extends to advising clients considering structuring Family Investment Companies (FICs) and Life Bonds.

Our team collaborates with financial advisers, financial institutions, and lawyers & accountants to ensure that whether you choose an FIC or Life Bond, your investment is structured correctly.

Whether you're handling funds from a business sale, aiming to safeguard assets for your descendants, or introducing the next generation to financial stewardship, Trident Tax offers personalised guidance to navigate the complexities of choosing between Life Bonds and FICs for optimal family investment planning.

Our advice is defined by our knowledge and refined by our experience.

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