TRIDENT TAX

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

Guide

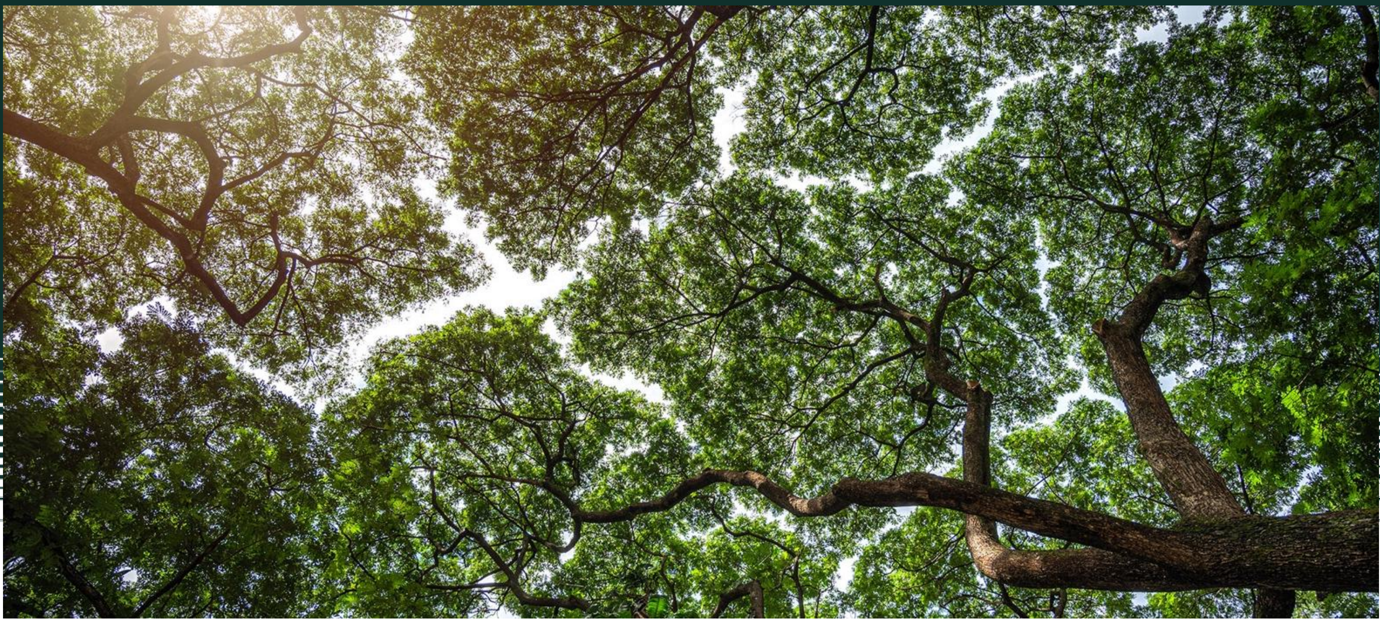
November 2024

Securing the Future: A Comprehensive Guide to Family Investment Companies

This guide aims to provide a foundational understanding of Family Investment Companies, highlighting their strategic advantages for wealth management within families. For more detailed guidance tailored to specific circumstances, consulting with a UK tax adviser is recommended.

GLOSSARY

- FIC: Family Investment Company
- Corporation Tax: Tax on company profits
- Dividends: Payments made to shareholders from company profits
- Inheritance Tax: Tax on the



Overview of Family Investment Companies

01

A Family Investment Company ("FIC") is a UK tax-resident company which undertakes investment (rather than trading) activity, and all shares are owned by members of the same family.

Such a company can be a flexible and tax-efficient way of holding, growing, and passing on wealth within a family.

Key Features:

- Tax Efficiency: Minimises tax liabilities on investment returns compared to personal holdings.
- Control and Flexibility: Allows family members significant control over investment decisions.

How is a FIC taxed in the UK?

02

FICs are typically used as a long-term structuring vehicle, where after-tax returns are then reinvested. Depending on the choice of investments, the corporation tax paid by the FIC on the investment return would usually be less than the tax which an individual would have paid if he had held the investments directly.

- FICs often incur lower tax rates than individuals on personal investment income.

To be cost-effective, a FIC would usually have profits of more than £100,000 per annum. Given that the company will have reporting requirements (company accounts and a corporation tax return), the amount invested would need to be at least £2m, and the FIC would pay corporation tax at a rate of 25%.

An individual who was taxed at higher rates would currently pay tax at 39.35% on dividend income, 45% on interest income and 24% (generally) on investment gains. The tax rate on interest received is significantly lower in a company, although corporation tax is paid on interest earned while income tax is paid on interest received so there may be timing differences.

- Special exemptions apply, including no corporation tax on most dividends and certain shareholding gains.

There are also specific situations where no Corporation Tax is due, on most dividends and on some gains on shareholdings of at least 10% in trading companies.

The greater after-tax returns in the company (compared with investments held directly by an individual) which are reinvested should then result in greater compound growth in value.

Who can benefit from a FIC and how is it used for investments?

03

FICs are often set up by people who have received significant proceeds on the sale of a trading company, looking for a long-term investment vehicle. They can also be used by very high earners who want to use cash that they won't spend to make long-term provision for their family. It is often useful to have one set of accounts summarising all investment assets.

Often, the individual setting up the FIC usually serves as a director and retains control over the investment decisions. Investments can range from real estate and bonds to private equity, facilitating a diversified portfolio.

Types of Investments:

- Standard investment portfolios – equities, bonds, and other securities
- Rental properties
- Private equity
- Corporate bonds

Generally, when the FIC maintains a standard investment portfolio, such as one managed on a discretionary basis, the fees paid to the investment manager are typically deductible as management expenses.

Special consideration should be given if moving a personal portfolio into a FIC, as moving the whole portfolio may crystallise capital gains and trigger significant tax liabilities. Accordingly, a staggered approach investing the proceeds of disposals arising over time may be more efficient.

There are also certain specific types of assets which, if held, can have an unexpected tax treatment, and corporation tax advice on the proposed investments in any case should be taken.

Funding and gifts

04

FICs are typically set up as a newly founded company, funded by either loans, share subscriptions or a combination of the two.

- Money loaned to the FIC can be repaid to the lender without additional personal tax implications.

Where the money is loaned to the company, the lender can receive cash from the company as a tax-free repayment of part of the loan. This means that the company can make payments out of its investment return to the lender without any further tax liability, allowing flexibility to extract the original funds invested.

- Loans vs. Shares: Considerations for initial structure to balance tax and inheritance benefits.

Where the initial funding is provided by loan, the shares will initially be of low value, and so gifts of shares to family members can be made without potential inheritance tax liabilities.

INSIGHT: WHERE A PRE-EXISTING FAMILY-OWNED COMPANY CEASES TRADING AND HOLDS CASH, IT MAY BE ADVANTAGEOUS TO USE IT AS A FIC. THIS CAN PROVIDE A GOOD ALTERNATIVE TO PAYING THE COSTS AND TAX ON EXTRACTING THE MONEY BY VOLUNTARY LIQUIDATION.

Scenario 1

Leveraging a Family Investment Company for effective Succession planning and support for disabled family members

Consider the scenario where a family wants to engage in succession planning while also supporting a family member with disabilities. By establishing a Family Investment Company (FIC) funded through a loan, the family can strategically manage both objectives.

Succession planning:

The loan used to fund the FIC becomes a valuable asset that can be partitioned and gifted in tranches over time. This method allows for a gradual transfer of wealth to future generations, such as grandchildren, through the issuance of shares. These shares can be held in a discretionary trust, which not only spreads the value among the grandchildren as they come of age but also defers significant inheritance tax liabilities through ten-yearly charges on the trust.

Support for family members with disabilities:

For a family member receiving Disability Living Allowance, shares of the FIC can be transferred into a "trust for vulnerable persons." This special type of trust offers tax advantages, ensuring that the family member is provided for in the long term without the immediate tax burden that might otherwise arise from direct gifts.

In this case, the initial loan allows the family to maintain control over the company's funding and ensures that the shares initially have no value, further aiding in the smooth execution of these plans. Should the donor survive for seven years after transferring these shares, no inheritance tax would be due on these gifts, making it a fiscally prudent approach to managing family wealth and ensuring care for vulnerable family members.

05

It is possible to set up a FIC with different classes of shares. The articles of the company will set out the entitlements which different classes give to votes, dividends, and assets on a winding up.

- FICs can issue various share classes, each with specific rights to dividends, voting, and assets on dissolution.

Dividend Distribution among Share Classes

If family members hold shares of a different class to the funder, then dividends can be paid only on that class. Where a minor child holds shares given to him by a parent, the parent would pay income tax on any dividend on those shares, but otherwise, family members are normally taxable on the dividends which they receive in accordance with their own circumstances.

- Strategic gifting of shares can reduce potential inheritance tax liabilities

Reducing Inheritance Tax Exposure

It is possible to structure the company with shares which participate in the profits only once certain hurdles are met, and which then have a relatively low value at the incorporation of the company. Over time as the assets of the company grow, these shares become more valuable as they are entitled to a greater share of the company assets, and the effect of this can be that the inheritance tax liability on the funder's shares is capped.

Generally, where family members hold different classes of shares, these would have voting rights. The shares held by the original shareholder and funder may be valued for inheritance tax at a discount to a pro-rata valuation of the net assets of the company, because the funder has allowed their family to have shareholder rights. This means that the inheritance tax liability is reduced compared with holding the assets directly. It is also more practical to make gifts of shares than to gift parts of investment assets.

Where shares are held by family members other than the funder and their spouse, this can allow the funder to reduce his exposure to inheritance tax as other shareholders come to hold valuable shares.

It is important (although difficult) to structure the company initially to fit the family circumstances, as later changes (e.g. by issuing more shares or by changing rights of certain shares) carry risks of triggering tax charges, both to capital gains tax and inheritance tax.

FAQ: Can different family members hold different classes of shares? Yes, this allows for tailored dividend distribution and tax planning based on individual circumstances.

Asset protection and family dynamics

06

The legal documents which set up the company can be structured to include a shareholders' agreement, and this could be used to restrict the circumstances where shares can be held by non-family members, or to provide for shares to be purchased or transferred in certain circumstances.

- Shareholder agreements can restrict share ownership to family members and outline procedures for share transfer under specific circumstances.

The shares which a family member holds will be a part of their personal assets, but it may then be possible to ensure that a divorced son in law or daughter in law does not become a shareholder in the family company. If a son-in-law or daughter-in-law inherits shares in the family company on the death of the daughter or son, then the company may be able to buy their shares from them, so that they have cash, and the company continues to be owned by close family.

- A FIC can be used to protect family assets and ensures that they remain within the family, even in cases of divorce or death.

Step-by-step guide to setting up a FIC

07

As described above, there is a significant amount of flexibility in how a FIC is set up, how it is funded and how its shares are structured, and what investments it makes.

The steps below are a guide to the steps you may wish to take so that you can effectively set up a FIC tailored to your family's financial and strategic goals, ensuring compliance and tax and inheritance efficiency. An assumption is made that UK tax advice is being provided at all steps.

Step 1: Define Objectives and Family Situation

- Assess needs: Discuss and determine the financial goals, family needs, and objectives for establishing the FIC.
- Outline alternatives: Consider various options within the legal and tax constraints to find the best structure for your FIC.

Step 2: Model Financial Impacts

- Tax modelling: Analyse how corporation tax liabilities on projected profits compare with personal income tax and capital gains if a FIC were not used.
- Prepare the tax report: Develop a detailed report on the proposed FIC structure, including implications for initial gifts and ongoing operations.

Step 3: Legal documentation and review

- Draft legal documents: Instruct lawyers to prepare the articles of incorporation and shareholders' agreement.
- Review drafts: Examine these documents from a tax perspective to ensure they align with financial goals and tax strategies.
- Involvement of valuers: Engage valuers if shares have specific hurdles or valuation complexities.

Step 4: Establish governance

- Appoint directors.
- Appoint trustees if applicable: If trusts are part of the structure, appoint trustees and draft trust deeds.
- Coordinate with advisers: Work closely with tax and legal advisers to coordinate and review all legal and financial advice.

Step 5: Formalise and register the FIC

- Finalise funding and shares: Decide on the mechanisms for funding the FIC and the structure of share allocation.
- Register the company: Officially register the FIC with Companies House to ensure legal compliance.

Step 6: Set up management systems

- Accounting systems: Establish accounting and management systems to maintain records and manage the FIC's operations effectively.

Alternative structures

For clients interested in alternative investment structures, please refer to our other guides via our website, offering different benefits and considerations for asset management and protection.

Secure and Grow your Family's Wealth with Trident Tax

At Trident Tax, we specialise in structuring FICs to support financial growth and tax efficiency tailored to your needs and investment goals. Our expert team collaborates closely with professional advisers, financial institutions, and accountants to ensure your FIC is efficiently structured.

Whether you're transitioning from a business sale, aiming to protect assets for future generations, or involving young family members in wealth management, Trident Tax offers tailored advice to navigate the complexities of family investment structures.

TRIDENT TAX

Unlock the potential of your family's wealth with expert guidance and strategic insight from Trident Tax.

+44 (0)207 952 2921
admin@tridenttax.com
www.tridenttax.com

Registered Office: 25 Bedford Square, London WC1B 3HH Trident Tax Limited is Registered in England No.6945474. VAT Number 977613869