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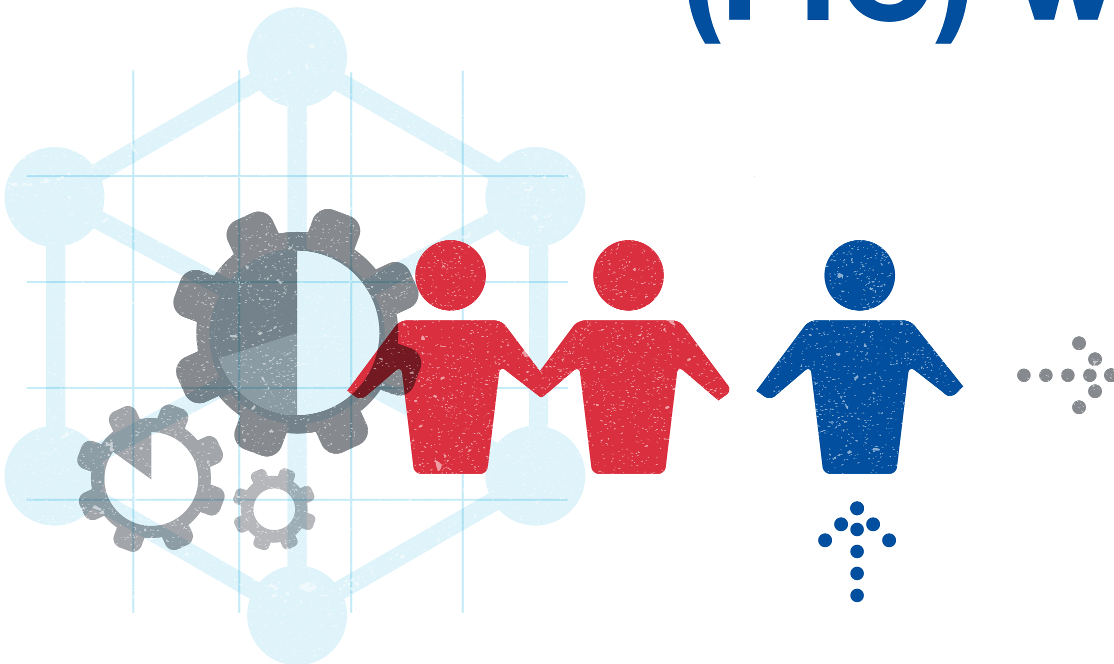
Shared Ambition

How a family investment company (FIC) works



A family investment company can provide a good approach to ensure that wealth is preserved for the next generation, whilst maintaining control. There will also be legal, commercial and emotional aspects that need to be considered.

What is a family investment company (FIC)?

A FIC structure will be specific to each family and will be dependent upon the assets and individuals involved. It is a private investment company where the directors and shareholders of the company are family members or trusts. For individuals who are looking to pass on wealth, they could be the principal directors to ensure that they have full control over how the assets are managed.

Family members are likely to have been involved in or surrounded by a company for many years. Most will be familiar with an underlying company structure and how income can be extracted and profits retained. Having a structure which family members understand will add to the appeal of setting up something to protect the family's assets.

The attraction of an FIC

FICs are used as an alternative to family trusts as a means of consolidating family wealth and protecting it for the long term good of the family.

Following tax changes in 2006, where an individual puts non-business assets of more than £325,000 into a trust, then there is an immediate lifetime inheritance tax charge of 20% on the excess. If the settlor pays the arising tax, this is regarded as a further gift, the tax must be grossed-up to value the 'loss' to their estate. This gives an effective rate of 25%. So, if a husband and wife want to put £2 million into trust, there is an immediate inheritance tax liability payable of at least £270,000. This makes high value trust planning very unattractive.

At the same time, corporation tax rates have continued to fall so that companies pay much less tax on retained income than trusts and individuals. Income and gains in the FIC are subject to 25% corporation tax (there is also a 19% rate that applies if the profits are £50,000 or less), compared to an income tax charge of up to 45% in trust on non-savings and savings income, and 39.35% on dividend income. In contrast, dividend income received by the FIC will not be taxable at all.

Further, the FIC can claim a deduction for interest on loans taken out to acquire new investments, whereas an individual or a trust generally cannot, and the position on borrowing against let property is much more generous for a FIC. Also, expenditure incurred in managing the investments, and directors' fees can be tax deductible in the FIC. Whereas the tax relief for trustees would be more limited and an individual could not claim any deduction.

Finally, FICs are more versatile structures than traditional trusts because the Companies Act permits considerable flexibility in ownership arrangements.

As a result of all these tax changes, FICs have become much more popular – especially for holding let properties. However, one downside is that FICs are much more public than trusts and information about them is publicly available from Companies House. Using an offshore company instead is possible although this has become less popular due to political pressure in the last few years.

The main driver is therefore to protect wealth and to keep it within the family – although the income of the FIC will be lower taxed, and this has a compounding benefit over time.

Minimising the inheritance tax that could arise on the wealth in an FIC

A key consideration is that FICs do not benefit from business property relief and so the shares are fully taxable to inheritance tax on death or gift. Further, there is no relief from capital gains tax so if value builds up in the shares in the FIC then it can be hard to pass on the shares without big tax bills.

An easily overlooked area is that transfers of value between shareholders are immediately chargeable to lifetime inheritance tax, as such gifts are not covered by the potentially exempt transfer rules and are still under the original capital transfer tax regime. The structuring of the share arrangements must therefore be on an arms' length commercial basis.

Whilst payment by instalments of inheritance tax is possible, the cash to pay the inheritance tax often has to come from the FIC, with the result that tax has to be paid extracting the cash – so tax is payable on tax. This is not attractive and so the structure should be designed to minimise inheritance tax – often by an element of loan or preference share capital being included.

This means that an inheritance tax mitigation strategy is required as part of the FIC structuring. This necessitates a long term planning approach and a careful consideration of the options on set-up. The easy answer is to suggest that the older generation with the existing wealth who are setting up the FIC should give away as much as possible at the outset. However, this is unlikely to be desirable in most cases, so two approaches can be considered:

- *Splitting the ownership of the shares to take advantage of minority share valuation discounts (see Table 1 for indicative investment company share valuation discounts). The amount of a transfer of value is the reduction in the donor's estate, so ideally, a husband and wife should hold a minority shareholding in the FIC at the outset – possibly with a number of trusts holding shares as well*
- *Having a class of shares with the existing wealth and a separate class of shares with the future wealth – so called "share freezing" or growth shares or flowering shares. These require very careful drafting, and employment related securities rules also need to be considered*

Both strategies are commonly used and there are many variations, including having multiple classes of income shares and separate capital and voting classes of shares. There is a balance between complexity and minimising inheritance tax, and this will depend upon the ages, health and personal circumstances of the individuals concerned and their objectives in setting up the FIC.

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Structuring of an FIC

The share structure of an FIC can be completely bespoke to meet the family's wishes and can include trust ownership of shares. In certain cases, money can also be introduced into FICs as interest-free loans although care is required where this is done.

One of the attractions of FICs is that wealth can be given away without losing the income that comes from the asset, although care is still required so as not to fall foul of the gift with reservation of benefit rules.

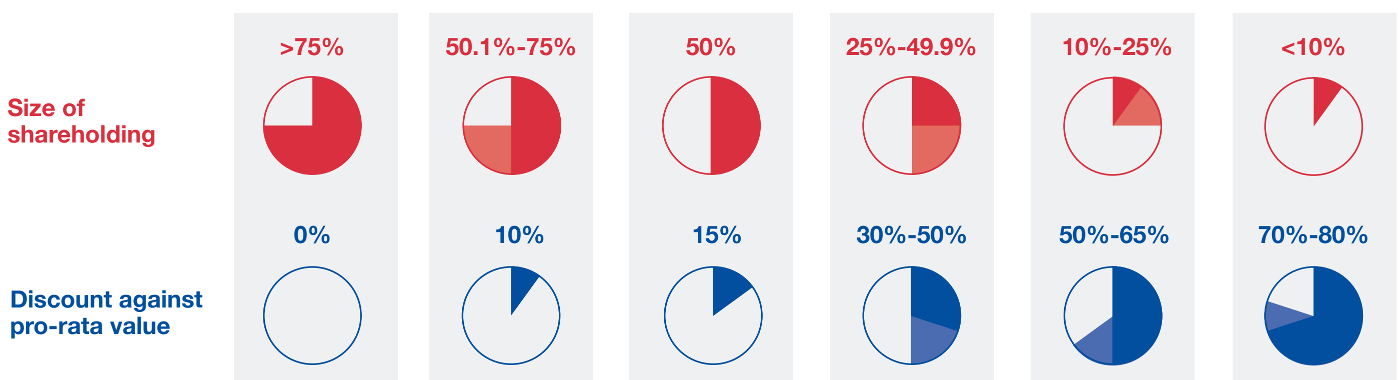
Whilst there is great flexibility in how the FIC is constructed, it is very important that the arrangements do not amount to a settlement such that an immediate charge to inheritance tax arises. Depending on the structure of a FIC, each shareholder could receive dividends of differing amounts or at different times. Another possibility is that a class of shares could then be allotted to children or a trust when the FIC is effectively worthless, with the shares having, say, no voting rights but the benefit of all capital and future income arising in the company. In doing this, the founders of the FIC can still retain control over the family's assets, what the FIC invests in and who can become shareholders etc.

In the event of any divorce within the family, the underlying FIC structure could prevent shares from being held by anyone outside of the immediate family (i.e. a spouse). Although, the courts may still take into account the value of any shareholding held by the divorcing parties.

As can be seen, there is a balance to be struck in the number of differing ordinary share classes, whether preference shares are included and whether funds are loaned to the FIC and if so, then on what terms. Finally, who should hold which shares and how many shares should they hold? All of this depends on the investment strategy of the FIC and the family's circumstances.

Tax, accounting and legal advice should therefore be obtained when setting up a FIC to ensure that the memorandum and articles of association are structured correctly, and, if applicable, a shareholders' agreement, directors' service contracts, loan agreements and trust documentation, together with appropriate minutes. There is a cost to a well-structured FIC that needs to be balanced with the benefits.

Table 1



Size of shareholding	>75%	50.1%-75%	50%	25%-49.9%	10%-25%	<10%
Discount against pro-rata value	0%	10%	15%	30%-50%	50%-65%	70%-80%

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