Family Investment Companies

A long-term investment vehicle for transferring wealth through generations of a family.

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“To build lasting relationships with our clients, across the generations is one of the reasons we established Progeny. Our comprehensive range of advisory services is designed to meet their changing requirements as they move through life.”

FICs are a bespoke investment vehicle structured as a private company with family members as shareholders.

FICs are primarily designed to permit the transfer of assets to the younger generation while allowing the older generation to maintain control over the assets. This solution significantly reduces an individual's annual tax exposure when compared to personal tax rates and without creating an immediate Inheritance Tax (IHT) charge.

While discretionary trust structures have traditionally been the most common instrument for managing wealth within a family, trusts have increased in complexity as well as in the cost of taxation in recent years.

This, coupled with IHT at 20% on transfers into a trust above the nil-rate band, has prompted many families to seek alternative options for administering the management and inheritance of wealth.

- Tax free withdrawals
- Faster investment growth
- Inheritance tax mitigation

Overview

FICs are typically registered as unlimited companies. The different generations of family members are the shareholders and the directors are most likely the senior generation who provide the capital.

A primary benefit of using a FIC is that the directors can transfer value and responsibility over time and in a tax-efficient manner, while retaining overall control. They also have the power to make investment decisions for the FIC.

When planning to mitigate Inheritance Tax (IHT), many people are put off from making significant lifetime gifts because they can't be certain they won't need this capital and the income it generates in the future. If the giver thinks they may need the funds back again, they can fund the FIC with a loan and the capital can be returned through the repayment of this loan. For those looking to receive income from the capital, this can be ensured by holding a share class which gives them the rights to receive dividends.

FICs can also be employed in pension planning for the shareholders. Reinvesting its income into other assets and/or making pension contributions could reduce or eliminate corporation tax payable on the FIC's income.

The articles of association which govern the FIC can be used to prevent a transfer of shares out of the family, or stipulate that transfer should only be to certain individuals. This can help protect family assets in the event of a divorce or disputes.

How do FICs work?

The FIC shareholders are bound by a shareholder agreement.

The articles of association are registered with Companies House and clarify the rights attached to the different share classes which are held by the different members of the family. They cover rights to receive dividends, entitlements to the capital value and degrees of control over company decisions.

Assets within a FIC can include a wide range of investments, such as cash deposits, share portfolios, investment funds and properties which can be sold to the company for their market value with the value remaining on loan back to the original owner.

FICs are managed by the directors and can be used as an investment vehicle to acquire other assets, or to generate money whether it is capital appreciation or income, giving families a long-term income source and opportunity for capital growth.

Investment income and gains are taxed at relatively low corporate rates rather than higher personal tax rates. This low tax environment enables investments to grow at a faster rate.

There may be capital gains tax and stamp duty implications of selling your investments to the FIC and we, or your accountant, can advise you on this.

Whilst the investments grow inside the company at preferential tax rates, you can draw down on the loan which the company owes you completely tax free.

Transfer value and responsibility to the next generation of the family over time and in a tax-efficient manner, while retaining overall control.

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Tax benefits

	Personal holding	FIC
Tax on capital gains (non-residential property)	20%	25%
Tax on dividends	Upto 39.35%	0%
Tax on other income	Upto 45.00%	25%
Tax relief for fees	No	Yes
Claim losses against other income?	No	Yes

* Rates shown are for 2023. As well as income, capital growth on certain investments (e.g. government stock) may be subject to tax in a FIC, even if not actually sold.

If the contributor thinks they may need the funds back again, FICs can be established with a loan and the capital can be returned through repayment of this loan. For those looking to receive income from its capital, this can be structured in the articles of association by holding a share class which gives the rights to receive dividends.

When would a FIC be useful?

While discretionary trust structures have traditionally been the most common instrument for managing wealth within a family, they have increased in complexity and the cost of taxation in recent years.

FICs work best for those with at least £1m to invest and who are willing to keep this money in the company to grow, rather than take it out on a regular basis. They're also a good option for those who want to avoid a large inheritance tax charge and retain control over their assets, especially, if their children are younger.

There are a range of scenarios where using a FIC can be beneficial. The below case studies provide examples from wealth and estate planning, and corporate law.

Mr A recently sold his business for £5m and has asked his wealth manager to invest the proceeds for him.

The wealth manager invests in a portfolio of **75% in shares** and **25% in other investments** and will charge annual fees of 1% of the portfolio value. Mr A has pensions and other income of £50,000 pa.

What would the benefit be to Mr A of using a FIC to hold his £5m portfolio (using 2023/24 tax rates)?

	Personal holding	FIC
Assumed income (3%)	£150,000	£150,000
Assumed gains	£50,000	£50,000
Total profit	£200,000	£200,000
Tax on dividends	(£46,799)	(£0)
Tax on interest	(£15,000)	(£0)
Tax on gains	(£8,800)	(£7,875)
Administration costs of FIC	(£50,000)	(£50,000)
Accountancy / compliance fees	(£0)	(£6,000)
Total costs	(£120,599)	(£63,875)
Net profits	£79,401	£136,125

*Rates shown are for 2023. As well as income, capital growth on certain investments (e.g. government stock) may be subject to tax in a FIC, even if not actually sold.

Key benefits

Maintain control

FICs offer a way for senior family members to transfer wealth to younger generations or to use it to benefit younger family members in a controlled way.

This control is exercised through the shares, with the senior members either holding a controlling stake or through the use of 'alphabet' or preference shares. The latter allow for different classes of shares, with the senior family members holding voting shares with control at board level and the more junior members each holding a different class.

Different share classes can be used to allocate different rights to income and capital between the family members and generations and also allows for dividends to be paid at different times, and in a controlled manner.

Flexible and bespoke

The articles of association and shareholder agreement can be drafted to meet their unique family requirements, and the structure can be amended to meet the changing, dynamic needs of the family.

Depending on the family's attitude to investment and appetite for risk, a FIC offers more freedom to a director than the responsibilities of administering a trust fund afford a trustee. A FIC director can take greater risks with their investment strategy and activities than more duty-bound and restricted trustees.

Protection of assets

FICs can help protect the family assets in the event of divorce or disputes. The articles of association which govern the FIC can be used to prevent a transfer of shares out of the family, or stipulate transfer should only be to certain individuals or trusts.

While the assets of a FIC are generally out of reach in the event of a divorce or bankruptcy settlement, the value of a shareholder's holding can be taken into account when determining the total value of their assets.

However, the value of the shares will be substantially reduced by the restrictions in the articles and shareholders' agreement. Minority shareholdings with limited rights will always be valued at a discount relative to the company's assets.

The senior family members could also include in the shareholders' agreement a requirement for junior family members to enter into pre- or post-nuptial agreements.

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Tax efficient

When the FIC is established, funds can be invested by providing a loan or subscribing for shares. This would not be seen as a transfer of value for Inheritance Tax (IHT) purposes so the normal 20% charge would not apply. The original return on investment can be returned free of a tax consequence if the investment is made in return for an interest free loan or shares.

The income generated by the company will be subject to corporation tax at 25%.

This is a more preferable rate compared with Income Tax, and significantly so if the shareholders are higher-rate tax payers in the 45% bracket.

Capital gains made by the company will be taxed at 25%, rather than the 20–28% payable by individuals. Retaining investment income within a company can therefore be more tax efficient compared with individual tax rates.

Income generated by the FIC can be distributed to family members as dividends. Currently the first £1,000 is tax free, with a maximum effective tax rate of 38.1%.

The FIC has a key advantage over a trust where, in the latter case, there is the 20% IHT charge on assets passing into the trust in excess of the individual's IHT Nil Rate Band.

This limits couples to putting no more than £650,000 into trust every seven years, unless the assets qualify for any IHT relief.

By contrast, gifting FIC shares to family members does not incur an immediate IHT charge. If the giver stays alive for seven years after making the gift, the 20% upfront charge is avoided.

The FIC can also be employed in pension planning for the family shareholders. Reinvesting its income into other assets for the long term and/or making pension contributions for the benefit of the family could reduce or eliminate any corporation tax payable on the FIC's income. Also, members can extract income from the FIC at a later date when their income is lower, and therefore their tax rate is likely to also be lower.

For tax purposes, the timing of any gifts the senior members/directors of the FIC make will be when value and rights are moved from them to the other family members. This can be done in stages, controlling the timing of the transition and the value that is transferred for tax purposes.

FIC comparison with discretionary trusts

While offering a number of advantages, FICs aren't for everyone or for every situation and there are a number of elements which could make them less attractive in certain circumstances.

They are broadly tax-efficient, however there is potential for double taxation when profits are taken out of the company. Corporation tax will have been paid on the income when received, and then any payment from company to shareholder as a dividend is liable for income tax above the initial £1,000 tax-free.

Ways to address this include careful choice of the investments held by the company and scheduling of dividend distributions at times when the shareholders may be subject to a lower rate of income tax.

In comparison with discretionary trusts, which offer complete flexibility of income and capital allocation between the trust beneficiaries, once shares in a FIC have been given away they cannot be recalled.

Additionally, a trust can span a 125-year period which allows families the scope to plan to mitigate their IHT over many generations to come. With a FIC, where the children are the shareholders only the IHT liability of one generation (their parents, the senior family members/directors) is avoided. The shares become IHT taxable assets when they pass into the hands of the children.

Progeny also advise on family trusts which can provide an accepted structure for passing on wealth and usually cost less to establish. For those seeking a simpler way to pass their wealth onto older children, an outright gift may be worth considering. However, this offers no control or protection over your assets, and might result in Inheritance or Capital Gains Tax.

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Summary

Family Investment Companies (FICs) are a popular alternative to trusts for transferring wealth down through generations of a family and to hold and grow family investments and assets.

They are private unlimited companies with their own bespoke articles of association and shareholder agreements tailored for use in family estate planning.

Senior family members can closely control distribution of wealth through use of different share classes, which also allocate different rights to family members.

FICs offer a range of tax efficiencies, primarily in relation to Inheritance Tax, but also Income Tax.

However, there is potential for double taxation, first in Corporation Tax on income generated, and second in Income Tax on dividends over the tax-free threshold.

The articles of association of a FIC can help protect assets and keep them in the family in the event of divorce or dispute.

A FIC does not offer the lengthy, inter-generational scope for Inheritance Tax mitigation that comes with a trust, which can span a 125-year period.

Directors of the FIC have more freedom with their investment strategy compared with the greater responsibilities of a trustee in administering a trust.

Note: HMRC investigated FICs and closed the review in 2021.

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