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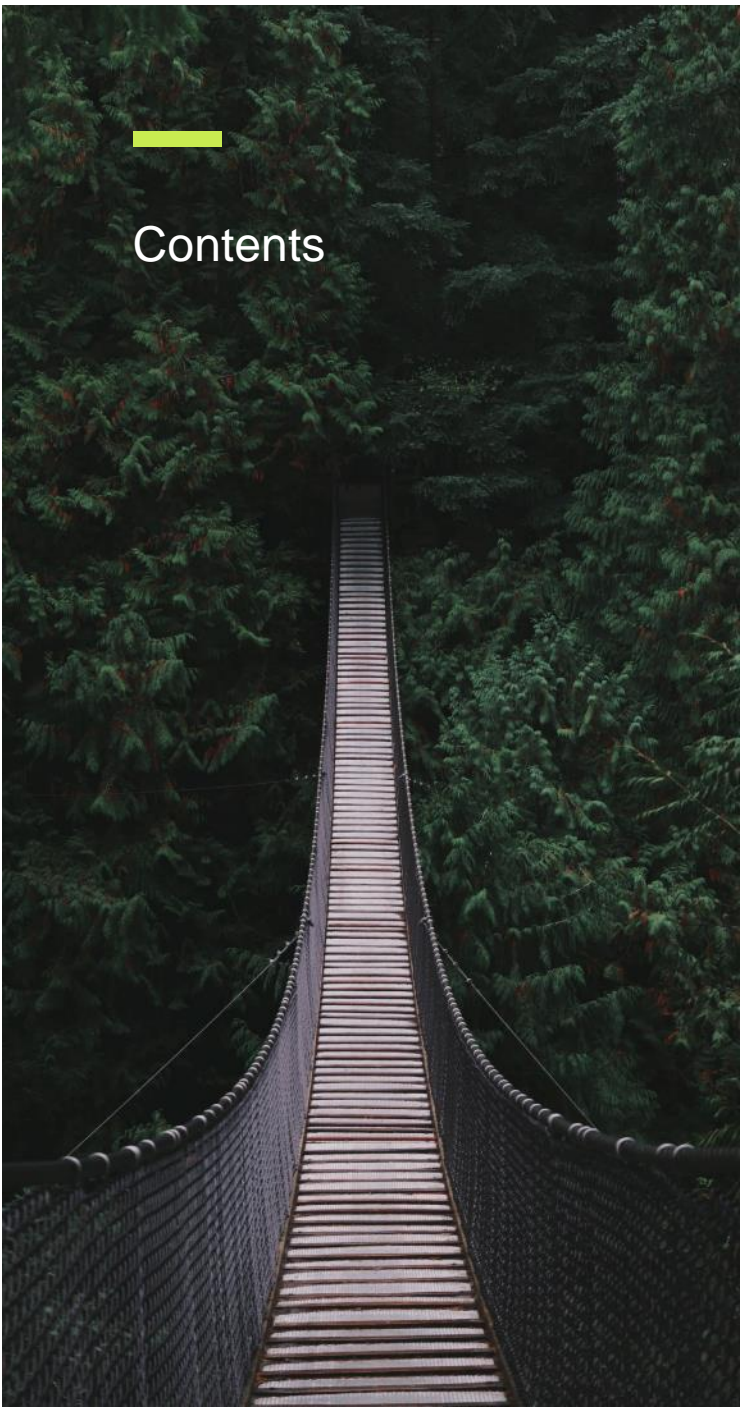
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Family Investment Companies in Tax and Estate Planning

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Now, for tomorrow





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What is a family investment company?

- A Family Investment Company (FIC) is a bespoke vehicle which can be used as an alternative to a family trust.
- It is a private company whose shareholders are family members.
- A FIC typically enables parents to retain control over assets whilst accumulating wealth in a tax efficient manner and facilitating future succession planning.





Set up and funding

Set Up and Funding	Family Investment Company	Practical Points
Corporate Form	Limited or Unlimited Company	Unlimited has lighter filing requirements at Companies House. Easier to return capital to shareholders
Funding with assets	Disposal for CGT and SDLT	Possibility for incorporation relief if transfer of a business
Cash: Share Capital	Unlimited and tax free	Consider share classes and rights
Cash: Loan	Flexible. Can charge a commercial rate of interest.	Repayable on demand if interest free to avoid CLT.



Share capital

Share Capital Features	Family Investment Company	Practical Points
Voting Rights	Shares can have full, restricted or no voting rights	Voting rights can have a material value
Income Rights	Alphabet shares provide flexibility	Consider total flexibility or defined pots for each share class (but be aware of possible reservation of benefit issues)
Capital Rights	Equal entitlement is normal but consider growth shares for established FICs.	Capital rights do impact on valuations Consider preference shares for flexibility and potential for tax free return of capital.



Governance & control

Governance	Practical Points
Directors	Directors are responsible for the day to day running of the company unless restricted by the constitutional documents
Shareholders	Shareholders have voting rights, but shareholder control is often over-estimated
	Consider a Shareholders Agreement, which works with the Articles to provide overall constitution of the company and manage expectations.



Who can benefit?

Benefit	Family Investment Company	Practical Points
Who can benefit?	Shareholders and employees	If a flexible trust is a shareholder potentially more can benefit
Distributions of capital	Not easily distributed	Easier with unlimited companies, redeemable preference shares, loan capital
Use of assets	Tax charges arise for shareholders and employees.	Much easier to use only for investments.



Tax position

Tax Position	Family Investment Company	Practical Points
Tax on Income	19% (25% from April 2023) 0% on dividend income	Note that small profits rate from April 2023 will not apply to close investment holding companies
Tax on Capital Gains	19% (25% from April 2023)	Watch for assets that fall into the loan relationship regime, such as corporate bonds where FIC is taxed on growth during the year depending on accounting treatment
		From April 2023: no longer the case that sale and re-investment cheaper in FIC
Interest Expenses	Tax deductible, subject to usual restrictions	By contrast, an individual cannot obtain relief for interest on loans to acquire portfolio of shares
Management Expenses	Tax deductible, subject to usual restrictions.	By contrast, an individual cannot obtain relief for expenses of managing a share portfolio.



Tax position

Tax Position	Family Investment Company	Practical Points
Distributions of income	Dividend income taxed at 8.75%, 33.75% and 39.35%	Can control the amount of dividend income arising to manage income tax position
	Dividend allowance of £2K	Alphabet shares provides flexibility
Inheritance Tax	Shareholders pay on the value of their shares.	Consider discounts when valuing shareholdings.

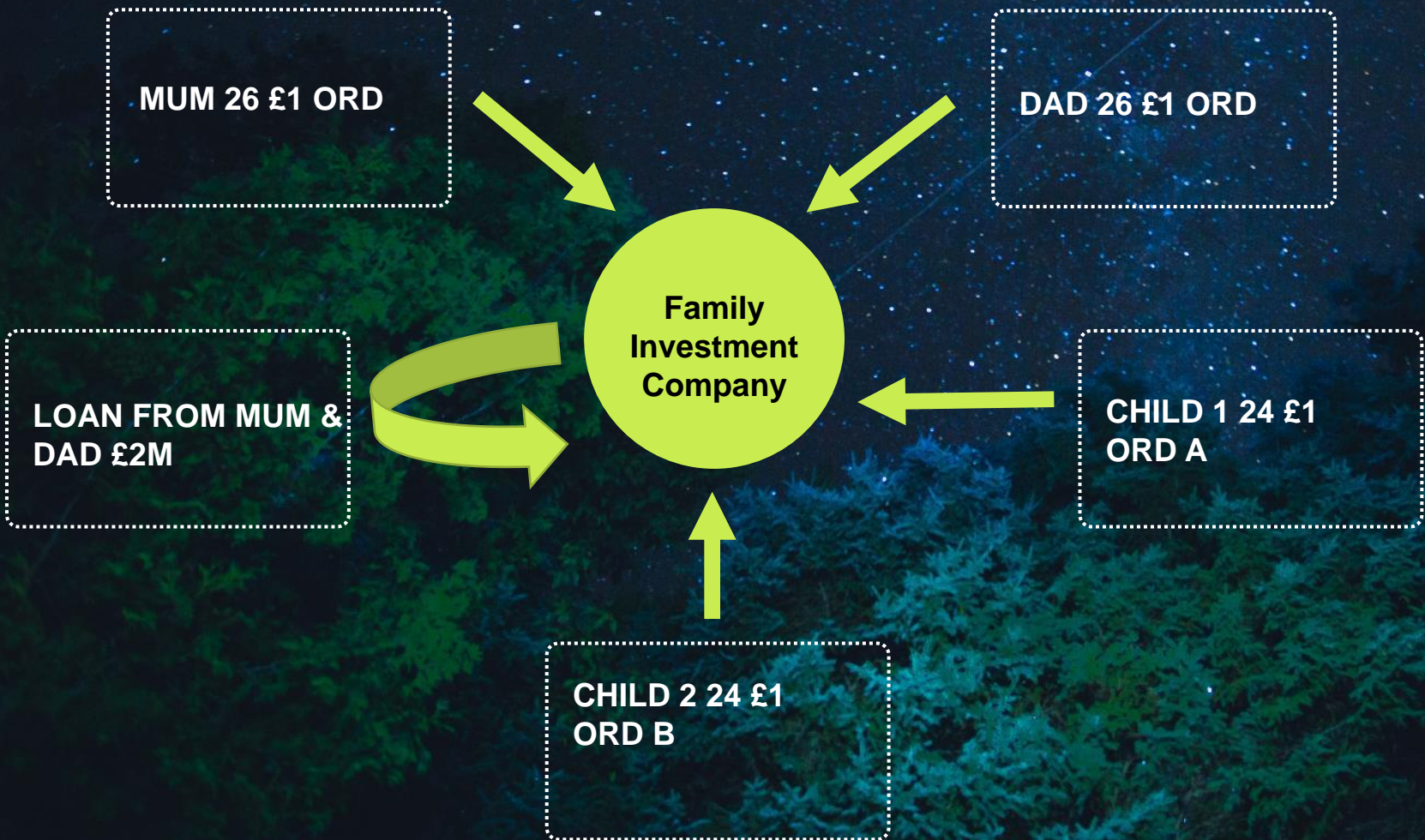
Typical structures

- The parents provide funds to the FIC in the form of either interest-free loans or by subscribing for preference shares. No transfer of value for inheritance tax (IHT) purposes and can be extracted from the company at a later date tax-free.
- The parents also subscribe for voting shares in the FIC, which give control of the company at shareholder and board level.
- The parents could also subscribe for a class (or classes) of non-voting shares, which are then given away to children before significant value accrues.
- The parents could also put funds of up to £662,000 into a discretionary trust for the benefit of their minor children without triggering an IHT charge.
- The parents should be irrevocably excluded from benefiting from this trust. The trustees then subscribe for a class of non-voting shares in the FIC at market value, ie at nominal value if the company is being newly created.



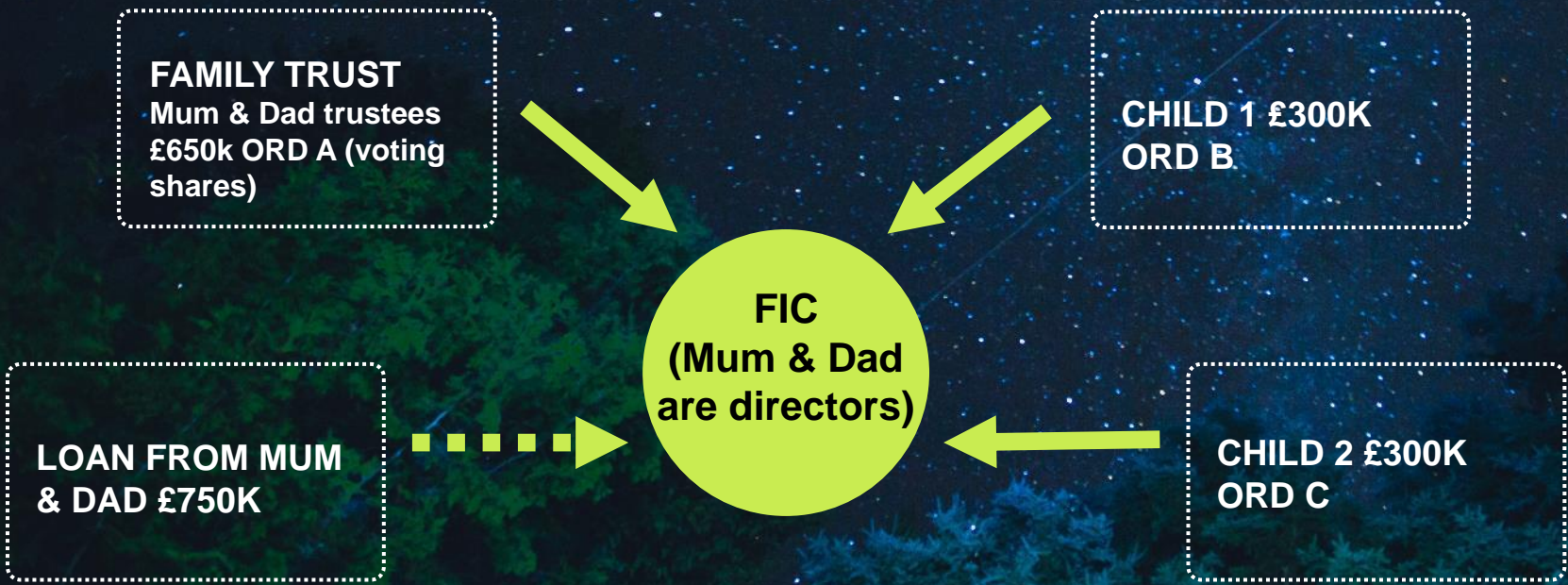


Typical structures (£2M FIC)



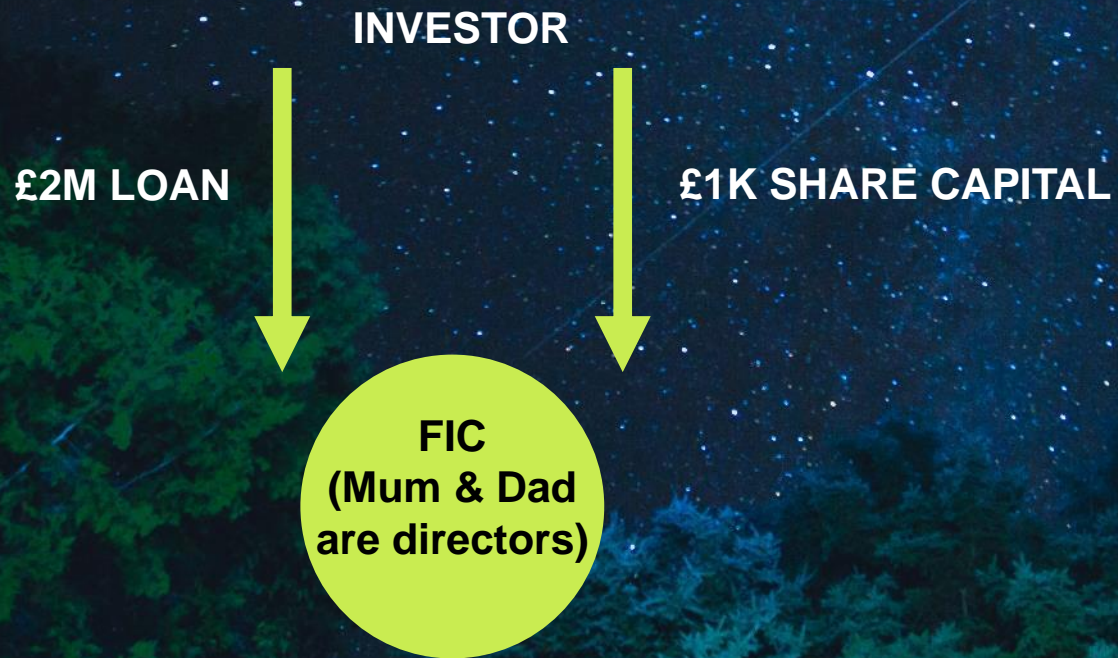


Typical structures (£2M)





Typical structures (£2M)





Profit extraction (current rates)

Tax Position	Basic Rate Taxpayer	Higher Rate Taxpayer	Additional Rate Taxpayer
Non-dividend income of FIC	£100	£100	£100
Less Corporation Tax	-£19	-£19	-£19
Net income paid as dividend	£81	£81	£81
Income Tax on dividend	-£7	-£27	-£32
Net balance	£74	£54	£49
Effective rate on £100	26%	46%	51%



Profit extraction (25% Corporation Tax)

Tax Position	Basic Rate Taxpayer	Higher Rate Taxpayer	Additional Rate Taxpayer
Non-dividend income of FIC	£100	£100	£100
Less Corporation Tax	-£25	-£25	-£19
Net income paid as dividend	£75	£75	£81
Income Tax on dividend	-£7	-£25	-£32
Net balance	£68	£50	£49
Effective rate on £100	32%	50%	51%



Tax Traps – settlements legislation

- Settlor retains an interest if “that property or any related property is, or will or may become, payable to or applicable for the benefit of the settlor or his spouse or civil partner in any circumstances whatsoever”.
- Wide definition of Settlement, consider in particular:
 - Spouse and minor children
 - Funding arrangements
 - Dividend waivers.
- Outright gifts to settlor’s spouse or civil partner are excluded provided it is not substantially a right to income.





Tax Traps – reservation of benefit

- For a reservation to apply:
 - There must be a gift; and
 - The property must be enjoyed to the entire exclusion of the donor.
- If parents hold an equity stake and retain wide rights to determine income distributions – is that a reservation of benefit?
- Consider restricting dividends payable through the articles of association.
- Consider each class of shares having a fixed entitlement to profits.

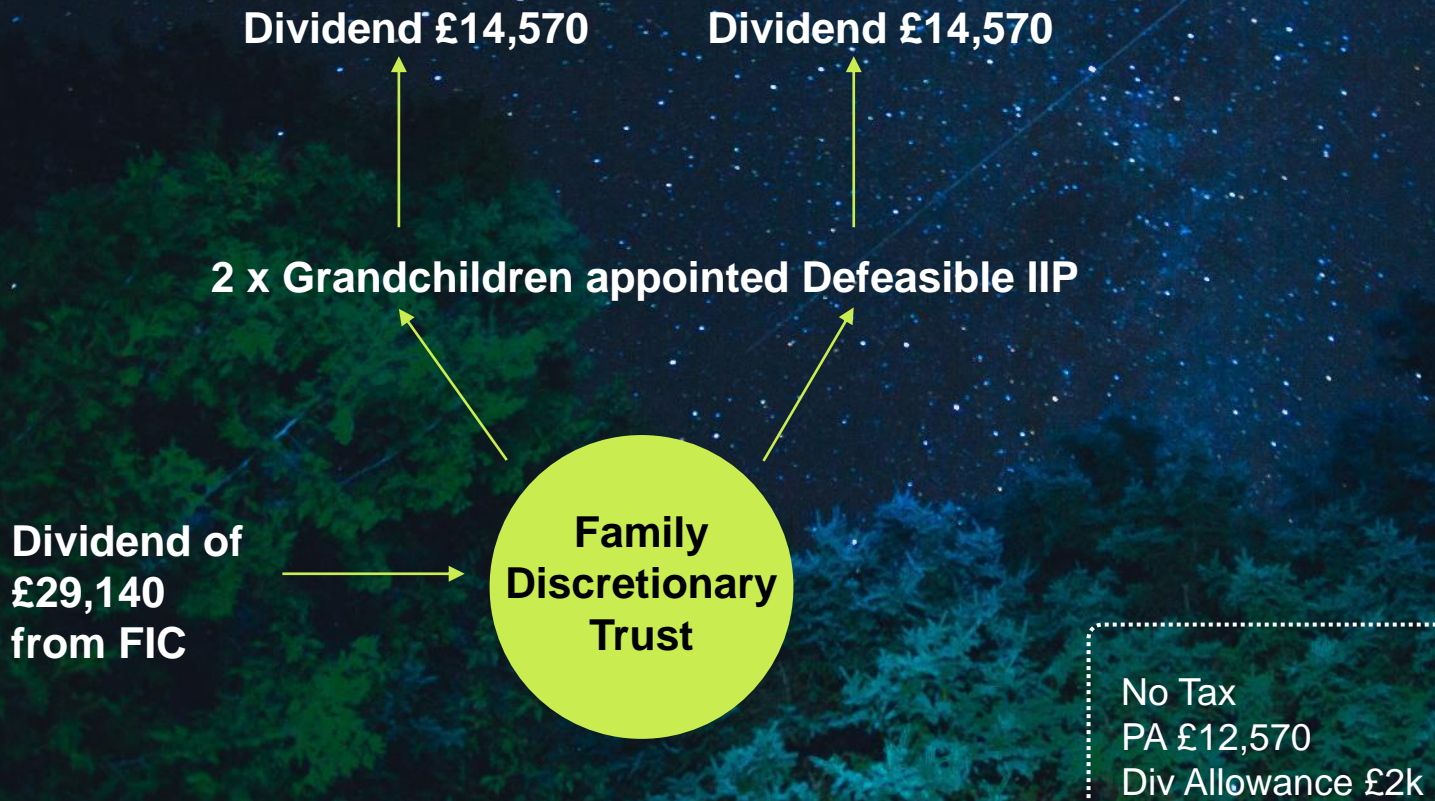
Use of trusts

- Bare / Absolute Trust – Beneficiary has the right to income and capital and may call for both to be remitted into his own name. Beneficiary's asset and income for tax purposes. May be used for holding minor children's shares in FIC.
- Discretionary Trust – Flexible type of trust, which gives trustees considerable powers over how the trust assets are handled. The beneficiaries do not have any automatic right to receive the income and capital held in the trust. Provides asset protection, control and flexibility.





Discretionary trust as shareholder of FIC





Planning for existing investment companies

- Growth share plan
- Current value of the business is 'frozen' into the existing shares and new "growth shares" shares are issued to capture any future growth in value of the company.
- Growth shares can then be passed into the ownership of other family members or trusts to remove the future value of these shares from the existing shareholders' estates for IHT purposes.



Growth shares – an example

- Property investment company, 4 x adult shareholders (two married couples).
- Whole company value £11M.
- Hurdle value £12M.
- Growth shares value for CGT: £1M.
- Direct gift = CGT at 20% and PET for IHT.



Growth shares – an example

- What about a gift onto a Discretionary Trust?
- CLT and value of transfer is calculated on 'Loss to donor' principle.
- This means we compare full value of company with value of retained ordinary shares.
- Value of retained ordinary shares is the expected return up to the value of the hurdle, which depends on the rate of return required for the level of risk and the length of time before a sale or return of capital.
- Low risk, so a factor of 3% and timescale of 5-20 years was used.
- Transfer of value £600K (£150K each) – CGT holdover relief, no IHT.



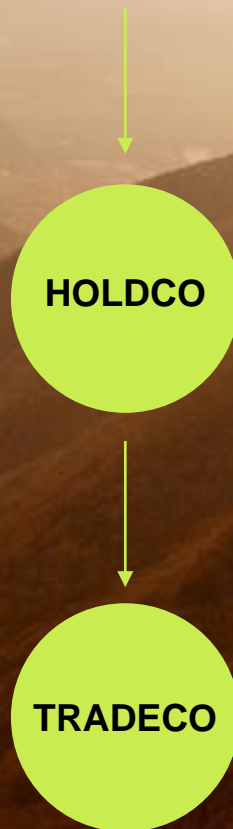
Growth shares – an example: further points

- No IHT100 required due to value of transfer below 80% of NRB.
- Voting rights not restricted but number of shares meant that Ordinary shares retained control.
- Future dividends for Ordinary shares restricted to value of Hurdle to avoid any suggestion of gift with reservation.



Sale of trading company?

Mr & Mrs X (Shareholders)



Dormant Holdco (or with investments that do not taint trading status of group).

Group in place for at least one year, sale of Tradeco will qualify for Substantial Shareholding Exemption.

Shares in holdco qualify for BPR.



Sale of trading company?

Mr & Mrs X (Shareholders)

Transfer shares onto Disc Trust while qualifying for BPR

Discretionary Trust



Sell Tradeco with SSE

BPR not withdrawn in the event of a death < 7 years

Making changes to your FIC

- Issuing new shares – market value.
- New loans.
- Gifting of shares – consider Family Trust.
- Changing share rights – be careful, possible transfer of value.
- Demergers.
- Winding up.



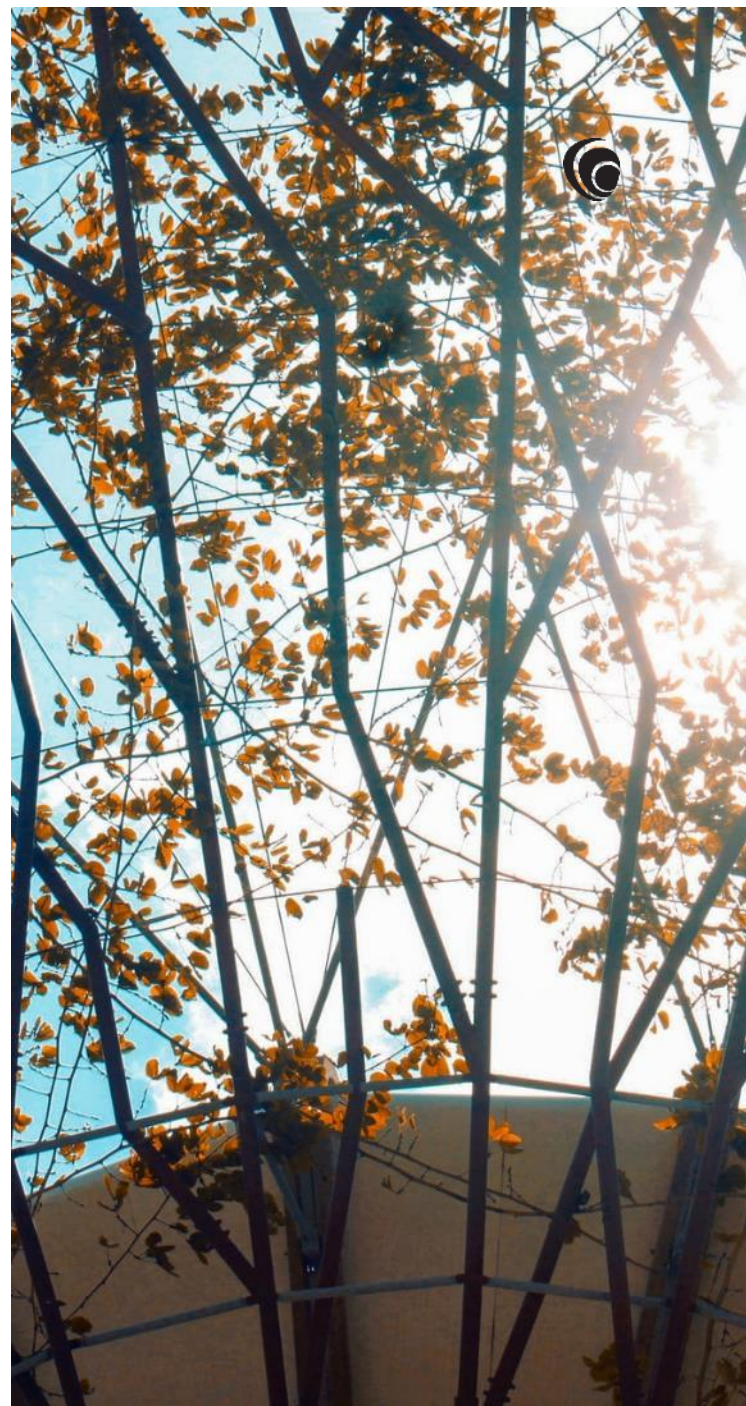
Possible future changes – taxing retained profits

- OTS report on capital gains tax in 2020 suggests taxing retained profits on winding up or sale of a smaller owner managed company at dividend rates or taxing them in the company at enhanced Corporation Tax rates.
- Close company apportionment legislation – abolished in 1989
 - If no reasonable distribution policy, the rules taxed retained profits
 - Complex rules deemed a notional dividend which was taxed accordingly to prevent accumulation of profits.



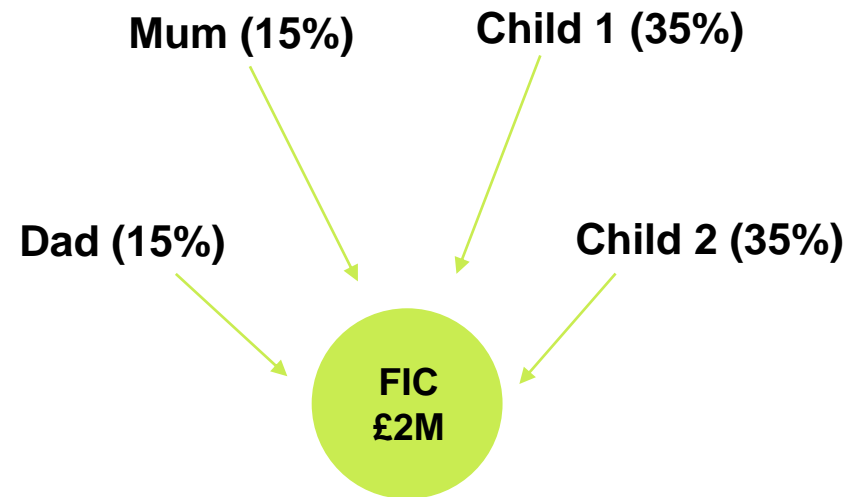
Valuation and related property

- On death the value of FIC shares is in the shareholder's estate for IHT purposes.
- There is a valuation advantage gained for IHT where all family members have a minority stake.
- Currently, the related property rules ensure spouses interest considered. The shares are valued based on aggregate holding.
- Could this be changed to include other family members?





Example



	Dad	Mum	Child 1	Child 2
Share of £2M	£300k	£300k	£700k	£700k
Discount (say 20%)	£60k	£60k	£140k	£140k
IHT Saving	£24k	324k	£56k	£56k



Conclusion

- FICs are increasingly popular.
- Keep them simple.
- Change in corporation tax rate makes them slightly less efficient.
- Possibility for future changes but currently the estate planning benefits remain.





Questions?



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