# Family Investment Companies Vs Trusts – choosing your best option

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# Speakers

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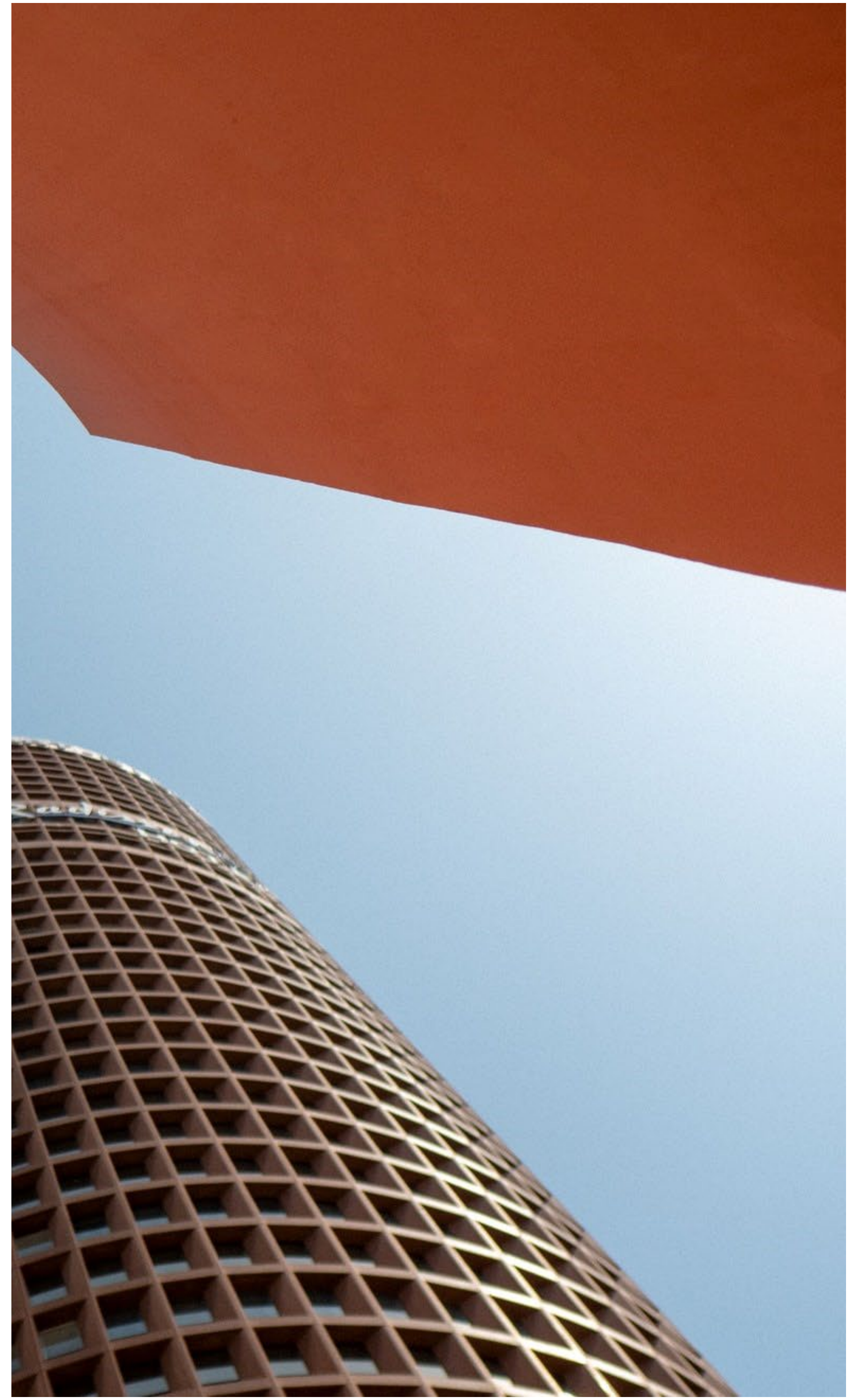
# What will be covered...

1. What is a FIC and its key features?
2. How is a FIC taxed?
3. A typical FIC structure
4. Profit extraction from a FIC
5. Some tax traps
6. What if you already have a FIC?
7. Trusts as an alternative
8. The right type of Trust for your circumstances
9. Summary



# Structure, benefits & alternatives

James Kipping

# What is a Family Investment Company?

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

**James Kipping**
Head of Private Client

# Key features

- Corporate form:
  - Limited or Unlimited Company
- Funding:
  - Assets – watch for CGT and/or SDLT
  - Cash: share capital
  - Cash: loan
- Share capital:
  - Share classes
  - Voting rights
  - Income and capital rights
- Governance and control:
  - Directors
  - Shareholders

**James Kipping**
Head of Private Client

# How are FICs taxed?

| Tax Position | Family Investment Company | Practical Points |
| --- | --- | --- |
| Tax on Income | 25% from April 2023<br>0% on dividend income | Small profits rate will not apply to close investment holding companies. |
| Tax on Capital Gains | 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 it is no longer the case that sale and re-investment is cheaper in a 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. |

**James Kipping**
Head of Private Client

# How are FICs taxed?

| Tax Position | Family Investment Company | Practical Points |
|---|---|---|
| Distributions of Income | Dividend income taxed at 8.75%, 33.75% or 39.35%<br><br>Dividend allowance £1,000 (£500 from April 2024) | Can control the amount of dividend income arising to manage income tax position.<br><br>Alphabet shares provides flexibility. |
| Inheritance Tax | Shareholders pay on the value of their shares | Consider discounts when valuing shareholdings. |

James Kipping
Head of Private Client

## Typical FIC structure

- 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 entry charge.
- The parents should be irrevocably excluded from benefiting from this trust. The trustees then subscribe for shares in the FIC at market value, i.e.: at nominal value if the company is being newly created.

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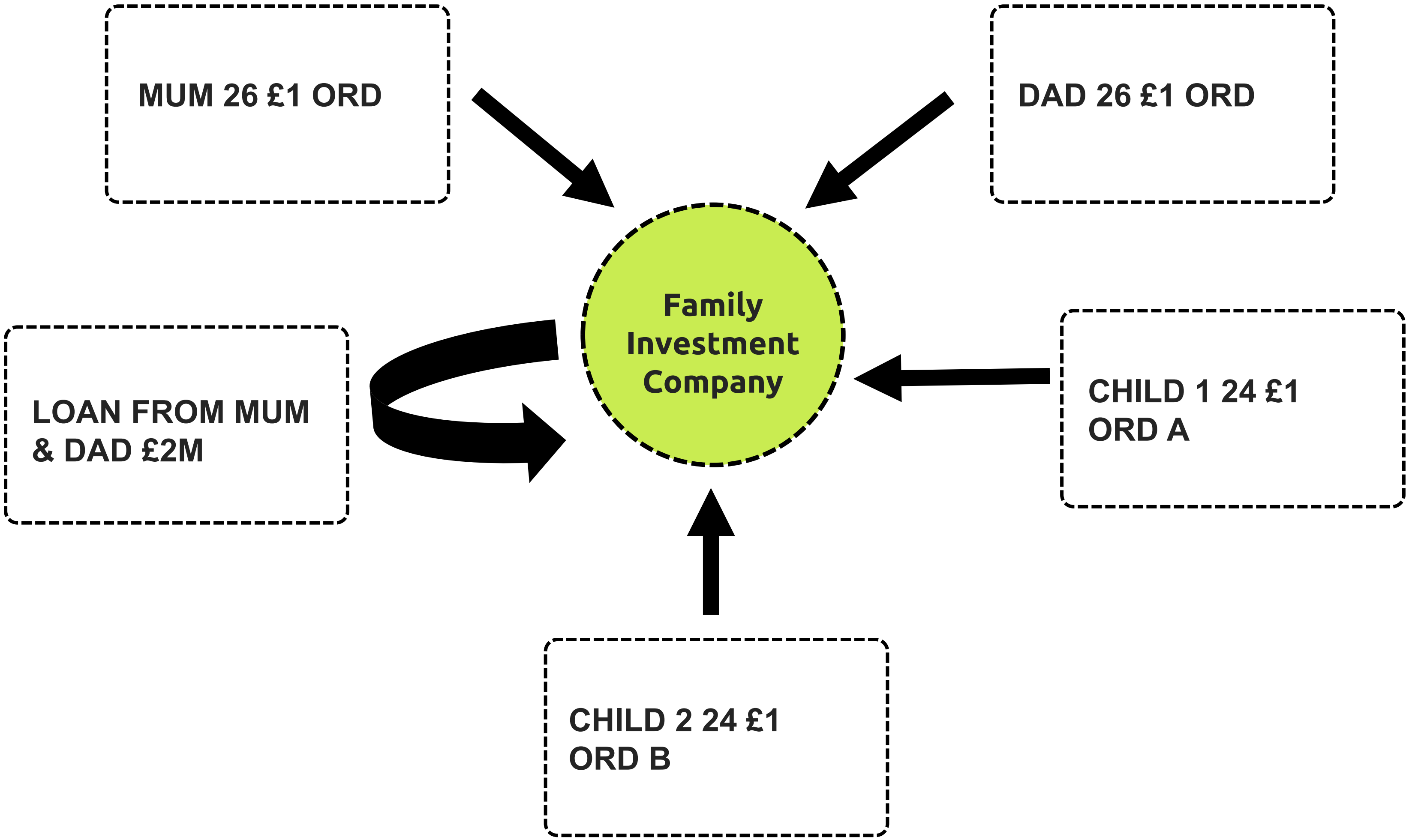
Head of Private Client

# Typical FIC structure





James Kipping
Head of Private Client

# Profit extraction

- Corporation Tax 25%
- Non-dividend income

| Tax Position | BR Taxpayer | HR Taxpayer | AR Taxpayer |
|---|---|---|---|
| Non-dividend income of FIC | £100 | £100 | £100 |
| Less Corporation Tax | -£25 | -£25 | -£25 |
| Net income paid as dividend | £75 | £75 | £75 |
| Income Tax on dividend | -£7 | -£25 | -£30 |
| Net balance | £68 | £50 | £45 |
| Effective rate | 32% | 50% | 55% |

**James Kipping**
Head of Private Client

# Profit extraction

- Corporation tax 25%
- Dividend income

| Tax Position | BR Taxpayer | HR Taxpayer | AR Taxpayer |
|---|---|---|---|
| Dividend income of FIC | £100 | £100 | £100 |
| Less Corporation Tax | -£0 | -£0 | -£0 |
| Net income paid as dividend | £100 | £100 | £100 |
| Income Tax on dividend | -£9 | -£34 | -£39 |
| Net balance | £91 | £66 | £61 |
| Effective rate | 8.75% | 33.75% | 39.35% |

**James Kipping**
Head of Private Client

# Tax Traps: settlements legislation

- Income may remain taxable on the settlor if they retain an interest in the property transferred. This is potentially relevant to the creation of a FIC.

- The 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.

James Kipping
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# Tax Traps: gift with reservation

- 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.

James Kipping
Head of Private Client

# What if you already have an FIC?

- If you already have a FIC and wish to undertake some Inheritance Tax planning, there are various options and bespoke advice will be required.

- Some of the options we will consider will be:
  1. Gift of shares or existing shareholder/director loan
  2. Gift of shares onto a Discretionary Trust
  3. Growth share plan
  4. Deferred share plan.

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Head of Private Client

# Trusts as an alternative

- 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.

**James Kipping**
Head of Private Client

# The right type of Trust for your circumstances

Marcus Bull

# Trusts

## Benefits

- Identify beneficiaries – dependent on the trust have the ability to change.
- No need for probate or prior payment of IHT.
- Free of IHT after 7 years from inception.
- Many different types of trusts for different needs.
- Trustees maintain control of funds rather than outright gift.

**Marcus Bull**
Independent
Financial Adviser
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# Trusts

## Absolute trust

- Cannot alter shares of any beneficiaries. If beneficiary dies prior to benefitting their share would pass under the will.

- No periodic charge and no risk of an IHT charge on payment to beneficiaries.

- Income distributions taxed on the beneficiary at their highest marginal rate.

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# Trusts

## Flexible trust

- Can change beneficiaries and properties of benefit.

- There is periodic charges;
    - Every 10 years in excess of Nil Rate Band (£325k) to max 6%.

- Immediate tax charge of 20% over the NRB.

- Income distributions to beneficiaries made net of 45%. Can be reclaimed wholly/in part by beneficiary based on their HMR via self-assessment.

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# Trusts

## Loan trust

- Access original capital: your client can access the original capital sum at any time, either as a full lump sum, occasional sum or regular repayments of the loan, addressing any concerns about unforeseen circumstances.

- Capital growth: any growth on the investment is part of the trust and therefore will not further increase the size of your client's estate.

- Probate: your client can choose for the loan to be waived on death, meaning that the trustees can access the money immediately.

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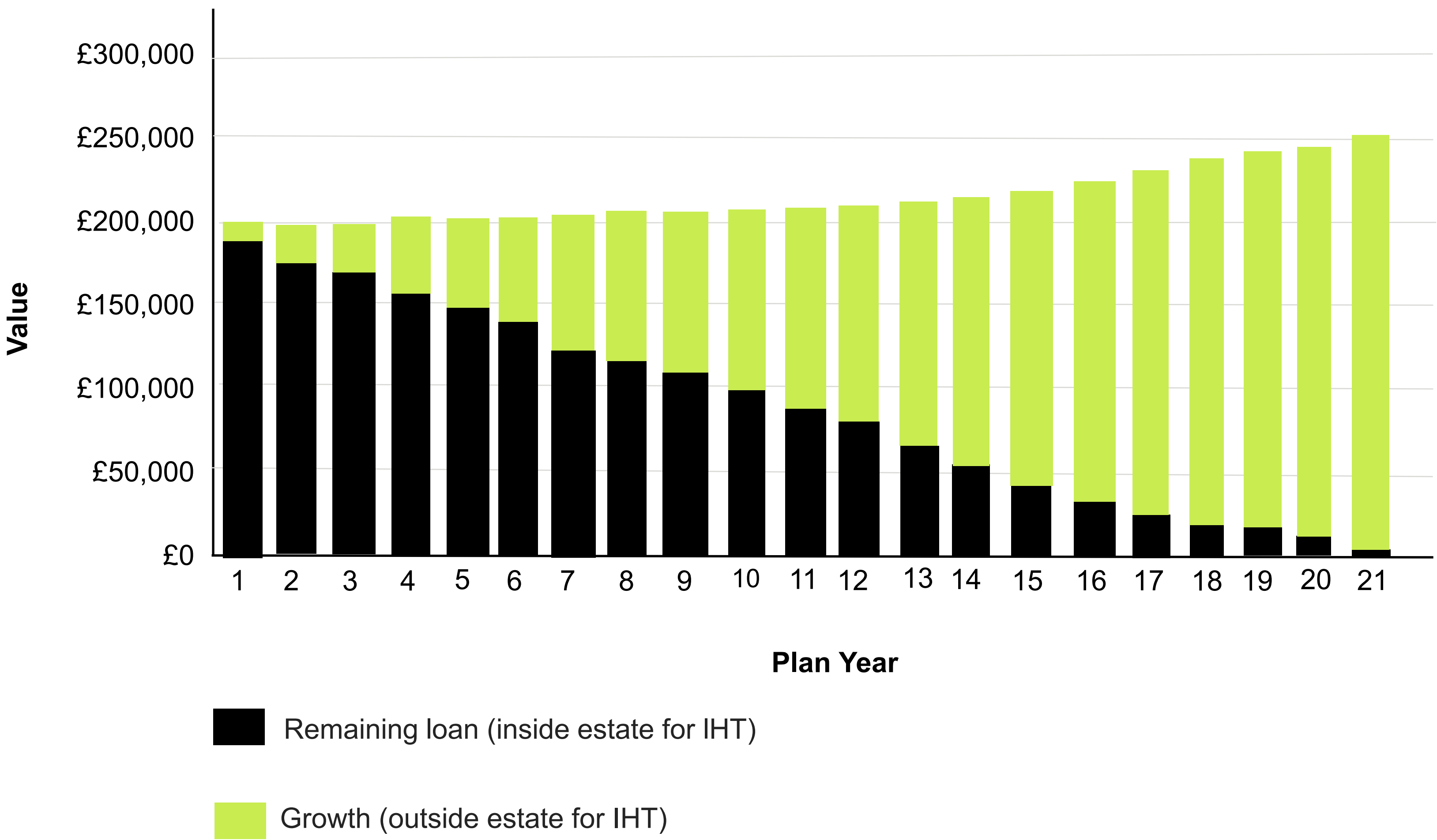
# Loan trust

**5% of loan repaid each year**

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# Rysaffe principle

- Trusts created on separate days by the same settlor are treated as separate settlements.
- It is possible to use multiple trusts to reduce the impact of the 10-yearly periodic charge which applies to discretionary trusts.
- Since 2015, any additions made to multiple trusts created by the same settlor will negate the tax advantage.

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# Offshore (International) investment bonds

- Single premium (contribution) policies issued and administered by a Life Assurance company, based in an offshore jurisdiction.
- Can be held directly within a Trust (for Inheritance Tax mitigation).
- Enables a portfolio of investments to be created and managed, on which no income or capital gains tax would be applied throughout the life of the Bond, enabling the underlying value of the portfolio to grow at a potentially faster rate than a portfolio subject to normal taxation.
- Investors have an annual tax deferred allowance of 5% of the initial investment amount that can be distributed as 'income' without being immediately assessable to tax. This 'income' does not have to be reported to HMRC when drawn, simplifying administration from a tax perspective. Any unused 5% allowances can be carried forward from previous years, with no time limit on these having to be taken.
- When the bond is finally encashed, any gain is assessable for income tax on the policyholder.
- The Bond is split into 'segments', any number of which can be assigned to lower rate tax paying individuals, taking advantage of their respective personal allowances and lower tax bands in order to legitimately mitigate, or reduce, a significant degree of tax that may otherwise be payable on encashment of the Bond.

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# Offshore (International) investment bonds

**Offshore Bond**

Held individually or within a Trust

**Investment Portfolio**

- Free of income tax
- Free of CGT

**5% p.a. withdrawals taken with no immediate tax payable**

**Segment(s) assigned to nil-rate taxpayer**

**Segment(s) assigned to basic rate taxpayer**

Segments can be encashed and any gain is assessable to income tax at marginal rate of the new owner(s).

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# Summary

James Kipping

# Summary

- FICs are a popular choice. They can replicate many of the features of a family trust but without IHT charges, they can provide flexibility, and clients understand companies.
- However, they are not always appropriate. Trust arrangements may often be preferred, particularly for less significant sums and/or where there is a passive investment approach.
- There are also other options not covered today…
- Bespoke advice is a must!

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# Questions?

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