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Family Investment Company

A Family Investment Company ("FIC") is a limited company whose shareholders are family members and whose memorandum and articles of association can be drafted to suit their needs. This can be extremely tax efficient vehicle used for estate planning. The FIC can invest to generate future income for the family.

Key Benefits of an FIC

- Offer an attractive alternative structure to trusts
- Dividends received by the company are tax free
- Other income of the company is taxed at lower rates than individuals and trusts
- Shareholders can hold different classes of shares so that they can receive different levels of income
- An FIC offers flexibility for wealth to pass to family members in a tax efficient way
- Voting shares in the FIC can provide control of the company at shareholder and board level.

Establishing the FIC

The shareholders' agreement coupled with the company articles provide that control will rest with the board of directors usually comprising the donor and their spouse or other trusted individuals.

No tax charge is payable on setting up the FIC when the initial subscription for shares is made in cash only. There will also be no Stamp Duty charge on the issue of the new shares.

An alternative to issuing the shares for cash is to loan the funds to the FIC. These funds can then be drawn down without any further tax charges (discussed further below).

Tax charges may arise in creating the funds required to transfer into the FIC, such as capital gains tax payable on the disposal of assets to create cash funds. We can advise you on this.

Running the FIC

Once the funds have been established within the FIC, they can then be invested, possibly into shares or property. Our Hawsons Wealth Management Team can provide further advice on the options available.

The taxation considerations when running the FIC are as follows:

<u>Corporation Tax ("CT")</u>

The FIC will pay CT at 19% on any interest or rental profit received. This is due to reduce to 17% from 1 April 2020.

Most dividends received by a UK company (including foreign dividends) are exempt from corporation tax. This exemption, together with the low rate of CT, will allow for tax efficient reinvestment within the FIC.

<u>Capital Gains Tax ("CGT")</u>

Gains realised by the FIC on the disposal of chargeable assets are chargeable to corporation tax. This is lower than the current main rate of CGT of 20% (28% for residential property) that would be payable by an individual.

Profit Extraction

In most circumstances, the FIC is created for the benefit of the family members and the main intention would be for funds to remain within the structure to grow tax efficiently. However, the residue of income received (less CT payable) can be extracted by the directors / shareholders if required.

The tax implications on extraction are broadly as follows:

<u>Salary</u>

Salaries paid to directors are generally the least tax efficient method due to the fact that National Insurance Contributions ("NIC") must be paid by both the employee and employer.

Any salaries paid are deductible, if commercially justifiable, to reduce the CT payable by the FIC.

<u>Dividends</u>

Although dividends are not deductible for CT purposes they are generally a more tax efficient method of withdrawing profits from the FIC than taking salary, due mainly to the fact that there is currently no NIC payable on dividends taken.

From 6 April 2018 the first £2,000 of dividends do not attract any income tax. Dividends are then taxed based on the level of other income the shareholder has, ranging from 7.5% for basic rate taxpayers up to 38.1% for additional rate taxpayers.

Loan account and interest

An alternative to buying shares in the FIC for cash is to loan the funds to the FIC. The lenders will be able to draw down on this loan without incurring any tax liability.

Interest could be charged on any monies loaned to the FIC. The receipt of the interest by the lenders could benefit from the savings allowance and potentially the zero-rate savings band. Provided the rate of interest paid was not excessive and was in line with commercial rates then it would be deductible by the FIC in computing it's CT liability.

Pension Contributions

The payment of pension contributions by the FIC is a tax efficient method of extracting funds. Provided the contributions are wholly and exclusively for the FIC's trade they will be tax deductible for the purposes of calculating the FIC's CT. In addition to this they are also a tax-free benefit in the hands of the director.

However, the contributions (including any personal contributions made) must not exceed an individual's annual allowance otherwise a tax liability would arise at a rate of 40% on the excess.

Inheritance Tax ("IHT")

One key difference between the use of an FIC rather than a trust is the IHT position.

There would be no immediate charge to IHT on the gift of shares in an FIC from the donor to another individual as this is deemed to be a "potentially exempt transfer". There would be no further IHT implications for the donor if they survive for 7 years following the date of gift. Therefore, unlike gifts into trusts where there is an IHT charge on transfers made in excess of a donor's available nil rate band (currently £325,000), with an FIC the value of the transfer can be limitless.

Any increase in the value of the shares subscribed for by the other shareholders would not be part of the donor's estate for IHT purposes.

Where the donor does not want to give away capital at the moment, a loan to the FIC can be considered. This loan will continue to form part of the donors estate but the future growth of the FIC will fall outside their estate.

Exiting

CGT will be payable on capital distributions on a liquidation of the company, currently at the rate of 20%. Capital distributions on liquidation are, however, treated as income for tax purposes in certain circumstances. In such cases the distribution will be subject to the relevant marginal rate of income tax applicable to dividends.

There are potentially, therefore, two charges to tax on extraction of profits; one at company level when investments are encashed and one at shareholder level, although this can potentially be managed depending on effective tax rates and the residence position of the recipients.

We can advise further on this.

Contact Us

Hawsons Chartered Accountants is of the UK's leading independent accounting practices, with nearly 100 partners and staff across three UK offices, in Sheffield, Northampton and Doncaster. Our clients, many of whom are long standing, cover a broad range of types, sizes and business sectors. We help our clients expand and develop and deal with problems and opportunities as and when they arise.

We offer all new clients a free initial meeting which will enable you to have a discussion about you and your business issues.

For further advice please get in touch with one of our Sheffield tax experts or your local contact.

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