KINGSLEY NAPLEY
WHEN IT MATTERS MOST

Family Investment Companies

A Family Investment Company ("FIC") is a private company that holds and manages a portfolio of assets for the benefit of future generations of the founding member's family. FICs are often used as vehicles for controlling family wealth as they allow assets to grow outside of the founder's estate. The directors and shareholders of a FIC are often members of the family (or family trusts).

One of the main reasons for using a FIC is to protect family wealth for future generations in a tax efficient way. A FIC is often used as an alternative to a trust or an outright gift. The founder of a FIC can retain control over the assets held by the FIC and can decide how such assets are invested. When the time is right, the founder may decide to pass control to other family members. The founder will also often have a significant role in deciding which family members benefit from any income generated and when they receive that income (via dividends).

Benefits of a FIC

- **Control –** Whilst the board of directors has responsibility for the day to day management of the FIC, the governing documents of the FIC, namely its articles of association and a shareholders' agreement, will often provide for certain reserved matters which require the founder's prior consent. For example, capital expenditure over a certain amount, the appointment or removal of directors, the creation of any security over the FIC's assets, or any amendments to the articles of association of the company.
- **Asset protection –** The FIC's articles of association, together with any shareholders' agreement, may include provisions to prevent a member transferring their shares to certain persons, such as their spouse, and also deal with what should happen to the shares when a shareholder dies.
- **Flexibility –** The structure can be varied as the family grows to allow for additional members. If the FIC has various classes of shares which are held by different family members, the directors can decide which family members receive dividends by resolving to declare dividends on one or more classes of share. Alternatively, the directors may not declare any dividends and instead allow funds to roll up and grow within the company or reinvest them. If the founder has particular rights to control the FIC (as a result of his or her directorship and/or the holding of voting shares), then he or she can decide to resign such office, and to transfer such shares, at a time to suit them and the rest of the family.
- **Tax –** There are various inheritance tax and other tax benefits (as described below).

Disadvantages of a FIC

- **Initial set up and running costs -** legal fees, preparing constitutional documents of the FIC and dealing with the transfer of any assets into the FIC; accountancy fees, directors/management expenses, etc.
- **Lack of privacy –** typically FICs are structured as private limited companies which means the company's annual accounts and articles of association will be publically available at Companies House. However, in certain circumstances it may be possible to utilise an unlimited company, where there is not a requirement to file annual accounts with Companies House.
- **Double taxation –** A FIC is most efficient when most of the income generated in it can be left within the company for reinvestment and is not immediately required by the family. Any income paid out as dividends will have already been subject to Corporation Tax. There is therefore an element of double taxation which can reduce the overall tax benefits, but there remains a far greater degree of control over the incidence and timing of tax charges upon the individual family members.

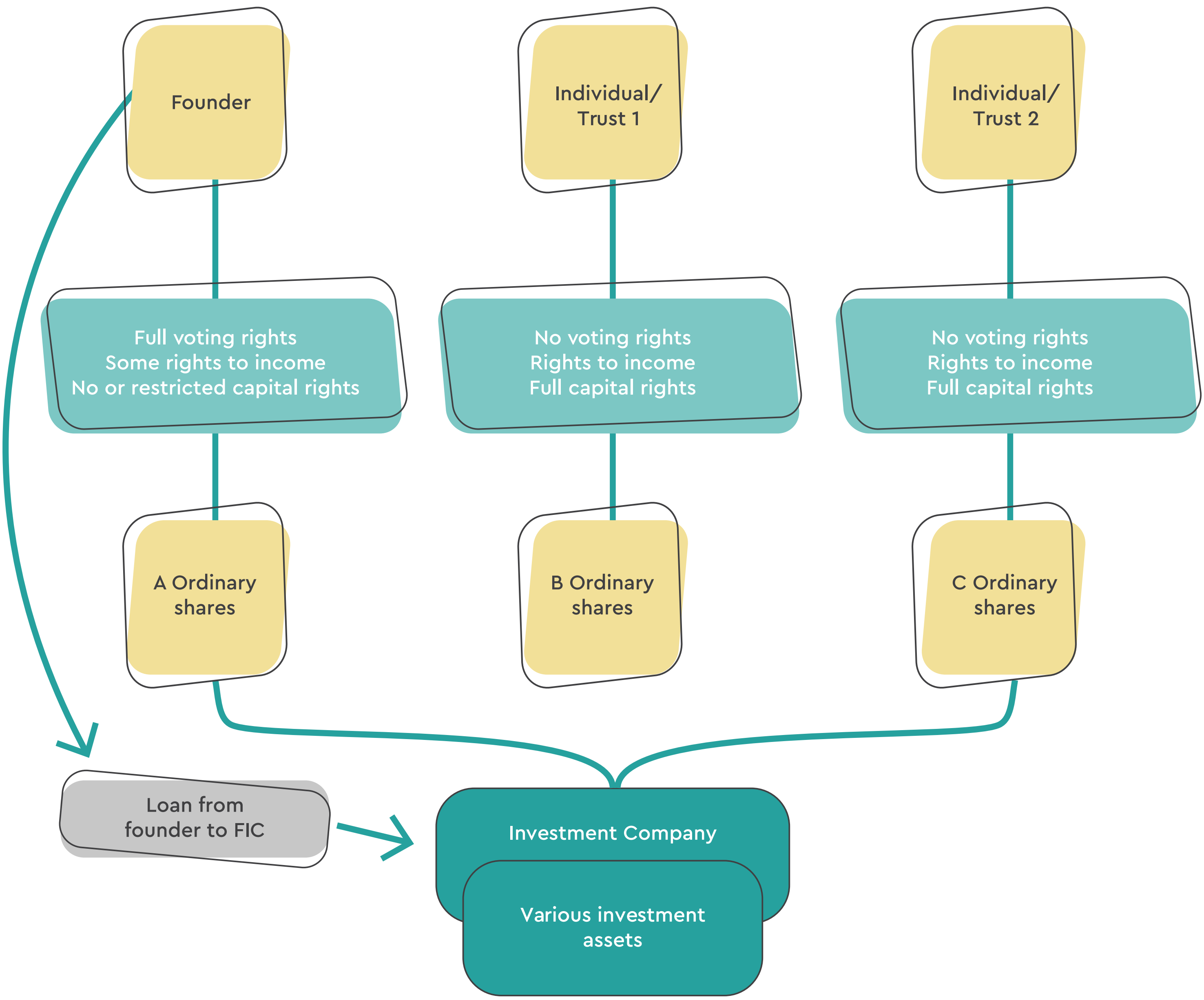
How is a FIC funded?

There are various ways of funding a FIC. Some of the most common ways are:

- **Subscription for shares –** For cash either on incorporation or as a way of injecting further funds in the future. This would not be regarded as a transfer of value for inheritance tax purposes and the 20% charge which may apply on a transfer of property into a trust, would be avoided. However, the transfer of non-cash assets into a FIC is likely to involve capital gains tax and stamp duty.
- **Loan to the company –** A Loan could be made to the FIC to provide it with initial capital. Any such loan should be repayable on demand and the lender (i.e. the founder) could charge interest. They can loan cash or assets into the FIC, and if they do require access to funds, this can be achieved via tax-free loan repayments.
- **Sale of assets -** However, the sale of assets may involve capital gains tax and stamp duty.
- **Gifts to the FIC –** This is likely to have inheritance tax implications.

What is a typical structure of a FIC?

A typical structure might look like this:



- **Shareholders –** Typically each family member who is to benefit from the FIC will hold shares or such shares may be held on trust for a family member, for example an infant. Different share classes allow for great flexibility which is one of the reasons why FICs are attractive. They can be used to differentiate between generations and levels of control (voting) and income and capital rights. Certain classes of share may give rights to certain assets in the FIC. Pre-emption rights can ensure shares remain within the family. The governing documents may also provide for certain transfers of shares to be permitted outside of the pre-emption procedure (known as 'permitted transfers'), for example to certain family members or family trusts. This is a further tax planning mechanic.
- Shares can have a combination of any of the following rights:
  - **Right to vote –** Usually the founder will retain control of the FIC and, in addition to being a director, will hold voting shares. Non-voting shares are commonly used for younger family members so that control remains with the older generation.
  - **Right to income –** Different shareholders can receive different levels of dividends; different classes of shares allow shareholders to receive different dividends at different times and rates for each separate class of shares. For example, if the founders of the FIC are grandparents they may want their children to receive different levels of income to their grandchildren and at different times.
  - **Right to capital –** Shares which provide an entitlement to capital (in defined amounts or proportions) in the event of a sale, return of capital or the winding up of the FIC. Capital rights in shares are often used to provide children with shares which will increase in value as the company (and capital within it) grows.
  - A right to income or capital, which is defined by reference to a particular class of asset (eg a property).
- **Directors –** The directors are responsible for the day to day running of the FIC. The directors are normally the founder and other older members of the family. The founder may be the chair of the board and have a right to a casting vote in the event that votes are tied.

Tax implications

- **Inheritance tax -** One of the main advantages to a FIC are the inheritance tax ("IHT") benefits. Not only is value passed to the other shareholders on the creation of the company (subject to the seven year survivorship rule) but any increase in value of the investments is transferred immediately. Any shares held by the founder may be transferred to other family members later, potentially via a trust. As the value of the founder's shareholding drops, the transfer of wealth to the other shareholders reduces the founder's exposure to IHT.
- Unlike trusts which pay periodic inheritance charges up to 6% every 10 years or exit charges, there are no anniversary charges or exit charges for FICs.
- **Corporation Tax -** Profits arising within in the FIC are chargeable to corporation tax, currently 25% rather than income tax rates (compared to personal and trust income tax rates of up to 45%).
- Expenses incurred by the FIC in managing its investments and running its business will be eligible for corporation tax relief. This will include investment managers' fees and sums paid to employees/directors.
- **Income tax –** The company wrapper shelters the investments from income tax until the funds are extracted from the company. When profits are extracted the shareholders will be liable to income tax on any amounts received. Each shareholder has a £500 tax free dividend allowance per annum and will be taxed based on their income tax band, but at a lower rate than for normal income (basic rate – 8.75%; higher rate - 33.75% and additional rate – 39.35%).
- Dividends paid to minor children are taxed on the parents. However, for children over 18, payment of a dividend up to the basic rate band can be a very efficient way of extracting funds to help with costs such as tuition fees.
- **Capital Gains Tax –** Any assets sold within the company would be charged at corporation tax rates rather than capital gains tax rates (20% and 24% for residential property).
- **Stamp Duty Land Tax –** There is a 3% surcharge on residential properties bought by companies.

How can we help?

There is no 'one size fits all' to succession planning, however there are considerable savings to be made where a FIC structure is appropriate. What is important is that a FIC is considered as part of your wider family wealth planning.

Kingsley Napley's Private Client and Corporate & Commercial teams work closely together to ensure we can help you create an appropriate plan to protect your wealth for you and your family.

James Fulforth
SENIOR PARTNER
CORPORATE, COMMERCIAL & FINANCE

jfulforth@kingsleynapley.co.uk

James Ward
PARTNER AND HEAD OF DEPARTMENT
PRIVATE CLIENT

jward@kingsleynapley.co.uk

Matt Spencer
PARTNER
CORPORATE, COMMERCIAL & FINANCE

mspencer@kingsleynapley.co.uk

Sophie Voelcker
PARTNER
PRIVATE CLIENT

svoelcker@kingsleynapley.co.uk

Luke Gregory
ASSOCIATE
CORPORATE, COMMERCIAL & FINANCE

lgregory@kingsleynapley.co.uk

Diva Shah
SENIOR ASSOCIATE
PRIVATE CLIENT

dshah@kingsleynapley.co.uk