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The Fortress Group

Family Investment Company as a trust alternative for IHT planning

Trusts have been the standard way to pass down family wealth to future generations. Recent tax changes mean that Family Investment Companies (FICs) may offer a more tax efficient option.

The Finance Act 2006 introduced significant changes to the UK's tax regime for family trusts. More changes are expected after some recent HMRC consultations on a "Settlement" Nil Rate Band (SNRB). Most new family trusts now enter into the "Relevant Property Regime" which result in:

- An immediate charge to IHT at 20% for transfers made in excess of a donor's available nil rate band (currently £325,000).
- Ten year IHT anniversary charges (capped at a rate of 6%).
- Further charge to IHT if assets "exit" the trust, also capped as above.

With these drawbacks, individuals wishing to pass down substantial wealth need to consider alternative vehicles, which may be more tax efficient. This is particularly topical at the moment due to the increasingly competitive rates of corporation tax available in the UK (20% from 1 April 2015) and whether it is possible to use a company as a vehicle for passing down family wealth.

What is a Family Investment Company?

A Family Investment Company (FIC) is a UK resident, private limited company, whose shareholders are family members. This vehicle can be extremely tax efficient where an individual transfers significant sums of cash or other assets into a company. The cash or assets could be invested to generate income for the family.

The Benefits of a Family Investment Company

- Assuming that an individual has available cash to transfer into a company, the transfer into the company will be tax free.
- There will be no immediate charge to IHT on the gift of shares from the donor to another individual, as this is deemed to be a potential exempt transfer (PET). There will be no further IHT implications on the donor if he/she survives for seven years following the date of the gift.
- The donor can still retain some element of control in the company providing the Articles of Association are carefully drafted.
- The company will only pay tax at the rate of 20% on the profits that it generates. This is scheduled to fall to 17% by 2020.
- Shareholders only pay tax to the extent the company distributes income. If the profits are retained within the company no further tax will be payable and the company acts as a **tax efficient store of profits** for further investment.

Case Study

Background

Jake and Bella Fortune have inherited a large sum of money from the death of Jake's Grandfather, James Fortune. They also have some personal investments that they would like to reorganise. Jake and Bella are higher rate tax payers.

Problem

Jake and Bella have decided that they would like to purchase some rental property to diversify their investment portfolio and are uncertain how they should address their own succession planning.

They are also keen to minimise their personal income tax liability. If they were to purchase some buy to lets in their personal names, they would be liable to pay 45% income tax on the rental profits when taking into account what they already earn.

Solution

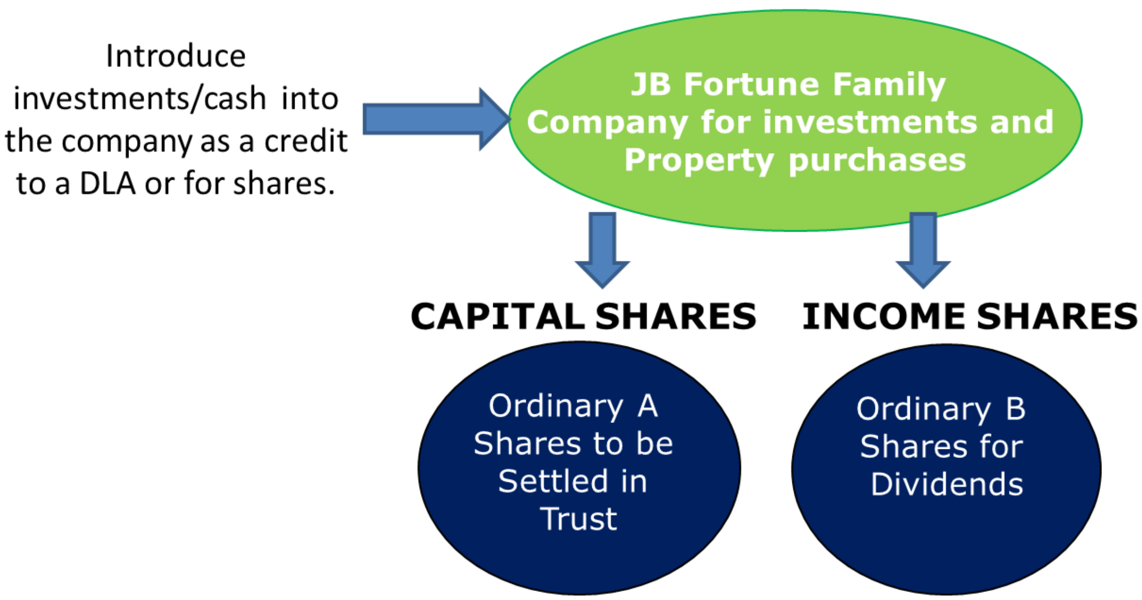
Jake and Bella set up a UK Family Investment Company where they introduce the cash and investments either as a credit to a Directors Loan account (DLA) or in return for shares.

The DLA will allow Jake and Bella to extract funds from the company more tax efficiently.

Jake and Bella would then buy the property in the company name and build up their investment portfolio. Profits can be stored up in the Family Investment Company and will be taxed at 20%, which is significantly lower than 45% if they were to purchase the assets in their personal names.

By reclassifying the shares, Jake and Bella can retain access to income whilst sheltering the capital value of the Family Investment Company from IHT.

What would it look like?



In Summary

With lower corporation tax rates, a Family Investment Company is something that should be seriously considered as an alternative to a trust for asset values exceeding the nil rate band. A FIC still allows the donor to retain control over their investments whilst avoiding an immediate charge to IHT.

Care does need to be taken, however, if assets other than cash are to be transferred into an FIC, but please get in touch if you have any specific situations to discuss and we can advise accordingly.

If you would like further information on Family Investment Companies, please contact Andy Lee at The Fortress Group.

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