In the family

Inheritance tax and trusts | Personal tax



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Jo White provides an overview of the benefits and issues facing Family Investment Companies

Key Points

What is the issue?

A Family Investment Company ('FIC') is a company to which the shareholders are different generations of a family. As with any family business the directors can be the same as the shareholders but in most instances, it is the individuals who initially provide the working capital that would be appointed.

What does it mean to me?

Due to the way shares are valued for inheritance tax purposes even if the donor owns shares in the company they will be worth a lot less than owning the assets in their entirety due to the application of minority share discounts for tax purposes.

What can I take away?

It is worth noting that a FIC is unlikely to attract any inheritance tax reliefs due to its investment activities. The Inheritance Tax planning is therefore in giving away any capital appreciation but can go further where the loan is assigned.

Is a Family Investment Company for me?

A Family Investment Company (FIC) is a company to which the shareholders are different generations of a family. As with any family business the directors can be the same as the shareholders but in most instances, it is the individuals who initially provide the working capital that would be appointed.

A FIC is created with the relevant family members subscribing for the shares at par. Where the company is formed with the relevant shareholders subscribing for these shares then no tax charge arises. The issue of new shares does not give rise to a stamp duty liability and as the company is not worth anything there is no gift for inheritance tax or capital gains tax purposes.

Once the company is set up the individual can transfer assets to the company or loan funds to the company. This could be cash, investments or property. Typically assets would be sold to the company for their market value with the value remaining outstanding on loan back to the original owner. For more information, please read the article 'Family Fortunes' in the June 2015 issue of *Tax Adviser*. Here we need to consider a number of things when advising our clients.

Where cash is transferred then there are no tax consequences on the initial loan of funds. If the assets being sold are investments then capital gains tax could arise based on the difference between their current worth and the original cost to the transferor. As the transaction is between connected parties, it will need to take place at its market value under TCGA 1992 s 17. In addition, stamp duty may be payable.

If property is transferred then the same capital gains tax issues will arise as if the assets sold on loan were shares. SDLT would also be payable by the company. Where the property being transferred is residential then the additional 3% SDLT surcharge would apply under FA 2003 Schedule 4ZA. There is also the additional 15% charge under FA2003 Schedule 4A to consider if the property was not being used for a qualifying purpose.

Whilst this initial transfer is not a disposition for inheritance tax purposes and the value remains payable to the vendor, this type of planning does come with some potentially significant inheritance tax benefits. The transfer of an asset is based on a value at a single point in time. Where the asset being transferred is likely to appreciate in value then any increase will not be attributed to their estate. The benefit arises by fixing the value of the asset at the date of transfer for inheritance tax purposes, but creating the opportunity to continue to benefit from that value at a later date, if required, by way of a loan repayment.

In some circumstances, the individual making the initial transfer will be a shareholder of the company. This has the benefit of them being able to retain some access to the income from the asset but to start giving away the capital value.

The company could be set up with different classes of shares with different rights. In the main you may wish to consider the same right to capital and votes but can use different rights to dividends allowing complete flexibility as to how any surplus profits are distributed among the family.

Due to the way shares are valued for Inheritance Tax purposes even if the donor owns shares in the company they will be worth a lot less than owning the assets in their entirety due to the application of minority share discounts for tax purposes. Providing an individual together with their spouse or civil partner do not have control of the company (more than 50%) then a fairly large discount can be applied to the price per share.

Once the assets are in the company then they can be managed by the directors. This could be the individual who transferred the initial working capital and/ or other family members. The assets can be used to generate money whether it is capital appreciation or income, giving the whole family a long-term income source and opportunity for capital growth. Corporation tax would be payable on any profits made at a current rate of 19%. Dividend income received in a company is generally corporation tax free under CTA 2009 s 931A meaning further money is available for distribution.

As with directors and shareholders of other family businesses it would be possible to pay a salary and benefits to those managing the company as well as pension contributions. Dividends can also be paid to the shareholders where there are sufficient distributable reserves to do so. From 6 April 2018 an individual is entitled to £2,000 tax free dividend allowance (ITA 2007 s 13A) which means distributions up to that level can be made to the individual shareholders without incurring a tax charge.

Over time the loan which was formed from the initial transfer of the assets can be repaid giving a post-tax form of income to the original asset holder. Alternatively the loan could be gifted/assigned to other family members where the capital value is no longer needed.

The gift/assignment of the loan would be a Potentially Exempt Transfer (PET) for IHT purposes. Providing the donor survives seven years from the date of the gift then no Inheritance Tax will be payable on their death. If they die within the seven-year period then Taper Relief (IHTA 1984 s 7(4)) may be available reducing the Inheritance Tax payable. Remember however, that Taper Relief applies to any tax payable and not to the value gifted, so if the value of the gift is covered by Nil Rate Band, no taper relief will apply.

Alternatively, it would be possible to gift/assign part or all of the loan into a trust. Any value transferred in excess of the Nil Rate Band (currently £325,000 per person) will be subject to a lifetime Inheritance Tax charge at 20%. When considering whether or not there is any lifetime IHT payable you need to consider any other Chargeable Lifetime Transfers (CLTs) made in the previous seven years. If there have been previous transfers then the value of these gifts will be used to reduce the available Nil Rate Band which can be offset against the value of gift for calculation purposes.

It is worth noting that a FIC is unlikely to attract any inheritance tax reliefs due to its investment activities. The inheritance tax planning is therefore in giving away any capital appreciation but can go further where the loan is assigned.

Image

CASE STUDY 1: MR WILKINS

Putting these points into context, Mr Wilkins came to see me to consider some inheritance tax planning. His estate is worth in excess of £4,000,000, half of which is made up of an investment portfolio which has built up over time. He has sufficient income from a final salary pension and is starting to think about giving away some assets to his children and grandchildren.

One option we discussed was the use of an FIC. The company would be set up with him, his children and a trust for the benefit of his grandchild (and future grandchildren) as shareholders. At the moment his granddaughter, Maisie, is under the age of 18 and therefore owning the shares in trust was a more appropriate option for him. He also liked the idea of the shares being for the benefit of all future grandchildren. The most suitable trust under this circumstance would be a discretionary trust. However, where dividend income is received by a discretionary trust it does not benefit from the tax free dividend allowance. It was therefore agreed that a revocable life interest would be created from the discretionary trust giving Maisie the right to the income for a period of time and therefore the dividend allowance being available. When further grandchildren are born, the life interest could be revoked or reallocated amongst all grandchildren or the trust can revert to a discretionary trust.

He liked the idea of having a share in the company in its infancy with the view to gifting the shares to his children in time. Although he had sufficient income from other sources he wasn't comfortable with giving away too much too soon and therefore the ability to receive an income from the new FIC was preferable. He would be appointed a Director along with his son so he could continue to make active decision in how the assets are managed.

of his son. This will be a Company pension contribution as he doesn't have suitable pension provisions at present. A small salary will also be paid to both of them for their director's duties although this will be reviewed annually to see if it is suitable.

We reviewed his portfolio to assess which of the assets may be best to transfer to the company. We managed to highlight a small number where the unrealised gain was fairly minimal. There were also a few shares which were running at a loss which seemed appropriate to transfer. Within his portfolio Mr Wilkins had a number of AIM listed and EIS investments. It was agreed that as these attract Business Property Relief at 100% there was no benefit in transferring these as they would lose their IHT free status once in the company.

Mr Wilkins asked if he should sell his shares and then transfer cash into the company. We discussed the merits of this however it was agreed that this could trigger two amounts of transaction costs which seemed unnecessary. Once the shares are in the company then as a director he could decide to reinvest these assets. As the shares will be transferred at their market value, no gain should arise if they are sold and reinvested early on. I advised he needed to speak to his Financial Adviser regarding the investments the company could make.

It was decided that Mr Wilkins would hold a 10% shareholding in the company. As the company would have the full loan outstanding initially the shares would be worth very little. However, when the investments grow in value or the loan is slowly repaid the share value will start to increase. Due to the nature of the company's activities a minority discount of approximately 50% could be applied. Say the company was worth £1,000,000. Mr Wilkin's share would be worth circa £50,000 as opposed to owning a 10%

Image

CASE STUDY 2: MRS JENNINGS

Another client where an FIC was suitable was for an individual who had just inherited a share portfolio from her late husband. This was her second marriage and she had step-children to whom the assets would go in the longer term.

A FIC was set up with Mrs Jennings transferring her newly inherited share portfolio to the company on loan. As the shares were only recently inherited there was no Capital Gains Tax in transferring them. Stamp duty was payable at 0.5% of the total consideration.

The FIC was set up with Mrs Jennings and her three step children as shareholders. They all had different classes of shares to allow for dividends to be paid at different times.

Mrs Jennings would continue to receive any income from the company partly as dividends and partly as loan repayment. The children would benefit from the capital appreciation. In time, as Mrs Jennings' income requirements changed this would be reviewed.

It was decided that the loan would be assigned in part to the grandchildren. As the parents were shareholders it was agreed that this value should skip a generation when considering the longer-term IHT planning of the family.

The gift of the loan was a PET for IHT purposes and therefore providing she survived seven years from the date of assignment, this value would fall outside of her own estate.

A Trust was considered as part of this planning. However due to the potential lifetime IHT charge where the value transferred would have been in excess of £325,000 it was felt that a company structure would ultimately achieve the same goals.