

Family Investment Companies: Holt v Holt

(Lecture P1207 – 11.15 minutes)

What is a Family Investment Company?

It is common for family members to pass assets (e.g. investments) down the generations. Family investment companies (FICs) are often considered as an alternative to the more traditional family discretionary trust, as a means of passing family wealth down to adult children and remoter generations. Furthermore, a FIC can be a tax-efficient 'wrapper' in which individuals can manage their wealth.

A FIC is simply a company in which its shareholders are family members. For example, parents may wish to apply their wealth for the benefit of offspring (e.g. an adult son and daughter) through a FIC. The FIC might be funded by cash initially. It may subsequently acquire (say) commercial properties in the UK.

Inheritance tax

The above gift of shares from parents to adult children is a potentially exempt transfer, so no immediate IHT liability arises and the gift generally becomes exempt if the parents survive at least seven years. Furthermore, any subsequent growth in value following an outright gift of the shares will normally fall outside the parents' estates (although care is needed to ensure that the gifts with reservation IHT anti-avoidance provisions do not apply to treat the shares as remaining in the parents' estates).

If the company's shares are spread (say, 25% each) between each parent and adult child, the value of the separate shareholdings are likely to be subject to discounts (e.g. to reflect non-controlling interests in the company), and so may further reduce IHT exposure in the parents' estates.

In some cases, the shares held by the children may carry different types of rights to those held by the parents, possibly resulting in a greater reduction in value in the parents' estates for IHT purposes.

Under attack?

It was reported in Taxation ('Future challenges to family investment companies' by Stephanie Parker, 18 March 2020) that HMRC had set up a 'secret unit' to look at how FICs are being used in IHT planning.

Prior to that, a Shares and Assets Valuation (SAV) Fiscal Forum meeting, which took place on 8 October 2018, discussed (among other things) HMRC's concerns about the use of FICs:

'[An HMRC representative] explained that SAV has begun to see companies with classes of shares that include a class with all voting rights but no rights to income or capital, plus one or more classes which have no voting rights but all rights to income and capital. It has been proposed by some agents that the voting classes have nil value. Whilst each case should be judged on its own merits, SAV may challenge a case where nil value is proposed for shares in the voting class. TS read aloud an excerpt from the Holt v Holt decision, in which

the Court suggested that the fair value of control was 20-25% of the company's value. TS asked if anyone was aware of a more recent decision that discussed the value of these types of shares, though no further cases were offered by those present.'

Holt v Holt

In the case referred to by HMRC in the Fiscal Forum meeting, *Holt v Holt* [1990] 3 NZLR (a New Zealand case), a divorcing couple's home was owned by a company. The share capital of the company comprised 1,000 shares of \$1 each. There were two classes of shares in the company. The husband held one 'A' share; the other 999 shares were 'B' shares, which were held by the trustees of a family trust (i.e. the 'B' shares were not the property of husband or wife).

The rights attaching to the 'A' and 'B' shares were identical in every respect except one; the single 'A' share carried 10,000 votes, while the 999 'B' shares carried one vote each. The husband exercised his voting rights to make himself the company's managing director.

The company's net asset value was agreed to be \$800,000. The New Zealand High Court and Court of Appeal both considered that the valuation of the husband's 'A' share for matrimonial property purposes was \$150,000. The husband appealed to the Privy Council. He argued that the proper value of the 'A' share was only \$10,000.

The Privy Council dismissed the husband's appeal. The rights attaching to the 'A' shares would continue until the 'A' shareholder (i.e. the husband) decided to alter the company's articles. In addition, the 'B' shareholder could obtain nothing without the cooperation of the 'A' shareholder. Thus the value of husband's one 'A' share out of 1,000 shares in total was \$150,000, out of an overall value for the company of \$800,000.

The future

If HMRC's FIC unit considers that FICs are causing an unacceptable level of tax leakage, it is possible that a targeted anti-avoidance rule will be introduced to counter that leakage; for example, a valuation rule to prevent the dissipation of a company's value as a result of the shares being spread among close family members.

In any event, if *Holt v Holt* is followed by the UK law courts, then (unless superseded by other litigation) it may transpire that FICs will be less effective to parents for IHT purposes in terms of reducing the value of their estates.

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