

Family Investment Companies (FICs) (Lecture P1282 – 17.08 minutes)

In essence, an FIC is a structure which can be used to transfer value to the younger generation of a wealthy family, while allowing the older members to maintain control over the assets. This is done without creating an immediate IHT charge and so, in recent years, has increasingly been seen as a popular alternative to family trusts following the changes in FA 2006.

In April 2019, HMRC established a special team to review the use of FICs in view of the surge of interest in setting up these arrangements. At the time, it was stated that the team's work was merely of an exploratory nature.

HMRC have now published their findings in the 13 May 2021 minutes of the Wealthy External Stakeholder Forum, concluding that:

- they have a better understanding of the characteristics of FICs; and
- the use of these structures does not suggest that the taxpayers who establish them are non-compliant when it comes to their tax affairs.

While so far there have been no significant shake-ups to the taxation of FICs, it is possible that we may see new anti-avoidance legislation in this area before too long. For the time being, FICs are 'business as usual' within HMRC – they do not have to be dealt with by a dedicated team in the Department.

An FIC is typically formed by parents providing funds for investment through interest-free loans or by subscribing for preference shares. Neither of these arrangements is regarded as a chargeable event for IHT purposes and the money transferred can be extracted tax-free from the FIC at a later date, using cash generated by the company's investments. The parents, who will be directors of the FIC, will also subscribe for two further classes of shares in the company:

- voting shares which will give them control of the FIC at shareholder and board level; and
- non-voting shares which are handed over to the children (preferably before significant value accrues on those shares).

The gift of the non-voting shares will not be subject to IHT, provided that the parents survive this event by seven years.

Dividends paid by the FIC will come from the non-voting shares. Assuming that the children are adults, any amount in excess of the younger individual's combined personal and dividend tax allowances (£14,570 for 2021/22) will be taxed at 7.5% if it falls into the basic rate band and at 32.5% if it reaches the higher rate bracket.

One important feature is that the FIC will pay corporation tax on its profits at 19%. However, with effect from 1 April 2023, this rate is due to rise to 25%. The 19% small profits rate, which applies to companies with profits of £50,000 or less from then onwards, is unlikely to be relevant for FICs in view of the fact that the lower rate is not available for close investment companies.

Other tax-related considerations for FICs are:

- Capital gains realised by an FIC are currently chargeable at 19%. For the time being, this is lower than the main rate of CGT for individuals (20%). Where assets have been held since before 1 January 2018, an indexation allowance can reduce the FIC's gain. If an FIC is disposing of all or part of a holding of at least 10% in a trading company, the substantial shareholding exemption should be available.
- Virtually all dividends received by an FIC (including from overseas) are exempt from corporation tax.

Dividends from abroad may be subject to a withholding tax. Withholding tax is offset against the UK corporation tax on the corresponding income. However, if the income is exempt from tax, any withholding tax will not be repaid by HMRC and so will represent a real cost to the FIC.

An FIC can claim a corporation tax deduction for interest paid on loans taken out against the value of its investments where the loans have been used for the purposes of the company's business (e.g. in order to acquire new shares or to manage the operation). Annual loan interest deductions may be restricted where the total interest payable exceeds £2,000,000. By contrast, individuals are not permitted to claim tax relief on the interest on loans to acquire a share portfolio.

Expenses incurred by the FIC in managing its investments and running the business will be eligible for corporation tax relief. This will include investment managers' fees and remuneration paid to employees or directors. The company can set off these expenses against its taxable income and gains – any unrelieved amount can be carried forward and deducted from the FIC's future taxable profits. Tax relief for such expenses is not available to individual investors.

On the liquidation of an FIC, CGT will be charged at 20% on any capital distributions. This assumes that the provisions of S396B ITTOIA 2005 have not been invoked by HMRC.

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