Keeping it in the family

By Eamonn Daly - partner

Following concerns over lack of knowledge on how Family Investment Companies (FICs) are used, HMRC created the Family Investment Unit in April 2019 to conduct risk reviews of them.

HMRC reportedly told the Financial Times that it was doing a "quantitative and qualitative review into any tax risks associated with them [FICs] with a focus on inheritance tax implications…".

But what is a FIC and why was it deemed necessary to investigate the concept in the first place?

FICs at a glance

A FIC is a well-known and legitimate company structure that has become increasingly popular with high-net worth individuals. In one sense it is simply a family-owned company holding investments, but the term "FIC" has become synonymous with a particular form of company structure which allows individuals to pass substantial value out of their estate whilst maintaining control over the assets transferred which are then held for the benefit of their family. The use of a FIC avoids the initial inheritance tax charge which would otherwise be suffered on a transfer of large sums to a trust. As such, a FIC can be seen as an alternative to a trust, albeit with various pros and cons.

A company structure bespoke to the family's circumstances is created. This is primarily achieved through the company's articles of association and a shareholders' agreement. Like any other company, it has filing obligations and is registered at Companies House.

The image at the bottom of this page illustrates the interdependencies within a typical FIC.

Founder (Director)

Passes value to family shareholders but retains control

- Day to day control of FIC
- Power to deal with assets held
- Decides on distributions of profits / capital
- Ability to declare different dividends on different classes of shares held by shareholders

Family Investment Company

Controlled by directors for benefit of family shareholders

- 0% tax rate on dividends received from other companies
- 19% tax rate on other income and gains; increasing to 25% from 2023/24
- Tax rates compare favourably with those for trusts and individuals
- Allows long term tax-favoured accumulation of funds within the FIC

Descendants (Shareholders)

Hold different classes/types of shares comprising value of FIC

- Hold different types of shares in the FIC, usually including some redeemable shares
- Directors' option to distribute capital to shareholders on redemption of redeemable shares without tax consequences
- Dividends distributed from FIC subject to tax on shareholders as determined by their own tax position

In some FIC structures, the founder will retain a financial interest and may even lend funds to the company allowing the tax-free extraction of profits via repayment of the loan.

Compliance with UK tax laws

A FIC follows a standard company structure and the normal corporate tax rules apply. With this structure comes the same tax advantages and benefits, as well as disadvantages, that apply to all companies. Concerns that a FIC has the potential to be a model for tax avoidance caused HMRC to quietly create its Family Investment Unit with the main aim of exploring whether this is the case and the risks of tax loss through avoidance using FICs.

> "It was recognised that a FIC was a planning strategy, the primary purpose of which was to transfer wealth between generations"

In reality, FICs are primarily used as a means to protect family wealth rather than for any unacceptable tax avoidance purpose. As with a family trust, the use of a FIC provides a measure of asset protection to safeguard wealth from, for example, future generations using it unwisely or losing it through divorce or insolvency.

Outcome of review

Following a two-year investigation, in May 2021 HMRC's Wealthy and Mid-Sized Business Compliance Directorate confirmed that the review found no evidence to suggest that there was a correlation between those who establish a FIC structure and non-compliant behaviours.

Furthermore, it concluded that those using FICs were no more inclined towards taking steps for tax avoidance.

It was recognised that a FIC was a planning strategy, the primary purpose of which was to transfer wealth between generations and the mitigation of inheritance tax.

The outcome appears to be that FICs will be assessed by HMRC using normal principles and not specifically targeted for future investigations.

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