Family Investment Company Inheritance Tax Planning

A Family Investment Company may be a suitable arrangement for individuals who hold cash in excess of £1 million which is currently exposed to 40% IHT. With careful structuring it may be possible to make IHT efficient gifts to family members whilst retaining control over investment strategy. It is often this loss of control which deters individuals from gifting large amounts to the next generation.

Why consider a Family Investment Company?

A company can be a very tax efficient investment accumulation vehicle compared to conventional trusts. Corporate rates of tax are currently 19%. In addition dividend income from UK equities does not attract additional tax in a company. In contrast income in discretionary trusts attracts tax at 38.1% for dividend income and 45% for other income and capital gains tax (CGT) at 20%.

The effectiveness of trusts as an IHT shelter has been further diminished over recent years with most transfers into trust now being treated as a chargeable lifetime transfer. An individual's ability to contribute to trusts without triggering an immediate 20% lifetime tax cost is generally limited to the nil-rate band (£325,000) every seven years.

The attractiveness of trusts for Inheritance Tax (IHT) planning has been significantly reduced over recent years. The potential for 20% lifetime tax charges and top rates of income tax being levied on income mean that alternative structures for planning should now be considered. A Family Investment Company can provide an attractive alternative.

The Planning

A parent could gift cash to their children, who together with the parent would form a limited company (although it could be unlimited (for privacy reasons) subscribing for a range of share classes which are likely to include voting ordinary, non-voting ordinary shares and redeemable preference shares. It is likely that a majority of the investment in shares would be in the preference share class. The gift of cash at the outset would be a potentially exempt transfer (PET) for IHT purposes. The voting shares could be retained by the parent or alternatively cash is gifted to a trust which in turn acquires the voting shares.

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Step 2 – Subscribe for shares

A Ords and redeemable prefs/loan stock — Child 1

B Ords and redeemable prefs/loan stock — Child 2

C Ords and redeemable prefs/loan stock — Child 3

Step 1 – Cash Gift
(Potentially Exempt Transfer)

Mum and Dad
Board of Directors

Family Investment Company

Step 3 – Cash invested in Corporate structure

Potential benefits

- Should remove value of gifted cash from IHT estate after seven years. 40% saving on value invested and no lifetime IHT
- Parents retain day to day control over investment decisions in their role as Directors
- Company can be governed by shareholders agreement which restricts movement of shares outside of immediate family members
- Should be no gift with reservation of benefit provided careful drafting of share rights
- Potentiallly attractive investment accumulation vehicle
- Investment returns attract corporate tax. Currently 19% but reducing to 17% by 2020. Lower than income tax rates of 45% and 20% CGT
- Dividends from UK companies do not attract corporate tax
- Dividends can be paid at differing rates/times on separate classes of ordinary shares
- Redemption of preference shares at par should return capital to individuals at no tax cost
- Ability to undertake further IHT planning using growth shares

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