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FAMILY INVESTMENT COMPANIES

A family investment company is an increasingly popular option for families looking to pass wealth down to the next generation while still retaining control over family assets and providing a flexible structure for managing and growing family wealth. Family investment companies are often seen as an alternative to creating a family trust.

WHAT IS A FAMILY INVESTMENT COMPANY?

A Family Investment Company ("FIC") is a company with at least two classes of shares:

- + **Voting Shares** – have the rights to vote and govern the company, i.e. the holder of the voting shares makes shareholder decisions in relation to the FIC. However, these shares typically have no or very limited economic rights (including rights to dividends or capital on a winding up); and
- + **Economic Shares** – have all the economic rights i.e. entitlement to dividends or capital on a winding up. However, these shares typically have no voting rights.

The Voting Shares are usually held by the parents, who can control the FIC as both directors and shareholders, while the Economic Shares are held by the children, who can benefit from the FIC's income and capital.

By dividing the economic and voting rights, a FIC can offer long-term asset protection for the family wealth. Parents can retain control over the FIC and its assets and place restrictions on the transfer of shares within the FIC's articles of association and shareholders' agreement.

The structure of a FIC is flexible and can be altered over time to suit the interests of the family and the investment strategy. As the children attain the age of 18 or such other age and reach financial maturity, the children can be invited to the board of directors to actively participate in the day-to-day management of the family wealth held within the FIC.

FUNDING A FIC

A FIC can be funded by both equity and debt, depending on the objectives and circumstances of the family. If a FIC is funded by equity, the parents can immediately pass value down to the next generation. However, care needs to be taken to ensure that any transfers of value by the parents to the children (through the issue of shares) is conducted without giving rise to a lifetime chargeable transfer (discussed further below). By comparison, if a FIC is funded by debt, the parents will retain the benefit of a loan in their name (thereby keeping value in their estate), but over time they can choose to assign the benefit of the loan (or tranches of the loan) to the children.



In terms of UK tax consequences, the mix of debt and equity will affect the inheritance tax ("IHT") and capital gains tax ("CGT") implications of the FIC, as well as the asset protection and extraction of value for the shareholders.

TAX CONSEQUENCES OF USING A FIC

IHT

In comparison to settling a UK trust under the Relevant Property Regime, funding a FIC can avoid the immediate 20% IHT charge as the allotment or issue of the Economic Shares to the children or the assignment of the benefit of the loan (or tranches thereof) can be structured as potentially exempt transfers. Such transfers of value will not give rise to an immediate IHT charge and will also fall outside the parents' estates for IHT purposes if the parents survive seven years from the date of the gift.

As part of any transfer of value, it is important to ensure that the parents do not retain an interest in the gifted shares as there is the possible application of the gift with reservation of benefit ("GWR") rules, which could negate the IHT benefits of the FIC, as the GWR rules operate to treat the reserved benefit as being added to the free estate of the donor parent, thereby failing to reduce the value of the parent's estate for IHT purposes.

Although they have no economic rights, the Voting Shares will retain some value and will be subject to IHT on the parents' deaths, unless they qualify for any reliefs or exemptions.

CGT

CGT will not typically arise on the initial funding of the FIC where the funding is through cash or an unrestricted loan. However, CGT may be due if any gain is realised by an increase in value of the gift of the Economic Shares to the children. This can be avoided by making the gift of the shares shortly after the FIC has been funded by the parents.

CGT can also arise on the repayment of a restricted loan to the children, as the value of the loan may increase over time. Obtaining a valuation of the shares and the loan at the relevant times may be advisable to support any necessary tax filings.

Income tax and extracting value from the FIC

The holders of the Economic Shares can extract value from the FIC by way of dividends, which will be taxed at the shareholder's marginal rates of income tax on dividends (currently up to 39.35%). Alternatively, if the FIC has been funded by way of loan, the holder of the benefit of the loan can extract value through repayment of the loan (or tranches of said loan), which will generally be tax-free.

Any shares held for the benefit of a minor child must be held on bare trust for the child. Accordingly, any income paid to the child while they are a minor will be taxed on the parent, as if the income arising were that of the parents.

Corporation tax

A UK resident or UK incorporated FIC will pay UK corporation tax (currently 25%) on its worldwide income, profits and gains, but it may benefit from an exemption for certain dividends received from UK or qualifying non-UK companies.

It is worth noting that one of the major considerations for using a FIC is that there is the potential for double taxation on the profit of the FIC. Firstly, corporation tax will be payable on the FIC's profits and then income tax will be payable on dividends made to the shareholders. However, this may not be a significant issue if the FIC is used for long-term accumulation of wealth rather than regular distribution of profits.

Annual Tax on Enveloped Dwellings ("ATED")

If the FIC owns UK residential property worth more than £500,000, it may be required to pay ATED. ATED is an annual tax payable by companies that own UK residential property. ATED is charged at flat rates by reference to the value of the UK residential property and the rates increase each year in line with inflation. For properties worth between £2m and £5m, the ATED charge is currently just over £30,000.

There are reliefs against the ATED charge, for example, if the UK residential property is let to a third party on a commercial basis and is not at any time occupied by anyone connected with the owner, letting relief will apply. However, a return will need to be filed annually by the company to claim the relief.



Anti-avoidance legislation

Certain anti-avoidance rules may also apply to the FIC, such as the settlements legislation, the transfer pricing rules, and the offshore anti-avoidance rules. Charging market interest on any loan to the FIC, or using a combination of restricted and unrestricted loans, may help to reduce the applicability of these rules, but advice should always be taken when setting up or altering the structure of a FIC.

Onshore vs Offshore FICs

Depending on the family's circumstances and their ties to the UK, it may be advisable to have either a UK incorporated, or a non-UK incorporated FIC. Both types of FIC can be managed and controlled in the UK, so will be subject to UK corporation tax, but the incorporation overseas can provide IHT advantages, by virtue of the shareholders owning non-UK situs shares. Therefore, subject to the underlying assets of the FIC, if the holders of the shares are not subject to IHT on a worldwide basis, this can reduce their exposure to IHT for the shareholders.

One notable downside of having an offshore FIC is that if there is an intention to hold UK residential property in the FIC, the FIC will need to register on the UK's Register of Overseas Entities, which comes with annual filing charges and additional disclosure requirements when compared to the UK's Persons with Significant Control register.

SUMMARY

Placing family wealth within a FIC can offer many advantages to clients who are seeking to start transferring family assets to the next generation. However, these are complex structures which require careful planning and ongoing management, particularly when there is a cross-border element.

Stephenson Harwood LLP can assist you with determining the benefits of a FIC for you and your family and building a strategy to establish and run your FIC.



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