Institute for
Family Business

21 November 2012

The Rt Hon George Osborne MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
London
SW1A 2 HQ

Dear Chancellor,

**Institute for Family Business with the Unquoted Companies Group Autumn Submission to HM Treasury November 2012**

We welcome this opportunity to make a submission to HM Treasury. The IFB with UCG is an independent, not-for-profit, politically neutral, membership association which supports the UK family-owned business sector - a total of three million enterprises generating revenues of £1.1 trillion and providing nine million jobs.[1]

I am pleased to inform you that the Unquoted Companies Group has recently taken the decision to merge its operations with the IFB, creating a single voice for family business in the UK.

Our submission focuses principally on areas of tax simplification that would act as a catalyst for growth in a key sector of the UK economy. With strategies that are inherently long term , family businesses experienced a lower rate of insolvency in the recession compared to other ownership models and are now looking for opportunities to grow and invest as the economy starts to recover.[2]

Our prime objective is to work with government to ensure the policy environment:

- Recognises the economic benefits of supporting the diversity of business ownership models in the UK as highlighted by the Ownership Commission Report, in particular the Family Business model.
- Recognises the considerable contribution of the family business sector to growth, investment job and economic prosperity.
- Fosters and unleashes the spirit of entrepreneurship, enterprise and innovation that is the bedrock of family businesses.

[1] IFB Research Foundation with Oxford Economics, The UK Family Business Sector: Working to grow the UK economy, November 2011, http://www.ifb.org.uk/media/152155/theukfamilybusinesssectorpressnov2011.pdf
[2] See [1], P.22

Our submission contains the following:

1. Introduction
    I. The Family Business Sector
2. Policy Recommendations
    I. Encouraging growth
        i. The tax treatment of debt and equity
        ii. The Enterprise Investment Scheme
    II. Ensuring stability and sustainability
        i. Business Property Relief
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        iii. Trust taxation
3. Concluding comments

**1. Introduction**

<u>1.1 The Family Business Sector</u>

As in other large economies, the Family Business sector forms the backbone of the UK economy. The IFB membership alone includes some of Britain's best known brands including: Virgin, Clarks, Dysons, Warburtons, JCB, Fullers, Morgan Cars, Aunt Bessie's, Ginsters, Boodles and William Grant & Sons.

Research on the UK family business sector conducted for the IFB Research Foundation by Oxford Economics estimates that[3]:

- Family firms account for 66 per cent of private sector enterprises in the UK economy – three million businesses.
- Family firms account for more than 40 per cent of private sector employment, providing jobs to 9.2 million people, nearly double the public sector.
- Family firms generate over £1.1trillion turnover, 35 per cent of the private sector, contributing almost a quarter of total UK GDP – more than double the contribution made by the FTSE 100.
- Family Businesses are estimated to have contributed £81.7 billion in tax receipts to the UK Exchequer in 2010, 14 per cent of total government revenues in that year. FTSE 100 firms contributed £56.8 billion, only 11.9 percent of 2010 tax receipts.

The family business sector has always been a strategic pillar of our national economy and many of the Family firms play a significant role in their local economies and communities. This sustainable strategy has been built on the responsible long-term stewardship of people and resources and is a incubator for entrepreneurship and future growth.

**2. Policy Recommendations**

**<u>2.1 Encouraging growth</u>**

[3] See [1], page 2

2.1.1 The tax treatment of debt and equity

**Recommendation:** HM Treasury conduct a review of the differential in tax treatment of debt and equity business financing with a view to levelling the playing field. HM Treasury should introduce the same tax deductable treatment for equity financing as currently exists for debt financing.

**Why it matters:** One major problem currently preventing UK business growth is the availability of finance as banks reduce lending in order to shore up their balance sheets. Businesses therefore turn to other finance streams. However, the current tax system skews financing towards debt funding, penalising firms who use equity and retention of profits to finance investment. This is particularly problematic for family firms and disadvantages them compared to other ownership models.

If a firm uses debt-financing, corporation tax does not have a negative impact on financing options. However, if a firm uses equity or retained earnings - corporation tax raises the cost of equity capital creating a significant disincentive for growth.

The recent Mirrlees Review conducted by the Institute for Fiscal Studies says that “Some corporate investment that would otherwise be viable is likely to be deterred by a standard corporate income tax.” At a time when growth is critical for the UK economy as a whole it is important to examine the details of how growth finance is treated by the tax system.

2.1.2 The Enterprise Investment Scheme

**Recommendation:** The connected persons’ test for the Enterprise Investment Scheme (EIS) should be removed to promote investment in family start ups.

**Why it matters:** A fundamental check on the growth of new business start-ups is the availability of finance for investment in growth. The EIS has proved highly successful with 76 per cent of business angels reporting they had used the EIS for at least some of their investments.[4] However, the connected persons’ test results in an active disincentive for non-connected family members to invest in start-ups with a family association.

Family Businesses are good incubators of the entrepreneurial talent. Start-ups are encouraged as incubators of innovation and often seek investment from non-employee family members. It is estimated that 13 per cent of family businesses are start-up spin-offs from an existing family firm[5].

In our view, investment by a family business owner in another family enterprise should attract the same relief as an investment by a family business owner in an enterprise outside the family. Such a tax simplification measure would be a further boost to innovation and enterprise.

The current system results in an active disincentive to invest in family connected businesses and is a barrier to potential investment that would help grow the UK economy. The connected persons’ test should be removed to create a level planning field for all investors. A survey of IFB members found 38 per cent of respondents said they would increase investment, or begin investment in family start-ups, if connected persons restrictions on EIS were lifted.

[4] HM Treasury, Financing business growth: The Government’s response to financing a private sector recovery, October 2012, P.16, http://www.bis.gov.uk/assets/biscore/corporate/docs/f/10-1242-financing-business-growth-response.pdf

[5] Global Entrepreneurship Monitor, Family Business Specialist Summary, 2006

## 2.2 Ensuring stability and sustainability

### 2.2.1 Business Property Relief (BPR)

**Recommendation:** Business Property Relief is maintained in full.

**Why it matters:** BPR is a crucial relief for family businesses. It facilitates the continuity of family business management and ownership between successive generations, allowing a long term approach which focuses on stability and sustainability.

In the absence of BPR, the family business ownership model would no longer be possible and the successful transfer of three million enterprises would be put at risk. Without such a relief the tax implications for any successful business on ownership of management transition would almost certainly require a sale, liquidation or substantial borrowing. Ultimately, the death of a major shareholder could bring a profitable business to an end.

The IFB welcomes HM Government's commitment to maintain 100 per cent BPR on inheritance tax, which is a highly significant plank of the Government's policy on business transfer. BPR prevents inheritance tax from becoming a tax on business and allows the family business model to coexist on equal terms with other forms of ownership such as private equity, multinationals and Listed PLCs.

### 2.2.2 Business Asset Holdover Relief (BAHR)

**Recommendation:** HM Treasury consults on introducing a single qualifying test to apply equally for BAHR and BPR. The new single test should be no more stringent than the current test for BPR.

**Why it matters:** BAHR and BPR both protect family firms from the danger of having to sell a business to pay a tax bill, such as capital gains or Inheritance Tax when no cash disposal is intended or planned. However, to qualify for these reliefs firms must pass different "trading" tests, creating confusion and difficulties for family businesses. The different tests for BAHR and BPR restrict the use of these reliefs and their potential benefit to family businesses.

BAHR is only available if a business contains more than 80 per cent trading activities. In contrast the BPR position, which refers to a business being 'wholly or mainly' trading, effectively imposes the requirement that in order for BPR to apply to shares in an unquoted trading company, the company must undertake at least 50 per cent trading activities and the application of this test is not always clear.

Simplification would increase the understanding of the two reliefs, reduce bureaucracy and help ensure smoother succession planning for family businesses. Without this change there is the treat that family businesses will fail in greater numbers.

2.2.3 Trust taxation

**Recommendation:** HM Treasury should review the tax treatment of Trusts so that sensible succession planning can take place over extended periods.

**Why it matters:** The transfer of management responsibilities between generations tends to be a gradual and ongoing process - taking place as younger generations mature. Trusts have proved an important facilitator in this process and can ensure a smooth transition of management and ownership between generations in a flexible and controlled manner. Trusts are also helpful in cases where ownership is divided between numerous persons or generations.

The IFB agrees with the policy objective set out by HM government in its 2004 consultation document, Modernising the Taxation of Trust, for a tax system for trusts which does not provide artificial incentives to set up a trust, but equally, avoids artificial obstacles to using trusts where they would bring significant non-tax benefits.

However the current tax treatment of trusts is creates a disadvantage to putting assets into Trust. This can create a desire to gift business assets inappropriately to a minor child or young adult, rather than planning for gifts to be made through a Trust at an age the responsibility of ownership, management and strategy is more appropriate.

**3. Concluding comments**

The IFB is eager to work with HM Treasury on the range of issues discussed in this submission in order to create an efficient, pro-growth, sustainable tax system where family businesses continue to play a significant role in driving growth in innovation and enterprise. If you need any further information on the recommendations outlined above, please do not hesitate to contact me.

Yours sincerely,


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