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

29th January 2016

Dear Chancellor,

The family business sector in the UK now comprises some 4.6 million businesses. From micro start-ups to worldwide brands the innovation, agility and resourcefulness of family owned firms is second to none.

By their very nature family firms take a long-term view, built on long-term stewardship of people and resources. They act as incubators for entrepreneurship, future growth and employment. In the UK almost 12 million people are now employed by family owned businesses.

The family business sector is a great British success story, it generates a quarter of UK GDP and has a turnover of £1.3 trillion – it numbers some of Britain's largest, leading and most trusted companies and is the UK's Mittelstand. Over half of all mid-sized businesses are family owned, and one in ten large businesses are family firms – those large and mid-sized firms employing nearly 3 million people between them. At the other end of the business scale family run firms also make a phenomenal contribution – 74% of micro firms (1-9 employees) are family owned, as are 61% of small businesses.

Despite the enormous contribution which they make, many of those running family firms feel that their hard work and commitment to sustainable business practices isn't recognised and championed by Government. The recommendations in this submission reflect the unique challenges which family business owners encounter.

This submission highlights particular policy recommendations which can support family firms as they encounter periods of transition in their business life – finding funding for sustainable growth, developing export markets and fostering a long term vision for growth over generations.

The Institute for Family Business is the UK's family business organisation, supporting and promoting the UK family-owned business sector through events, networking, representation, thought leadership and research. Our members have a combined turnover of £100bn, and employ around half a million people. We would welcome the opportunity to meet and discuss the issues raised in this submission in more detail. If you need any further information on the recommendations outlined above, please do not hesitate to contact us.

Yours sincerely,

Peter Armitage
Chairman

Supporting Long Termism in Business

Family firms exemplify long termism and sustainability in business. They don't obsess about quarterly results, rather they look at business decisions over the long term to build businesses which will continue to be successful for generations to come.

This long term outlook requires a level of clarity and certainty in the regulatory environment in which they are operating, and a key issue within that is the tax situation when ownership of a family firm is transferred between generations of responsible owners.

Transitions within family firms – be they in the management or ownership of the business – are times of significant opportunity but also provide challenges. As an organisation we share knowledge and best practice of how to manage these periods of transition, but there is still more which could be done at an official Governmental level to increase knowledge amongst family firms of the resources available to them to support them in securing the long term future of their business.

Recommendation: Support smooth transition of ownership of successful businesses between generations, and maintain Business Property Relief (BPR) in full.

Why it matters: Without Business Property Relief, each time ownership of a business passed from one generation to another an IHT tax liability would be created, the implications of which would be that a sale, liquidation or indebting of the company would be required. This would distort the market by imposing a tax penalty on the transfer of family firms which is not paid by other businesses on transfer.

Ultimately, without BPR, the death of a major shareholder could lead to the end of an otherwise profitable business. BPR has a clear objective and purpose – it facilitates the continuity of family business management and ownership between successive generations, allowing businesses to develop a long term approach which focuses on stability and sustainability. Maintaining BPR is therefore essential to maintaining the family ownership model in the UK.

HM Treasury should also consult on introducing a single qualifying test to apply equally for Business Asset Holdover Relief and BPR, to reduce bureaucracy and help ensure smoother succession planning for family businesses.

Recommendation: 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, and trusts have proved an important facilitator in this process offering stability and structure.

However the current tax treatment of trusts creates an active financial disadvantage to putting assets into Trust. The result can be that inappropriately gifted assets are in the possession of a child or young adult before they reach an age where responsibility of ownership, management and strategy is more appropriate. The long-term effect of this could undermine the stability and continuation of many UK businesses.

Investing for Growth

Family firms are innovative and entrepreneurial by nature, thriving over generations by growing and adapting to modern markets. There are 16,000 mid and large sized family firms in the UK, amongst them many internationally recognised and well regarded companies and brands.

The recommendations below reflect the desire of family firms to grow and are designed to address some of the barriers which they encounter. Family firms turnover £1.3 trillion in the UK each year. Growth in the sector brings benefits to the whole UK economy, consumers, the exchequer and the millions who work for family firms.

Recommendation: Support investment in the growth of mid-sized businesses

Why it matters: There are over 15,000 mid-sized family businesses, over half of all mid-sized businesses in the UK. The government should extend the EIS thresholds to support investment in the growth of mid-sized businesses, taking the threshold to 500 employees (the same used for the small firms R&D tax credit) and increasing the investment limit. This will help firms grow further, and move from being mid-sized business to world-leading large firms.

Recommendation: Support sustainable business financing by equalising the tax treatment of debt and equity financing

Why it matters: Their long term focus means family businesses are prepared to sacrifice short-term gains to achieve their longer-term goals. As part of this, family firms plough profits back into their businesses rather than loading themselves with debt. The current tax system favours debt over equity financing. At a time when further growth is needed in the economy it is important to examine how growth finance is treated by the tax system. We recommend resolving this issue, and making progress in rebalancing the economy, by introducing the same tax treatment for equity financing as debt financing. This will allow businesses to make their investment decisions for commercial reasons and not tax advantage. It would also have the benefit of simplifying the tax code and the overall regulatory burden on business.

Family businesses have also expressed concerns to us about the recent proposals for changes to taxation of dividends, and the subsequent impact this has on the attractiveness of funding business through equity – and the potential to lead to volatility in long term shareholdings in family owned firms.

Equity funding supports and encourages decision making that enhances the long term competitiveness of business. This long term outlook means family firms are able to make large investment in new product lines, factories or in transforming underperforming companies - benefitting the wider economy through investment in productivity and employment. Undermining this could damage the firms themselves and the wider economy. We ask the Government to look closely at the wider impact of these proposals, in particular given the existing bias towards debt financing.

There are also concerns about the potential impact on those who own and manage small and micro businesses – the vast majority of which are family firms.[1]

Recommendation: Ensure pension deficit calculations are appropriate to family firms

Why it matters: The calculation of deficits for defined benefit pension schemes at present relies heavily on the use of interest rates linked to Corporate Bond yields. A function of this formulaic calculation is that even where family businesses are confident that they are able to meet the requirements of their scheme, the exceptionally low bond yields at present mean much larger pension deficits being forecast than are necessarily accurate.

[1] 61% of small firms, 74% of micro firms employing between 1 and 9 people. The State of the Nation: The UK Family Business Sector 2015/16, Oxford Economics and IFB Research Foundation.

As a result, family firms are forced into finding funds to 'plug' the calculated deficit, significantly reducing the funds available to invest in growth. This applies a considerable constraint on the ability of family firms to invest in increasing productivity, creating employment and moving into export. All this is sacrificed, whilst at the same time the system provides no practical benefit to the members of the pension schemes themselves. This particularly impacts on family firms which do not usually have the same access to capital markets as other ownership models. The Government, pension regulators and accounting bodies must work together to urgently address this issue.

Recommendation: Increase the finance options available to family firms to help them grow

Why it matters: The long term outlook of family firms is reflected in the needs they have when accessing finance to invest in their business. Family businesses need increased competition in the finance market with more options which are aligned to their long term outlook and don't necessitate sharing equity. In our recent survey around three quarters of family firms agreed that "Government should encourage greater competition and choice in business financing", with over half saying that "a lack of non-bank lending in the UK acts as a barrier to growth".

The Breedon Taskforce estimated that a UK private placement market could be worth £15bn. At present, whilst UK issuers account for nearly 21% of the global private placement market, because the UK market is underdeveloped, UK businesses look to the US for this type of financing.[2]

The IFB is working with industry bodies to support growth and awareness of the options available through Private Placement Markets and investment from insurance and pension lenders; however more support is needed from Government to increase awareness of these alternatives to bank financing and to develop the UK investor base for private placements.

Creating More Family Firms

Between 2010 and 2014 an estimated 1 million new family businesses were created – start-ups by enterprising families. Whilst many of the country's most successful family firms are centuries old, family ownership is still a relevant, popular and sustainable business model.

During the last Parliament there was a focus on increasing the number of start-ups and encouraging entrepreneurship. All too often the advice to these business owners is concentrated on how they can build a business which, once successful, can be sold. We believe a better balance should be introduced, promoting the benefits of building a sustainable business for the long-term and highlighting advice and support for business owners to help them achieve this.

We would encourage the Government to work to promote and discuss the benefits of the family business model for business owners, and to provide advice to support them as they go through the transition from start up to established family firm.

Recommendation: Unlock more investment in start-ups by removing the Connected Persons' Test for EIS

Why it matters: A fundamental check on the growth UK businesses is the availability of finance for investment in growth. While the EIS has proved highly successful with business angels, the Connected Persons' Test results in an active disincentive for otherwise non-connected family members to invest in

[2] Breedon Taskforce Report, March 2012: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/32230/12-668-boosting-finance-options-for-business.pdf

start-ups with a family association. Family businesses are excellent incubators of entrepreneurial talent – with an estimated that 13 per cent of family businesses starting as spin-offs from an existing family firm[3].

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. HM Treasury should consider lifting the Connected Persons' Test for a temporary period in order to encourage increased investment in new businesses.

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