HMRC Consultation: Company Distributions
Institute for Family Business Response

Introduction

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, generating a quarter of GDP and paying £125 billion in tax.

A healthy economy must be a balanced economy, and a thriving family business sector is an essential part of this mix. Their long term outlook rather than a focus on quarterly results, their commitment to local employment and communities, and to investing in sustainable and thriving businesses for the future, make family businesses a vital component of our economy.

As such Governments must ensure that legislation supports the family ownership model, and that legislation does not disproportionately impact and disadvantage family ownership over other types of ownership.

This proposed legislation, designed to address the behavioural changes the Government anticipates as a result of the changes to taxation of dividends, would cause severe unintended consequences to family owned firms, and risks interfering with the ability of shareholders to make the best commercial and investment decisions for the firm.

In particular because this consultation specifically addresses close companies it disproportionately affects family owned firms. Close shareholdings of responsible and engaged owners makes a business more secure in the long term. Not only do the shareholders uphold strong values, but it enables the business to pursue long term strategies, informed by engaged and insightful owners. This enables investment decisions to be made for the long term benefit of the firm, and the UK economy as a whole.

We would welcome the opportunity to discuss the concerns raised in this submission with officials in greater detail, and to provide further examples of the ways in which family firms use retained profits for investment, the way succession can be managed, and how future proposed changes would affect family firms.

Summary

This submission focuses on behaviour and activities of family firms, and the impact of the proposed changes on individual family businesses and the ownership model as a whole.

A thriving family business sector is an essential component of a healthy economy. With their long term outlook, strong values, active and responsible owners, and commitment to investment, family businesses are the backbone of our economy.

We are concerned about some of the proposals in this consultation, and the disproportionate impact measures which focus on those companies which retain profits, unquoted companies, and the transfer of shares between family members will have on family businesses.

We would welcome the opportunity to discuss the issues raised in the consultation document, and our response, with officials.

Disposal of shares to a third party

There are many commercial reasons why a family firm may retain profits by withholding dividends. Family businesses are highly represented amoungst cyclical industries (such as construction) and shareholders agree to profits being retained in order to ensure that the business can continue to operate in poor market conditions. Family firms also often prefer to fund acquisitions or investments in new product lines and services through reinvesting cash rather than borrowing. It better reflects their long term planning and outlook.

We are concerned about the interpretation of “main purpose” (section 3.6) and seek clarification on the definition of this, and how shareholders in businesses which are primarily accumulating cash for future investments and operating will be protected from this legislation.

Repayment of share capital

There are many valid commercial reasons why a business may want to restructure itself whilst it has retained profits. It is important to understand the behaviour of family firms and why they, in particular, tend to retain profits and the way that this money is then used within the firm.

Family firms retain profits because they take a long term outlook. This means that they focus on the long term sustainability of their business rather than a short term financial gain. As a result they may choose to make a large investment from retained profits, as the lending terms offered by banks and other lenders focus on repayment in 3-5 years, rather than the longer timeframes in which family firms operate.

Family firms are also disproportionality represented in manufacturing and other sectors which have capital cycles. Family firms retain profits in order to pay for capital investments to fund growth. This allows family firms to make investment decisions for the long term benefits of the firm and the wider economy.

Any measure which targets firms that retain profits will affect the ability of family firms to operate flexibly as others do, and thus penalise family firms disproportionately to other ownership models. We are happy to discuss this use of retained profits with officials, in order to provide examples of firms which have used this in practice.

Purchase of own shares (for unquoted companies)

Planning for a transfer of ownership between generations is an essential part of ensuring a family firm will continue to thrive for many years to come. Succession can take many forms, as families and businesses develop a process which is most suitable to their unique circumstances.

In many instances this will see owners gradually phase their withdrawal from the business as the next generation become more involved in the firm, as they perhaps step back from day to day management, or when they retire from the business entirely.

In these circumstances shareholders may be 'exiting' from some of their share, but still intend to remain a shareholder in the business. There are familial reasons and those of heritage to remain a shareholder, as well as financial reasons.

It is imperative that families, shareholders and businesses are allowed to manage the delicate issue of phasing succession in the business in a way that best reflects the long term needs of the business, and that they are not penalised unfairly in comparison to other ownership models for doing this.

There are other reasons why a shareholder may choose to divest of some of their shareholding whilst still retaining a significant share of the business. For example, a family member may need to realise some of the value of their shares, but still intend to remain involved in the firm. It is perfectly feasible and reasonable for a major shareholder to reduce their shareholding in the family business without wishing to bring in a third party.

Questions 1 and 2

The scenarios detailed in Section 3 do not recognise the legitimate reasons for which family firms retain profits, or the ways in which family firms are organised within family firms and how this affects how succession planning is phased.

We have serious concerns about the way in which the proposed changes will disproportionately fall on family business over other ownership models, and believe more investigation is needed of the impact of these changes – on family firms in particular – before they can be introduced to Parliament.

Introducing a "connected persons rule"

We are extremely concerned about the significant impact of these proposals on family business succession. As detailed above, as part of the sensible succession planning in family firms shares are sold to family members as shareholders phase their exit from the firm or reduce their involvement if they no longer wish to take a role as a responsible owner.

Close shareholdings of responsible and engaged owners makes a business more secure in the long term. Not only do the shareholders uphold strong values, but it enables the business to pursue long term strategies, informed by engaged and insightful owners. This enables investment decisions to be made for the long term benefit of the firm, and the UK economy as a whole.

Selling shares to the family is critical to succession. The proposed "connected persons rule" fundamentally undermines this and specifically penalises family owned firms. It introduces a specific tax disadvantage to keeping the shareholding within the family, and encourages the selling of shares to third parties instead – fundamentally undermining the family business ownership model, and the long term stability of the firms themselves.

More thorough study of the impact of this proposed change must be undertaken before any such rule is introduced before Parliament.

Proposed wider solutions

We would welcome the opportunity to discuss any further proposed changes with officials in order to ensure that the family business sector's behaviours and contribution are fully recognised, understood, and that no proposed solutions particularly disadvantage this important ownership model.

Regarding the reintroduction of close company apportionment in some form, this would also particularly disadvantage family firms and should not be considered. As detailed above family firms retain profits to invest in their business, thus creating employment and increasing productivity. Close company apportionment risks penalising firms which take a prudent approach, and those who look to long term investment in their businesses.

It is important to note that this draft legislation, and proposals for future action, have come about as a result of the Government's belief that behaviours will change as a result of the increased rates of Dividend Taxation.

Whilst we are supportive of measures to reduce sharp practices, these must be carefully balanced and researched to avoid unintended consequences for those acting legitimately.   Legislation should not be introduced to meet the 6 April 2016 deadline unless the consequences of the proposed changes are fully understood and Government are confident that the impact of these proposals will not fall disproportionately on the legitimate practices of family firms.

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