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Rt Hon Phillip Hammond MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
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Dear Chancellor,

IFB Autumn Statement Submission

Family business is the backbone of our economy, and the bedrock of our communities. In your first Autumn Statement family businesses are eager to see an agenda which reflects the needs of UK private business, recognises what makes these businesses different, and one that identifies the importance of a balanced economy where diversity of business ownership models is supported.

This submission also recognises the significant changes which have taken place in the UK since the Budget earlier this year, and highlights those areas in which family businesses need particular reassurance given the degree of uncertainty felt across the business community. In the wake of the EU referendum family businesses need stability and clarity, and the confidence to make investments decisions which will benefit growth for the long term.

The family business sector in the UK now employs almost 12 million people, generating a quarter of GDP and paying £125bn in tax. From micro start-ups to worldwide brands the innovation, agility and resourcefulness of family owned firms is second to none.

Sustainability, custodianship and long termism are the core values which unite family businesses. This long term outlook gives family firms the opportunity to invest in training their employees, and to innovate and develop new products, processes and services. Continuity within the businesses support innovation, investment and increased productivity. They also act as incubators for entrepreneurship, future growth and employment. Family businesses are ambitious to grow, to support strong communities and explore new opportunities. To ensure they are able to meet these ambitions it is essential the tax environment remains stable, giving them confidence to plan for the future.

Alongside the large number of growing entrepreneurial first generation family business, many family firms have been operating for hundreds of years and their longevity and enduring success are testament to their innovative and long term outlook. Family firms survive and thrive over generations by taking a long term and sustainable approach, whilst adapting to stay relevant to the modern world. Family firms turnover £1.3 trillion in the UK each year. Growth in the sector brings benefits to the whole UK economy, consumer, the exchequer and the millions who work for family firms.

Family businesses are found in all parts of the UK. There are almost half a million family firms in the East of England, over one hundred thousand in Northern Ireland, and over three hundred thousand in

Yorkshire. Over half of all mid-sized businesses are family owned, and one in ten large businesses are family firms. 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 responsible and sustainable business practices isn't properly recognised or championed by Government. The recommendations in this submission reflect the unique challenges which family business owners encounter, and highlight how Government can support this great British success story in building thriving enterprises for generations to come. This submission highlights particular policy recommendations which can support family firms as they encounter periods of transition in their business life.

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, and thought leadership. 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 we can provide any further information on the recommendations outlined in this paper, or on the family business sector as a whole, please do not hesitate to contact us.

Yours sincerely,

Peter Armitage
Chairman

IFB Recommendations

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 ensures they are often able to perform better during periods of economic downturn. In order to achieve this they require a stable tax system which supports their ambitions to grow and plan for the long term. This requires a level of clarity and certainty in the regulatory environment in which they are operating now, and how that will look in the future. Core to this is the tax situation around the transfer of ownership between generations of responsible owners.

Our members, and others within the family business community, have spoken to us about the uncertainty they feel following the EU referendum result. Whilst we understand there is still much to be decided in terms of our future relationship with Europe, it is important at this time that the Government aims to provide clarity and stability where they can.

Transitions within family firms – be they in the management or ownership of the business – are times of significant opportunity but also provide challenges. Ensuring that these successful businesses are able to plan and continue to thrive after an ownership transition is important not only for the owners, employees and communities which rely on those businesses, but the UK economy as a whole.

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 assert a commitment to maintaining Business Property Relief (BPR) in full.

Why it matters: BPR is a crucial relief from inheritance tax that facilitates the transfer of family management and ownership of the businesses between generations; allowing a long term approach which focuses on stability and sustainability.

Without Business Property Relief, each time ownership of a business passed from one generation to another an IHT tax liability would be created. In order to satisfy this liability the family business would require to be sold, liquidated or indebted. 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.

BPR means that when inheriting a share of the family business and successfully continuing the business the next generation of owners does not face a tax charge which they do not have the liquidity to fund. This policy has been highly successful and other countries in the EU have adopted a similar strategy.

Some 85,000[1] family SMEs are expected to transfer ownership of their business to a new generation each year. BPR affords these firms an option to plan for a stable succession while maintaining ownership

[1] Department for Business, Innovation and Skills, 2014 Small Business Survey

stability. It also plays a key role in ensuring that these small and medium firms can focus on scaling up their businesses. Around 64% of family SMEs are estimated to be first generation businesses[2]. Without BPR these family firms would lose the opportunity to grow under stable ownership and successfully transition to the next generation, as the firms would have to be partially liquidated or sold to fund payment of any IHT charge arising. Therefore, BPR is a significant pro-growth policy for business.

BPR is a positive example of how tax reliefs can support business growth. The introduction, and maintenance, of BPR gave business owners the confidence to focus their efforts on building their businesses and competing globally, rather than looking inwards and impeding growth to prevent risking the future of the business after their death. The introduction BPR took away the disincentive for families to grow their businesses, and subsequently continues to benefit the UK economy as a whole. Research currently being carried out indicates that the presence of BPR has a significant positive effect on family business behaviour and UK GDP.

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. At a time of significant economic uncertainty it provides family businesses with some of the stability they need to be able to continue to operate and plan for the future. BPR is therefore essential to sustaining the family ownership model in the UK and we hope that you will affirm your commitment to maintaining this important relief in full.

Recommendation: HM Treasury should consult on introducing a single qualifying test to apply equally for Hold-Over Relief and BPR, in line with the current BPR test.

Why it matters: Hold-Over Relief 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 Hold-Over Relief and BPR restrict the use of these reliefs and their potential benefit to family businesses.

Hold-Over Relief 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.

There are many legitimate reasons which may see a trading family business taken out of the 80 per cent trading activities, including the impact of economic conditions and natural business cycles. Successful family businesses also often choose to retain profits (to use for future investment in the growth of the business) and diversify risk into investment activity. Such assets including property can provide counterweight to funding riskier investments while enhancing the organisation and the strength of its balance sheet.

Because of the greater burden of the trading criteria for Hold-Over Relief this can mean that gifts of shares are not made according to a family business succession plan but are made for tax reasons sometimes hindering owners transmitting shares during their lifetime.

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[2] Praxity, 2015

Bringing the Hold-Over Relief qualifying criteria in line with BPR 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 threat that family businesses will fail in greater numbers.

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.

<u>Investing for Growth</u>

Family firms are innovative and entrepreneurial by nature, thriving over generations by growing and adapting to modern markets. There are over 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: Extend the EIS threshold to support growth in mid-sized businesses

Why it matters: There are over 16,000 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 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 consider 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.[3]

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. This has been exacerbated in the wake of EU referendum result as bond yields have further declined, and is likely to extend the timeframe needed for deficit recovery.

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 and explore ways to introduce a level of flexibility to the existing rules to ensure that the long term sustainability is not threatened.

<u>Creating Tomorrow's World Leading Family Firms</u>

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, to provide advice to support them as they go through the transition from start

[3] 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.

up to established family firm, and to focus on encouraging firms to take a more rounded view on success and what it means to be a responsible business. This includes investing in people, taking a long term outlook, and considering the social footprint of your business (including environmental and community engagement).

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 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[4].

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.

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