Treasury Select Committee Tax After Coronavirus Inquiry
Institute for Family Business Response

Summary

During these challenging economic times, it is essential that businesses are supported to invest and grow by the tax system. Businesses need a system that provides them with stability and confidence to recover and plan for the future.

Whilst we recognise that there may well be a need for changes in the rates of tax, and to the overall tax system due to the money spent to combat COVID-19, our submission focusses on how the tax system can provide this much needed stability and confidence to family owned businesses.

Family owned business thrive when they have a level of clarity and certainty in the regulatory environment in which they are operating, along with a clear understanding of how that will look in the future. Central to this is the tax situation around the transfer of ownership between generations of responsible owners. In particular, we believe that it is essential that:

1. **The Government reaffirms its commitment to maintaining Business Property Relief (BPR).** Specifically designed to facilitate the transfer of family businesses from generation to generation, Business Property Relief (BPR) is a relief that provides business owners with the confidence needed to support business growth and provide stability. At a time when stability and growth are both needed in order to support the economic recovery, changes to the BPR regime would harm both investment and employment by family businesses across the country.

2. **The Government also maintains Business Hold-Over Relief (HR) in full.** This relief helps family businesses by preventing businesses from being sold to pay a tax bill where no cash disposal is intended or planned. Ensuring that the relief remains in place, while also reforming the current eligibility tests to bring them in line with BPR would help ensure smoother succession planning and provide businesses with the additional support they need during this crucial period.

3. **The tax regime continues to recognise the importance of Trusts for family business in planning for effective succession.** Trusts can help in the succession planning process for family businesses, and allow for transitions to take place while ensuring stability in ownership and management. Not driven by tax incentives, use of trusts are instead linked to a range of other factors while also bringing new skills and oversight through trustees.

About Family Business

Family business is the backbone of our economy and the bedrock of our communities. In the UK, family firms generate a quarter of GDP and employ over thirteen million people.

By their very nature, family businesses take a long-term view, building on long-term stewardship of people and resources. Their commitment to passing something on to the next generation is locked into their corporate DNA.

The family business sector is extremely diverse. From micro start-ups to worldwide brands the innovation, agility and resourcefulness of family owned firms is second to none. Family businesses are found in all parts of the UK. Growth in the sector brings benefits to the whole UK economy, consumers, the exchequer and the millions who work for family firms.

A Tax System Which Supports Family Business

As lockdown restrictions continue to lift and attention turns to the UK's economic recovery from COVID-19, there is an opportunity for business and policy-makers to forge the future of our economy, working together to maintain and implement long-term policies focused on regional growth, investment, good jobs, and responsible business practices.

Within this context, ensuring the continued and sustainable growth of family businesses not only brings benefits to the whole economy, but to consumers, employees and the Exchequer too. Crucial to this will be ensuring the delivery of a tax system and wider tax environment which supports and encourages growth for businesses across the country, while also ensuring that businesses are given the short term stability and confidence to return to their usual operations. This means working with business to ensure that effective tax reliefs are maintained, with best practices of businesses promoted in the process.

Of particular significance to family businesses are Inheritance Tax (IHT) and Capital Gains Tax (CGT). In the context of successful succession planning, for most families these taxes are inextricably linked. Although often viewed as personal tax issues, both these taxes have a significant impact on how family businesses transfer between generations. These transitions – 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.

This long-term outlook ensures family owned businesses are often able to perform better during periods of economic uncertainty. 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.

While CGT and IHT fall under the personal taxation regime, the reality is that the cost of paying any liability would fall on the business, as the individual shareholders will frequently not have enough assets outside the business to meet the tax change. Addressing this challenge directly, the current regime of Hold-Over Relief and Business Property Relief has allowed family businesses to compete on a level playing field with businesses in the UK under different kinds of ownership.

1. Allowances, Exemptions and Reliefs

Business Property Relief (BPR)

BPR is a positive example of how tax reliefs can support business growth and help to facilitate the transition of businesses from one generation to the next. Some 85,000 family SMEs are expected to transfer ownership of their business to a new generation each year, and BPR affords these businesses an option to plan for a stable succession while maintaining ownership stability.

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

This would have a knock-on effect on employment and investment. BPR has allowed family businesses to compete on a level playing field with businesses in the UK under different kinds of ownership, and foreign businesses (family owned or not) for which IHT is not a concern.

Businesses which were required to sell all, or part of, the business in order to meet the IHT charge, or those that paid extraordinary or additional dividends to shareholders to do this, would also face significant double taxation. If a dividend payment was made, this would mean the individual would face a tax charge on the dividend in addition to the 40% IHT charge. This would see even more money – which could be used for investment in growth – taken out of the business to cover the dividend and IHT charges. Where businesses were sold, as a whole or in part, they would also incur a CGT charge

The introduction of BPR also took away the disincentive for families to grow their businesses, and subsequently continues to benefit the UK economy. The impact of a possible future IHT charge on family business confidence and ability to invest would be significant whatever the rate of IHT at the time. And the challenges around the illiquidity of family business owners estates and assets would also remain regardless of the rate.

The importance of BPR has been reaffirmed by HM Treasury. In the response to the Patient Capital Review, the Government stated “BPR plays a valuable role in preventing the breakup of otherwise viable businesses purely in order to meet IHT liabilities […] and is committed to protecting the important role that this tax relief plays in supporting family-owned businesses[1]”.

[1] Financing Growth in Innovative Firms: Consultation Response, HM Treasury, November 2017

<u>Business Hold-Over Relief (HR)</u>

Not all transfers of family business occur at death – many business owners phase their departure from the company. This is both a sensible and efficient part of planning management and ownership succession. For these transfers made before death, business owners may be eligible for HR from CGT.

As with BPR, HR protects family businesses from the danger of having to sell a business to pay a tax bill when no cash disposal is intended or planned. However, to qualify for these reliefs, firms must pass different "trading" tests, creating confusion or difficulties for family business. The different tests for HR and BPR restrict the use of these reliefs and their potential benefit to family businesses.

HR 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 HR 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.

The current test acts as a significant disincentive to family business owners planning and executing a phased and efficient succession plan. **We believe this is an area which the Government should address, by bringing the HR qualifying test in line with the BPR test.**

Bringing the HR qualifying criteria in line with BPR would increase the understanding of the two reliefs, reduce bureaucracy, help ensure smoother succession planning for family businesses and ultimately increase the number of family businesses continuing to thrive for generations to come.

At a time of significant economic uncertainty Business Property Relief and Hold-Over Relief provide family businesses with some of the stability they need to be able to continue to operate and plan for the future. Changes to the BPR regime would harm both investment and employment by family businesses. We understand that the Government must continue to ensure that tax policy is fit for purpose, and we are supportive of measures to reduce sharp practices. However this must be carefully balanced and researched to avoid potentially disastrous unintended consequences for those acting legitimately

Taxation of Trusts

Trusts can help in the succession process in family businesses and enable the transfer of management responsibilities to be brought in gradually, smoothly and selectively in the context of family members' skills, competencies and interests. Trusts allow general transitions to take place while ensuring stability of ownership and management.

Tax is not a driver for family businesses to use trusts – the 2006 changes mean that using trusts is now tax inefficient, and further tax burden should not be added to these. The reasons family businesses use trusts to hold shares and business assets are not tax driven, but rather linked instead to long-term decision-making, separation of control and benefit, fairness and protection of vulnerable family members. Trustees also bring new skills and oversight to a family business, which support stability and a long term view that promotes the interests of the business, its staff, customers and suppliers.

2. About the Institute for Family Business

The Institute for Family Business (IFB) is the UK's family business organization. Our members include some of the most successful, world leading, businesses in the country. Together they employ over half a million people and have a combined turnover of £100 billion annually, and work across the whole UK in every region, and every sector. We work with family businesses to help them build better and stronger business for future generations of their families, employees and communities.

We work closely with family firms to support them in growing their enterprises for generations to come. A central part of our work is to provide educational resources and knowledge-sharing designed to support business owners and those who work in family business. We aim to champion best practice within the family business community and help others to learn from these examples.

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