Institute for Family Business

Rt Hon Rishi Sunak MP
Chancellor of the Exchequer
HM Treasury
1 Horse Guards Road
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Dear Chancellor

I am writing to outline the Institute for Family Business' (IFB) priorities for the upcoming Budget. The IFB is the UK's largest family business organisation, supporting and promoting UK family-owned businesses to help them continue to be successful for generations to come. Family businesses are the backbone of the UK economy, generating a quarter of our GDP, employing more than 14 million people and contributing £196 billion in tax.

IFB's Recommendations

1. Support confidence, stability and future investment in family businesses by maintaining Business Property Relief (BPR) in full.
2. Support succession transition planning in businesses by aligning Holdover Relief (HR) eligibility with BPR.
3. Update the conditions for both Holdover Relief and Business Property Relief to ensure businesses with Joint Ventures aren't penalised.
4. Support greater sustainable long-term investment through targeted incentives and allowances.
5. Launch Patient Capital Review part two.
6. Prioritise greater support and focus on mid sized firms.
7. Help young people get back into work, and improve the apprenticeship system.

Last year's Budget took place at the very start of the Coronavirus pandemic. In the weeks that followed that statement the situation for families and businesses changed rapidly. We are proud of the way the family business sector with its long-term approach responded to the crisis and the resilience they continue to demonstrate; quickly adapting how they work to keep their employees and customers safe, changing how they operate when they could not open as usual, and supporting their local communities during difficult times. The support made available to businesses in the form of grants, loans and the job retention schemes, was welcomed by family businesses, and helped many of our members during these difficult times.

A year later as we approach the 2021 Budget, many businesses have again had to close for an indeterminate period, while those which can continue to operate do so despite many challenges. Over the past year these family businesses have faced enormous pressure, investing heavily in keeping their employees and customers safe, while facing changing restrictions, changing support, and for many their cash reserves of a year ago have been seriously depleted.

With vaccines now being administered there is light at the end of the tunnel. And a speedy and effective rollout must be the Government's priority, to ensure we can get back to a more normal life as soon as possible.

In the meantime, it is critical that the Government commits not to make changes to existing tax structures and design which could hamper confidence and investment in both the short and longer term. Amidst the uncertainty of COVID, providing certainty around the tax regime is important. Short term taxation changes will make little impact on the level of debt incurred during this crisis, but changes now would be highly damaging to businesses ability and confidence to rebuild and invest in a way that will deliver sustainable future growth. The priority right now must be on supporting and incentivising sustainable investment, which will help our economy to grow and create the wealth needed to reduce the long-term debt burden.

While we are still not out of the crisis, and businesses will continue to need support during ongoing restrictions, this Budget should also focus on how we will 'build back better'. This is an important moment for businesses and policymakers to come together to set out how we can repair the economic damage caused by the crisis, and look to build a robust and growing economy that delivers benefits across the whole of the UK for years to come. The road to recovery will be long, but the family business sector is well placed to play a central role, and is ready to do so.

We believe that to effectively rebuild there are two important elements that need to be addressed:

- **Stabilisation** – No conversation can be had about growth without addressing the stability that businesses need to survive. These are extremely uncertain times for business, with many having to make difficult financial and operational decision regarding their future. As part of the road to economic recovery, businesses need the confidence that they can start doing business again, accepting that it may require new and innovative ways of working. That includes confidence in how that are expected to operate, but also a tax system which enables them to rebuild and invest.

- **Growth** – The Government must also look at how to stimulate investment as a means of achieving future economic growth. In particular, the Government must use all the levers at its disposal to help stimulate capital investment, investment in new jobs and investment in skills. As you look to level up the country and target regional growth, we also need to take a strategic approach to supporting mid-sized businesses which play a hugely important role in our country but often seem to be overlooked in policy.

The long-term outlook of family businesses ensures they are often able to perform better than others during periods of economic uncertainty. However, in order to achieve this, they require a stable tax system which supports their ambitions to invest, grow sustainably and plan for the future. This requires clarity and certainty in the regulatory environment in which they are operating now, and how that will look in the future. Central to this is the tax situation around the transfer of ownership between generations of responsible owners.

Recommendation One – Support confidence, stability and future investment in family businesses by maintaining Business Property Relief (BPR) in full.

Transitions within family firms – be they in the management or ownership of the business – are times of significant opportunity but also presents 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.

Business Property Relief (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 be required to be sold, liquidated or indebted. This would distort the market by imposing an additional tax penalty on the transfer of family firms which is not paid by other businesses.

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 have adopted a similar strategy.

Whilst IHT falls under the personal taxation regime, the reality is that the cost of paying the liability would fall on the business, as the individual shareholders will in the vast majority of cases not have enough assets outside of the business to meet the tax charge. 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 subject to a full or partial sale in order to meet the IHT charge, and those that paid extraordinary or additional dividends to shareholders to do this, would also face significant double taxation. If a dividend payment were 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 Capital Gains Tax (CGT) charge.

BPR is a positive example of how tax reliefs can support business growth. The introduction, and maintenance, of BPR has given 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 of BPR took away the disincentive for families to grow their businesses, allowed family businesses to grow 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.

Some 85,000 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 stability. It also plays a key role in ensuring that these small and medium firms can focus on scaling up their businesses. Around 77% of family SMEs are estimated to be first generation businesses. 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 for the business owners. Therefore, BPR is a significant pro-growth policy for business.

Ultimately, without BPR, the death of a major shareholder could lead to the end of an otherwise profitable business, and associated job losses. 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. 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 by affirming your commitment to maintaining this important relief in full you will provide family business owners with additional confidence to invest in recovery and future growth.

Recommendation Two – Support succession transition planning in businesses by aligning Holdover Relief eligibility with BPR.

Not all transfers of family business occur at death, and some business owners will phase their departure from the company, often passing part of the of the business ownership to the next generation upon retirement or as part of a phased transfer to the next generation. This is both a sensible and efficient part of planning management and ownership succession in a business. For transfers made before death, business owners may be eligible for Business Assets Holdover Relief from Capital Gains Tax (CGT). Both Business Assets Holdover Relief and Business Property Relief (BPR) protect family firms from the danger of having to sell a business to pay a personal tax bill when no cash disposal is intended or planned. It also ensures family businesses do not have to hold cash aside for future tax bills and can instead continue to reinvest profit into the business.

However, to qualify for these reliefs firms must pass different trading tests, creating confusion and difficulties for family businesses. The different tests for Business Assets Holdover Relief and Business Property Relief can act as a barrier for some businesses in executing an efficient ownership transfer during an owner's lifetime. Business Assets Holdover Relief is only available if a business contains more than 80 per cent trading activities. In contrast the BPR position refers to a business being 'wholly or mainly' trading, the company must undertake at least 50 per cent trading activities.

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. Certain types of businesses are also more likely to be taken out of the 80 per cent threshold, whilst still being trading businesses (e.g. pub and brewing companies). Successful family businesses also often choose to retain profits (to use for future investment in the growth of the business) and invest in physical or counter-cyclical assets. Such assets, including property, can provide the balance sheet strength that enables investment in new ventures that may otherwise be considered too risky.

Because of the greater burden of the trading criteria for Business Assets Holdover Relief this can mean that gifts of shares are not made according to a desirable family business succession plan but are instead delayed for tax reasons sometimes hindering owners transferring shares during their lifetime. This can create a disconnect between the interests of the owners and the interests of the business, slowing sustainable economic growth and innovation by the next generation.

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Bringing the Business Assets Holdover Relief qualifying criteria in line with BPR would increase the understanding of the two reliefs, reduce bureaucracy and unnecessary costs, help ensure smoother succession planning for entrepreneurs and ultimately increase the number of businesses continuing to thrive for generations to come. It is essential that any changes must not restrict availability of either relief, as this would have serious implications on family business investment and growth.

Recommendation Three - Update the conditions for both Holdover Relief and Business Property Relief to ensure businesses with joint ventures are not penalised.

More businesses are now also likely to fall into the category of not qualifying for Business Assets Holdover Relief or Business Property Relief because of the way in which joint ventures are treated when calculating trading tests. This is an area of particular concern when looking at how businesses will recover from the pandemic or explore opportunities to trade on the global stage. In relation to both Holdover Relief and Business Property Relief the legislation has not moved to reflect now common business practices.

Businesses will enter joint venture arrangements for a variety of reasons. If family members directly held the investment in the joint venture, and it was relevant business property, it would be eligible for relief. However, if the holding company owns an interest in a joint venture and the size of the joint venture is greater than the original business (as can be the case if the project is commercially successful) then the holding company might be considered to be holding investments (therefore excluded from reliefs). Generally family businesses also prefer to be involved in joint ventures at a practical level, not just as a silent investor. We believe this is an area which needs to be addressed.

Feedback from the IFB's membership strongly suggests that business is being held back by uncertainty on this issue in relation to IHT, and we believe the same is true in relation to CGT. The difficulty in receiving guidance from HMRC or achieving pre-clearance also causes issues for those running businesses. In light of the UK's withdrawal from the European Union and the Coronavirus pandemic, joint ventures are likely to be increasingly attractive to businesses, as businesses look into developing new opportunities and relationships for growth.

Joint ventures provide an attractive route to new markets for businesses who are looking for local partners who can provide resources and expertise – particularly when undertaking foreign expansion, as a means to reduce the initial risk. It is therefore important that this issue is resolved, so that family businesses can make plans to grow their businesses and seek out new opportunities, feeling confident they are not risking the future succession of the business.

Recommendation Four – Support greater investment through targeted incentives and allowances.

On investment, the Government must look at how it can support businesses to invest in themselves and the future. For many, the money they had planned to use for investing in their business has been used to keep them going through the past year. Others have taken on significant debts. We therefore need measures which help lower the cost of entry for investment, in both people and capital expenditure. This approach would help recovery, productivity improvements, and good quality job creation.

The Government should therefore look at incentivising investment through targeted allowances. For example, extending the capital expenditure which is eligible for First Year Allowances. The increased Annual Investment Allowance – the timeframe for which was recently extended – should also be made permanent.

In line with the family business sectors strategy for long term sustainable growth targeted incentives for green investment should also be supercharged, to support the ambition to 'build back better' and greener.

Recommendation Five – Launch Patient Capital Review part two.

Family firms have a unique ownership model which, at its best, sustains and promotes long-term stewardship balancing the management of resources in the short, medium and long-term. They embody long term investment and patient capital. They tend to be less driven by short-term financial results which allows them to align the deployment of resources with their strategic objectives. A parallel exists with the German Mittelstand where profit maximisation is not the exclusive business goal. Investment, long-term sustainable growth, and commitment to their local community are generally prioritised.

The long-term outlook of family firms influences their needs when accessing finance to invest in their businesses. For example, families seek investment options which do not require them to give up equity in the business, as this is unattractive to some family business owners as it dilutes the family ownership and can introduce shareholders who may not share the same core values. They are also unlikely to look to public markets to raise finance, as keeping the business private allows for longer term planning, rather than focusing on quarterly reporting, which is essential for their sustainable economic growth.

Family businesses also typically have lower rates of borrowing than non-family firms. 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 reinvest profits back into their businesses rather than loading themselves with debt. One consequence of the average low leverage in the sector is that during the last recession there were lower comparable failure rates for family firms.

The Government's Patient Capital Review in 2017 focused on long term funding options for 'innovative, high growth companies'. It did not address the availability of long-term funding for other types of businesses. As they look to rebuild, create jobs, and invest in green technologies family firms will be need funding. Now is the time to fix the historic gaps in the funding landscape to ensure that businesses of all sectors, sizes and locations can invest in their futures. We call on the Government to consider opening a second Patient Capital Review with a broader remit, to build on the work of the first report.

Recommendation Six – Prioritise greater support and focus on mid-sized firms.

Mid-sized businesses will be a key component in our recovery and future growth. There are over 17,000 mid-sized family businesses, over half of all mid-sized businesses in the UK. In the North East there are nearly 500 of these businesses, and in the North West over 1800. Empowering these businesses and supporting investment would see significant economic and employment benefits in their communities. Supporting their growth is an opportunity to transform the business landscape in the UK, enabling them to take the step from regional player to international competitor.

The UK needs a strategy which addresses the needs of mid-sized businesses and supports mid-sized business growth. These businesses are often overlooked in policymaking, with the focus either on very large or small businesses. These firms – the UK's Mittlestand – have huge potential, which needs to be harnessed as we look to build a stronger economy at both a national and regional level.

To stimulate additional long-term investment in mid-sized businesses the government should extend the EIS threshold to support investment in the growth of mid-sized businesses, taking the threshold to 499 employees (the same level as for knowledge intensive companies) and increasing the investment limit. This will help firms grow further and move from being mid-sized business to world-leading large firms.

The Government should also launch a cross departmental review of how all areas of business, employment and tax policy affect mid-sized firms, and how the burden on these engines of growth can be reduced. The current definitions mean a business with 300 employees is currently subject to most of the same regulations and administrative burden as a business with 13000 employees. This acts as a major barrier to growth, eating up time and money that could be dedicated to scaling up. Identifying these barriers would be an important step forward in empowering these businesses to grow and create more high-quality jobs.

Recommendation Seven – Help young people get back into work and improve the apprenticeship system.

Family businesses have a generational outlook and are acutely aware of the need to support and build opportunities for the generations following them. Family business owners are particularly concerned about the impact this crisis has had on young people, who are more likely to have lost their jobs. Creating opportunities for young people and supporting them in getting back to work must continue to be a key priority for the Government. In addition to the measures already announced, the Government should reduce or remove employer NICs for people under 25.

We also believe more still needs to be done to make the apprenticeship system work for employers and young people. The Apprenticeship Levy system should be overhauled to allow businesses to use a portion of their pot on in house training. And there is a need to develop a more coordinated approach between the different systems in each nation to ensure training and apprenticeship are delivered where they are most needed, not where a business happens to pay most in Levy payments.

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As the Government looks to support growth and develop opportunities across every part of the UK, family businesses have an essential role in delivering this ambition. Family firms are the driving force across all regions, communities and sectors of the UK. Well over 80% of businesses in Yorkshire, the North West and the Midlands are family owned. In those regions alone family firms employ nearly four and a half million people.

This Budget must focus on what needs to be done to ensure businesses can recover from the pandemic, and support them in making the decisions and investments which will lead to sustainable growth. Only through long term growth can we create new jobs to replace those that have been lost, and generate the wealth to reduce the debt burden long term. Growth – through investment – must be the priority, not tax changes which will damage confidence and recovery.

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

Andrew Osborne
Acting Chairman