



The Importance of Business Relief for Family Businesses

The majority of British businesses are family businesses. They range from multinational, multi-billion turnover businesses to micro start-ups. The sector employs around 14 million people across the UK and makes an enormous contribution to the UK economy.

Family firms thrive across generations by innovating, adapting and exploring new markets and opportunities. They make investment decisions for the long term, often reinvesting from retained profits bringing stability and certainty.

To achieve this, family business owners require a stable policy and tax system which supports their ambitions to grow and plan for the long term. Given a supportive policy environment family businesses flourish and, the stability offered through their long-term approach, means they often perform better during periods of economic uncertainty.

To enable family businesses to thrive and grow Business Relief – also known as Business Property Relief (BPR) - is essential.

Family businesses are the backbone of our economy. The sector makes up 90% of all private sector firms. They are rooted in their communities putting people at the heart of their business.

Family business owners are motivated by a desire to pass on the business to the next generation in a stronger state than they themselves inherited it. They feel a sense of responsibility to future generations, their employees and the communities in which they operate.

Key to ensuring family businesses can be passed seamlessly to the next generation is Business Relief – sometimes called Business Property Relief (BPR), which forms part of the Inheritance Tax regime. Business Relief allows family business owners to confidently make succession plans without family members or the business being penalised.

Removing Business Relief potentially puts family businesses, along with thousands of jobs, at risk.

Family Business UK is particularly concerned by reports the new Labour Government may change or remove Business Relief. We know that jobs and growth are the priority of all major parties. Removing Business Relief would run contrary to this effort.

BPR is a positive story of how tax reliefs can support business growth. Since its introduction in 1976, BPR has given business owners the confidence to focus their efforts on building their business and competing globally, which is one of the fundamental reasons that successive Governments have sought to retain the policy.

The Office of Tax Simplification's review of Inheritance Tax acknowledged the importance of BPR in ensuring businesses survive when passing between generations.

Given its longevity, BPR is well understood by family business owners enabling them to plan the seamless handover of the business from one generation to the next.

By their nature, family businesses have few shareholders meaning shares and assets held by family members are illiquid. Typically, between 80%-90% of the value of those shares / assets are retained within the business. There is often little or no market for them, making them hard to value.



Consequently, without BPR, shares passed as a result of the death of a family member would mean the Inheritance Tax liability would likely be borne by the business itself. This could require the entire family business, or various assets to be sold, liquidated or broken up to raise the money to pay the charge.

This would have a knock-on effect on employment – potentially putting at risk the jobs of hundreds or thousands of working people.

Prior to the introduction of BPR, family businesses were forced to limit their growth. BPR takes away the disincentive for families to grow their businesses, invest and create new jobs. Subsequently, it continues to benefit the UK economy as a whole.

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 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.

A worked example can be found below which demonstrates the vital role Business Relief plays to family firms across the UK:

- A medium sized 2nd generation family business employing 100 people, working in logistics has a turnover of £25m p.a. with EBITDA of £4.5m p.a. The founder is working in the business alongside son and daughter, all in board roles being paid modest salaries, low leverage max 20% of turnover on rolling credit facility.
- Shares held by founder and his wife will be left to the son and daughter equally on their deaths with some lifetime gifting anticipated planning ahead for succession by the son and daughter. The succession plan will enable business stability and the bank requires forward planning on who will own and control the business in the event of the founder's death or incapacity.
- The founder dies unexpectedly and the shares pass to the children directly, their mother has a pension and/or retains some shares to provide her with an income and retains the family home.
- With BPR the business can continue as normal albeit the death of the founder is disruptive, but the son and daughter can build their profile as the new joint leaders of the business without an immediate concern over financing a large tax bill or with their relationship with their bank.
- Without BPR, the business may have instalment option available to them so the tax can be paid off over 10 years. Interest is charged at the HMRC rate of 7.75% which is more than their bank would charge. The tax bill is assessed at 40% of the market value of the whole business which at 5 x EBITDA will be £22,500,000 – therefore the tax bill is £9m in total.
- That tax bill has to be paid by the beneficiaries whether from their own funds or the estate. The latter is far more likely to be the source of funds – very few family business owners have substantial liquid assets - they tend to keep their businesses well capitalised rather than taking out profit to fund their personal wealth or lifestyles.



In order to fund the tax bill, the business would have to

- (a) Declare a dividend grossed up for the income tax due on the income at 39% so a dividend of c £15,000,000 would have to be paid. That business and the family is highly unlikely to have that money available so borrowing or using the instalment option will be the most obvious way to pay the tax.
- (b) In terms of interest on borrowing they will pay currently 6% plus in bank interest per year (with HMRC rate at 7.75%),
- (c) An annual dividend would have to be declared to pay that interest grossed up to £900,000 to £1.16m.
- (d) The instalments will be c.£900,000 pa plus the interest on borrowing of £900,000 to £1.16m per annum for 10 years.
- (e) The overall cost to the family will be £18m to £20.6m against an IHT bill of £9,000,000.

At that point it is likely the business would have to either be sold or bring in outside investment which would remove the benefits of being family run as to longevity, stability, long term employee retention rates and so on. They are unlikely to regard the cost of the tax bill as being one the business could simply absorb and carry on as usual.

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