Budget 2019 – a family business wish list

By Siobhán Baldwin and Teresa McColgan, PwC

In the run-up to Budget 2019, tax director and tax partner in PwC's Family Business group, Siobhan Baldwin and Teresa McColgan, suggest a wish list for family businesses.

Against the backdrop of a changing international tax environment, the number of challenges facing family run businesses appears to increase with each passing year. Family businesses need to be operating in a business environment with tax certainty and we hope that Budget 2019 will address a number of the key challenges currently facing them.

Financing

Many new businesses are established as family businesses, and even with long established family businesses, innovative NextGens (the next generation of the family) are increasingly establishing their credibility within those businesses by establishing their own ventures. Some of these new ventures may be closely aligned to the existing family businesses while other families seek to bring their businesses in new directions while both limiting initial risks and facilitating NextGen entrepreneurship.

One of the biggest issues for start-up/scale-up companies is the whole issue of financing. Very often, friends and family are the first and only source of finance available for these business ventures.

The Employment and Investment Incentive (EII) Scheme is a tax relief incentive scheme which provides for income tax relief to qualifying investors for investments in certain qualifying small and medium sized companies (SMEs). It encourages investors to place finance in early stage businesses that have limited funding opportunities. However, there are now many blockages within the scheme, including the EU state aid General Block Exemption Regulations (GBER) under which the EII operates.

It is now particularly difficult for businesses that have been in business for seven years to qualify for EII under the rules. The GBER restrictions also affect businesses that are less than seven years old in cases where they previously raised EII and now want to raise a second round of finance. The GBER provisions are applied retrospectively to business plans which were prepared before the introduction of the regulations and they require that a second round of financing should have been envisaged in the original business plan. This is totally unrealistic from a commercial perspective.

The connected person rules can also prove restrictive where family members participate in the fundraising. For start-up family businesses who typically look to friends and family in the first instance for financing, this is certainly not helpful.

Entrepreneur relief

With a capital gains tax (CGT) rate of 33%, Ireland has the third highest CGT rate in the OECD. Ireland's entrepreneur relief reduces the level of CGT on the sale of a business to a limited extent by allowing for a 10% rate of CGT to apply to the first €1 million of gains. This relief is uncompetitive when compared with our closest neighbour and competitor for new business, the UK. The UK scheme provides that the first Stg£10 million of gains are taxed at the 10% CGT rate.

To qualify for entrepreneur relief in Ireland, the entrepreneur must hold at least 5% of the company's shares and meet requirements relating to working time in the business. Therefore, the 10% CGT rate is only available to the actual owners and managers of a business and not to third party investors. We need to protect our family and private business sector from a divergent UK and match their incentives for entrepreneurs. Irish businesses want to see this relief extended to be more competitive with the UK regime and also to allow for "angel investors" to be eligible to claim this relief.

These sort of investors are often willing to invest in high risk investments which banks are not willing to finance, and they should be rewarded if such investments are successful. We should be encouraging angel investors, who don't just bring money to the table but valuable mentoring and business contacts for growing family businesses.

The capital gains tax rate directly affects the willingness of angel investors to fund both start-ups and growth companies. Often when angel investors exit an investment, they use their after-tax returns to fund new companies. Accordingly, the higher the tax rate on gains for such investors, the fewer potential projects that will get the green light for investment.

Retaining employees and staff

Family businesses need to be able to incentivise their key employees in order to retain them. While some businesses are unwilling to have non family members as shareholders, there are many family businesses that, when unable to match the attractive salaries that can be offered by multinational businesses, want to be in a position to be able to offer opportunities for staff to participate in the equity of the business. However, the question needs to be asked as to whether the KEEP share scheme is up to this task. There has been a low uptake on this new scheme to date. In addition, there is a €3m cap on the value of shares subject to the scheme. This results in a constant valuation requirement when new shares are issued which can result in a high administration burden for the company. In addition, connected parties are

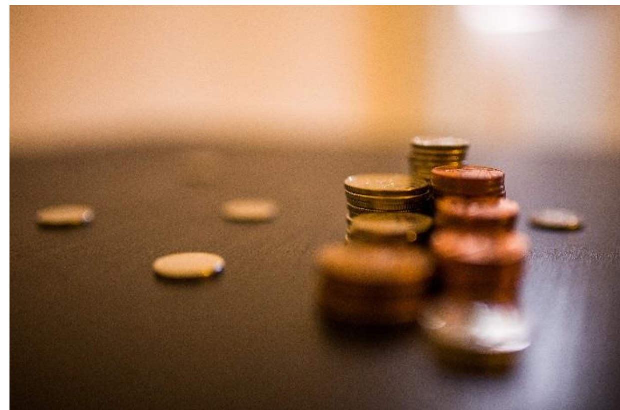
not allowed to participate, so again this rules family out from being able to participate in the scheme.

Given the high personal tax rates, it is essential that we have a workable share option scheme that can help Irish private businesses to attract talent and grow their businesses.

Sale of businesses

While the Irish CGT rate may be high in comparison to its OECD member countries, it is significantly lower than the Irish income tax rates that are applied to income in Ireland.

Following an amendment to tax legislation last year, which occurred without consultation with tax practitioners, it is now difficult to give vendors certainty that their gain on a sale of the shares in a business will be taxed at the CGT rate of 33% as opposed to income tax rates at 55%.



As is common practice, a sale of a private or family company can often involve an earn-out over a period of time. This can happen where there is a management buyout of a family business and the purchasers want the comfort that the expected profits will be maintained and key client relationships retained etc.

As a result of last year's tax amendment, if a business is regarded as helping to finance its sale, income tax treatment may now apply. Unfortunately, the legislation does not include "a bona fide" exemption, and therefore vendors can now find themselves potentially liable to income tax on gains on the sales of their shares. This particular legislation is only applicable when the purchaser is an Irish closely owned company, thus potentially discriminating against Irish family businesses and in favour of foreign purchasers.

These changes are hardly a reward for shareholders that have built up a business, provided employment and contributed to the economy. Owners of private businesses need clear guidance and certainty.

Succession planning

Businesses are relieved from CGT where the person disposing of the assets is aged 55 or over and had owned and used the assets for the ten years prior to the disposal. The operation of the relief differs between people aged 55 to 65 and people aged 66 and over. For individuals aged 55-65, the relief applies to assets valued up to €750,000 where the assets are transferred outside the family. Where the disposal is made to a child or favourite niece/nephew, there is no monetary limit to the relief. For individuals aged 66 years and over disposing of businesses to a child or nephew/niece who has worked full time in the business for the previous five years, the relief can only be claimed up to a consideration or value limit of €3m.

Significant anti-avoidance legislation has also been introduced which is aimed specifically at family businesses and succession planning reliefs. For example, CGT retirement relief is now unavailable on the sale of goodwill to a company, and potentially unavailable also on the sale to a company owned by next generation purchasers.

The legislation should recognise that sometimes the next generation need finance in order to take on a family business and that the business itself is the cheapest source of finance available.

A €3m cap on the transfer of a family business to the next generation is now aggregated with the separate CGT retirement relief on transfer to a child's company. The question to be asked is why we are penalising those over 66 years of age? Life expectancy is increasing and parents are having their children later in life. Is it realistic that you would pass your family business to your children before the age of 66 when your child may not even be 30 years of age?

Tax rates and administration

Our income tax regime still penalises the self-employed worker relative to an employee. A 55% income tax rate applies for self-employed individuals earning over €100K while PAYE workers are paying 52%.

Our CGT and gift/inheritance tax rates discourage growth and passing on wealth. Historically, when the rates were lower, there was a higher yield. As outlined, our CGT rate is the third highest in the OECD. The Department of Finance Tax Strategy papers, which were released in July, have acknowledged the arguments for reducing the rate of CGT and such amendments would be welcomed by family businesses.

Family businesses would like to see the CAT thresholds increased to the levels that they were prior to the recession to match the increase in values over the last few years.

While Ireland has an attractive R&D tax credit regime, there is a low take up amongst family businesses because of the administrative blockers and the costs of processing claims.

And finally, Irish private businesses would like to see our tax appeals system fixed so that businesses and Revenue have certainty and closure on issues. Currently, there is a ten-year backlog of tax cases, penal rates of interest and significant costs incurred by businesses in dealing with cases over a period of time.

Conclusion

Irish family businesses have the potential to increase productivity and for this reason, they should be supported in Budget 2019. We would like to see the administrative burden on family businesses eased. Businesses need guidance and more clarity to allow them to operate with certainty in an Irish context in a time of great uncertainty abroad. Legislation should be drafted in consultation with tax practitioners to allow for our legislation to be commercial and not to hinder businesses.