

JOHNSONS, Chartered Accountants

Passing on a family business

With 'baby boomers' now attaining state retirement age there is an increasing number of family businesses that will be handing over the reins in the ensuing years.

Research carried out on behalf of the Institute for Family Business (IFB) found that only 30 per cent of leading UK businesses that were family controlled in 1996 were in the same hands a decade later. Of the others, 42 per cent were taken over, and family control had been conceded in 28 per cent through a dilution of hereditary shareholding. This means that British firms have been passing out of family control at twice the rate than elsewhere in Europe.

Benefits and risks

There are clearly a number of important considerations to take on board when planning to pass a business on to the next generation of your family.

The assets remain within the family, which can bring long-term security to your children and relatives and the career prospects of the next generation are looked after. All your hard work in building up the business doesn't go to benefit another owner or company. But there are risks to be assessed as well. You will have no guarantee that your children,

later in their lives, will want to take over the running of the firm, or that your children will be best equipped to manage the business.

That is why it is important to prepare the way for a family succession carefully and dispassionately and, most importantly, well in advance of any changeover. The fundamental question you must ask yourself is whether a family succession is the best decision for the firm. It may be that other, younger family members do not have the ambition or the skills to assume control of the business. It may be that a succession can create tensions and conflicts within both the family and the firm itself.

And don't forget that your family could still benefit through a sale of the business, or through a management buy-out or flotation. Or, indeed, through recruiting professional managers to ensure that the enterprise remains a source of income irrespective of the actual involvement of any family members.



Planning a family succession

If it is your aim to pass on your enterprise to your family, it is vital you involve your children in the business as soon as it is possible and in as many aspects of its running as possible, from product development to sales and marketing, from financial management to staff management. This will not only provide them with a proper understanding of how the business works, it will also give them a real chance to discover if certain roles suit and interest them. You will, after all, want them to be as enthusiastic about the future success of the firm as you have been. But never coerce a relative – allow them the space to make their own choices about their careers.

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Encouraging them to gain experience of working in other businesses and areas beforehand will help to broaden their outlook on how the business world operates. It may also deepen their appreciation of what is needed to make a success of developing the family firm.

You must take other, more specific issues into account as well. You will need to decide where responsibility and control lie, and to balance the demands of the business duties you hand to some members of your family with the shareholdings you give to others. Should, for example, some family members be given senior management duties, then their shares might come with full voting rights, while those shares assigned to family members without direct involvement in the firm could be non-voting but with preferential rights to dividends.

From this it should be clear that a family succession cannot be a relatively last-minute decision. It takes years. Even to the point that, when you first set up the business, you should be thinking about its eventual disposal. Timetable across the long term, plotting the stages that will lead up to the transition, noting those of your children or relatives who look best fitted for the roles they may later assume, training them accordingly, and ensuring that relationships between them and other key members of the firm are set on a confident, open footing. When the time comes for you to move aside, manage it in a way that is phased so that the switch of responsibilities is conducted smoothly.

What to look for

It is challenging but imperative to be unsentimental about a family succession. The business and the ability of your relatives to benefit from it will be compromised if the firm falters once it has been handed on. So look for family members who possess the right qualities demanded by running a business: good leadership, commercial acumen, the ability

to delegate to those more experienced in certain areas than themselves, the vision to grow and develop the business. When considering succession, hold open conversations with your family to find out if they are truly committed to the enterprise for the long haul. But always balance cold-eyed objectivity with fairness – you will have an emotional duty to every family member whether or not they possess the business flair needed to take over the operation of the firm. A successful succession is as much about family harmony as it is about the harmony of the business.

Is the business a genuine inheritance?

Coming to a realistic assessment of the future viability of the business is another important matter (a firm must be worth handing on if it is not to become a burden to your children). So come to a realistic assessment of the value of the business and an equally hard-headed judgement of its potential in the years to come.

Tax

Questions of tax are equally pertinent. There have been several reforms of the capital gains tax system in recent Budgets, and more may be in the offing.

Remember that entrepreneurs' relief has been introduced. Under the scheme as it currently stands, an owner will be subject to tax at 10 per cent on qualifying gains made from the material disposal of business assets up to the £10 million lifetime limit. Entrepreneurs' relief may be due on the disposal of all or part of a business, the disposal of the assets in the business after it has stopped trading or the disposal of shares in a company. Eligibility for relief is subject to specific conditions being satisfied. In order to benefit from the relief on the disposal of shares in a company, you will need at least a 5 per cent holding in the ordinary share capital, and that gives you at least 5 per cent of the voting rights, you will also need to work in the company or to hold a place on its board throughout a qualifying period of one year prior to disposal. Any sales of assets above £10 million are subject to a capital gains tax rate of 28 per cent, although if this is not the disposal of one asset then a small proportion of the gain could be taxed at 18 per cent.

There is also the possibility of a business property relief on inheritance tax if an owner passes a firm or shares to relatives. As a result, you may be able to carry out a transfer that is free of inheritance tax, although the specific circumstances of each business should be explored.

Summary

There are a wide range of related planning issues that need to be considered especially the impact of passing on the business on available income after the transfer of the business. Taking an objective view of such matters can be notoriously difficult when personal family relations form part of the equation. Which is why it is essential to consult others who may not be quite so close to the business.

A non-executive director can play a critical role in offering a proportionate, reliably disinterested viewpoint. And don't forget that as your accountants we will be able to make an overall judgement about the direction of a family firm, and will also be in a position to provide professional, expert guidance on how best to handle the often complex tax implications of any succession, and to advise on matters such as shareholders' agreements and amending a company's articles of association. The next step? It is never too early to start planning for the day you will hand over the reins. Please contact us for help and advice.

Please contact us if you would like to discuss passing on a family business

