

Western Europe aligned on tax treatment of Family Business transfer

Study into business succession tax schemes in Western Europe

April 2015



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Foreword

In this publication “Western Europe aligned on tax treatment of Family Business transfer – Study into business succession tax schemes in Western Europe”, we present the results of our research. We examined the schemes of Belgium, Germany, Finland, France, the Netherlands, Spain, Sweden, Switzerland and the United Kingdom one by one, paying particular attention to the treatment for gift and inheritance taxes. For practically all these countries, family businesses form the driving force of their economies.

The results from the *Global Family Business Survey 2014*, a study we conducted among 2,378 family businesses in over 40 countries, show that these businesses still constitute a dynamic and resilient sector in many countries. Apart from financing the company and retaining high-quality employees, business succession is one of the most important challenges facing a family business.



The business succession tax schemes appear to be under pressure in several countries, something that is confirmed by our West-European Family Business Specialists. This impression also emerges from the recent study PwC the Netherlands conducted into the necessity of business succession schemes for the continuity of family businesses in the Netherlands¹. *This study* reveals that the continuity of many family businesses will come under threat if the schemes are indeed cut back. Making the schemes less generous would increase the financing needs of many family businesses, where obtaining finance is already a major challenge for them.

Most of the West-European countries concerned have specific tax facilities for business succession that include substantial allowances. Something that stands out is the similarity of approaches towards the family business in West-European countries. The main justification for the schemes is that the continuity of family businesses must be safe-guarded. The effective tax rates in the subject countries – with a range of zero percent to 4.5 percent and an average of 2.8 percent – line up nicely with each other.

Our conclusion is that not only the backgrounds to the West-European tax facilities, but also the exemptions and related conditions all harmonise well. As such, Western Europe presents a level playing field. We urge that nothing be done to disturb the balance. The future of the family business lies very close to our heart. We therefore stress the need to retain and anchor these facilities, so that – and this is especially important in these uncertain economic times – family businesses will be able to focus on the continuity and growth of their activities, without the distraction of unnecessary tax issues. A situation of direct benefit to society in Western Europe.

Renate de Lange
Tax Partner

Hartwig Welbers
Tax Partner

¹ Direct line inheriting

Family businesses from a West-European perspective

Without question, the family business segment makes an exceptionally important contribution to the economies of Western Europe. In virtually every European country, the vast majority of companies are family businesses. Moreover, for most of these countries, the segment accounts for at least 50 percent of the gross domestic product, as the table below shows. Although family businesses are on average somewhat smaller than other companies, they generate almost half of all jobs. On a global scale, it is estimated that 80 percent of business activities are conducted by family businesses.

Strangely enough though, the segment receives relatively little attention from policymakers and researchers. There is not yet any systematic recording of data about the segment, as evidenced by the empty cells in the table. Research that is conducted shows that family businesses beat their counterparts as regards several indicators, including return on capital and long-term continuity. Family businesses can take credit for creating the lion's share of new jobs. On average, they are more innovative and more open to change.²

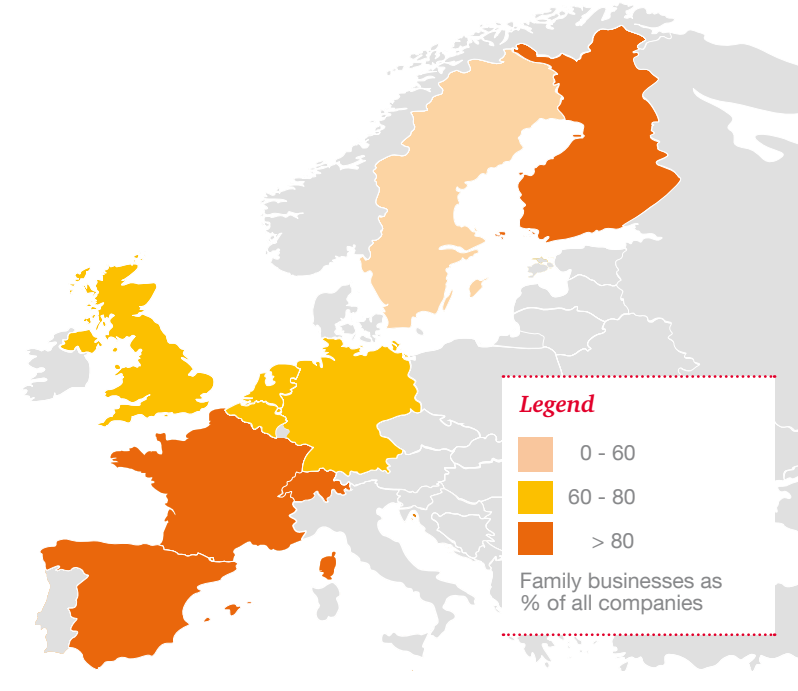
Figure 1 EU - family business metrics by country

	Family businesses as % of all companies	Family business employment as % of total	Family business employment as % of private sector total	Contribution of family businesses to GDP	Number of family businesses	Number of family business employees
Belgium	77%	45%	n.a.	33%	123,000	1,710,000
Germany	79%	44%	n.a.	55%	n.a.	16,929,733
Finland	80%	24%	42%	40% - 45%	250,000	600,000
France	83%	49%	n.a.	60%	n.a.	12,686,222
Netherlands	69%	49%	n.a.	53%	260,050	4,211,264
Spain	85%	42%	70%	70%	2,900,000	13,900,000
Sweden*	54%	35%	n.a.	30%	n.a.	1,594,260
Switzerland	88%	n.a.	n.a.	n.a.	n.a.	n.a.
United Kingdom	65%	n.a.	40%	24%	2,959,346	9,200,000

* Does not include companies with less than 5 FTEs and revenue less than 526 kronor, so that the number of family businesses is understated.

Sources: ecobelang familiebedrijven_nl, Instituto de la Empresa Familiar, Witboek_Familiebedrijven, met een familiebedrijf de crisis door, <http://knoema.com/OECD95dec/oecc-economie-no-95-december-2014>

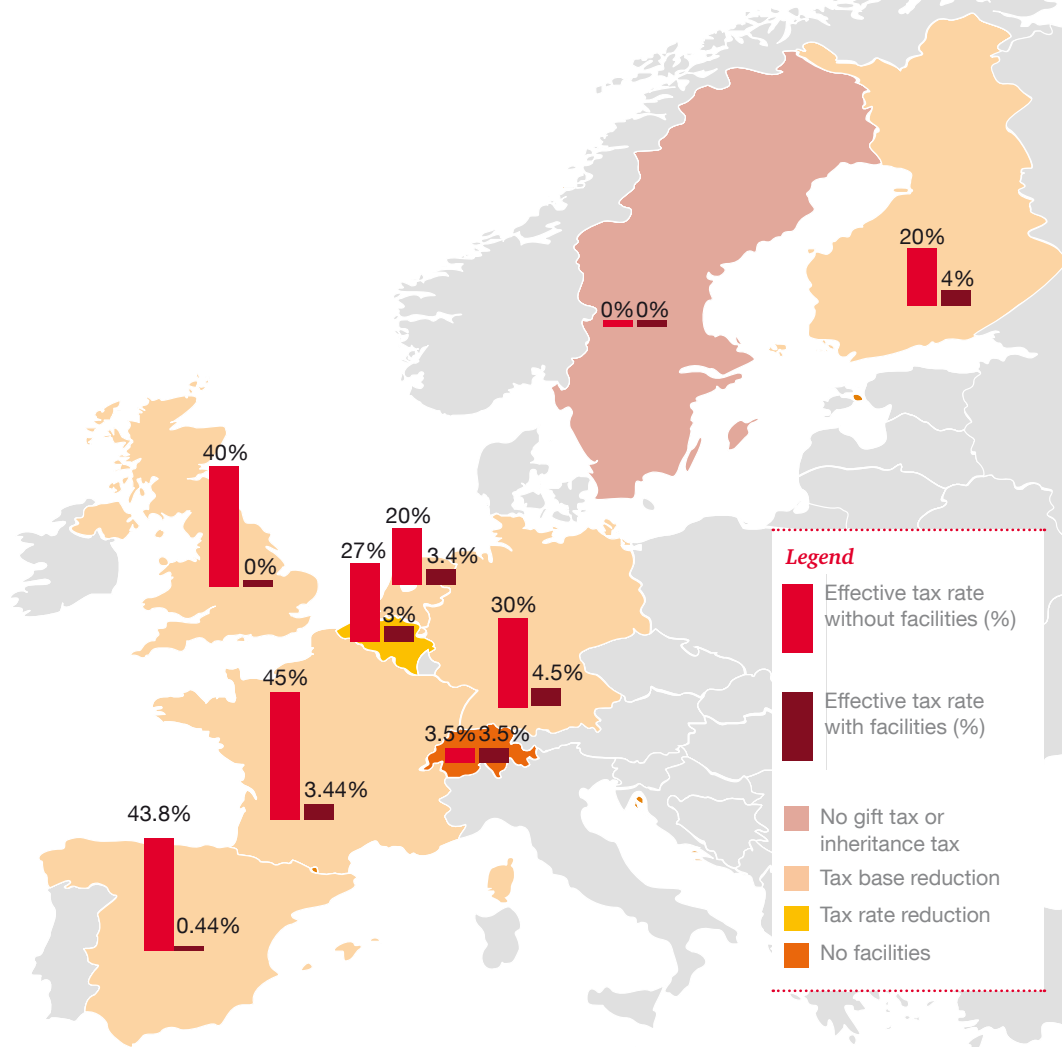
Figure 2 List of subject countries



² Global Family Business Survey (PwC, 2014).

Business succession schemes for gift and inheritance tax

Figure 3 Facilities in the scheme



Our Dutch study shows that the business succession scheme is a key factor for the continuity of family businesses.³ This motivated us to study the business succession schemes in nine West-European countries, including the reasons for implementing them. Below we provide an outline of the schemes in terms of gift and inheritance tax for these countries.

Main rules

Apart from Sweden, which abolished gift and inheritance taxes ten years ago, all the subject countries tax a gift or inheritance of a family business. The standard rates vary by country, from zero percent to 45 percent. They apply for the transfer to children and/or domestic partner. If an acquiring party does not fall into this category, most countries will levy a higher rate. For the acquisition by a child or domestic partner, the average minimum tax rate in all countries concerned is about five percent, and the average maximum rate about 30 percent.

Specific schemes

In seven of the nine countries, the standard tax system gives special treatment to the transfer of a family business. A special scheme is unnecessary in Sweden because gift and inheritance taxes were abolished there. Although Switzerland currently has no national scheme, most cantons grant full or partial exemption for the domestic partner, children and grandchildren, as well a reduction for other family members, such as parents and stepchildren.

In six of the seven countries with a business succession scheme, it takes the form of an exemption for the transfer. The exempt percentage varies from 60 percent to 100 percent, the average being 80 percent.

Finland has the lowest percentage (60 percent), but levies the tax on the carrying value of the family business for financial reporting purposes. This contrasts with the other countries, which use the market value. Under normal circumstances, the market value exceeds the carrying value. Accordingly, the effective tax rate in Finland is not substantially higher on average than in the other countries.

³ "Business succession schemes are essential – Study into the effect of business succession schemes on the continuity of family businesses" (PwC, December 2014).

In Germany, the Netherlands, Spain and the United Kingdom, the exemption is virtually 100 percent. The United Kingdom grants an exemption of 100 percent across the board. The exemption in the Netherlands is 100 percent for family businesses valued at approximately one million euros or less. For any amount in excess, an exemption of 83 percent applies. The standard exemption in Spain is 95 percent, increasing to as much as 99 percent in a few regions (Madrid being one of them). In Germany, too, there are different exemptions. There, the general exemption for a family business is 85 percent of its market value. However, if no more than ten percent of the capital in the family business represents investments (including surplus liquid assets), the exemption can be as high 100 percent.

Belgium's scheme is different, the facility being a reduced tax rate rather than an exemption. The standard rate for an inheritance is 27 percent (if the value is 250,000 euros or more), and for a gift, three percent. Where a family business is transferred, these rates drop to three percent and zero percent respectively.

Effective tax rate

As the above makes clear, the specific business succession schemes of the subject countries do not differ much, with most based on exemptions. The effective rates, too, show relatively little variation, ranging from zero percent to 4.5 percent.

Belgium, the United Kingdom, Switzerland and, subject to certain conditions, Germany levy no tax on the gifting of a company. The same applies in the United Kingdom, Switzerland and, subject to the same conditions, Germany in the case of an inheritance.

For the countries that impose a gift tax and an inheritance tax, the average effective rate is about 2.8 percent. We base this assertion on the maximum effective tax rate for each country. In almost all countries, the levy is well below five percent.

Payment schemes

All countries that levy gift and inheritance tax on the transfer of a family business have a scheme for payment deferral. The schemes show many variations. Some countries allow full deferral, with the entire sum falling due only after expiry of the deferment period. The Netherlands, for example, uses a deferment period of ten years.

Another variant is to spread the payment of the tax owed. In the case of France, the period is fifteen years. There are also mixed schemes, combinations of full deferral and spread payments. One example is Spain. It allows a five-year deferment period, followed by payment in ten instalments over the next five years. A further variation is that some countries charge interest on the deferred amount, while others do not.

Finally, there are differences in the degree of eligibility as regards the payment scheme. In Finland, France, the Netherlands and Spain, it is sufficient to simply request use of the facility. Belgium and Germany by contrast apply a test to see whether there is a threat to the continuity of the business or even an especially dire situation.

Figure 4 Exemption percentages

Country	Minimum exemption	Maximum exemption
Germany	85%	100%
Finland*	60%	60%
France	75%	75%
Netherlands	83%	100%
Spain	95%	99%
United Kingdom	50%	100%

* Exemption is based on the carrying value for financial reporting purposes.

Figure 5 Effective tax rate without facilities (%)

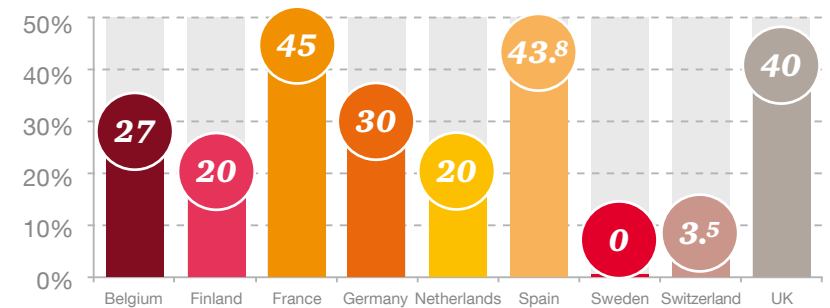
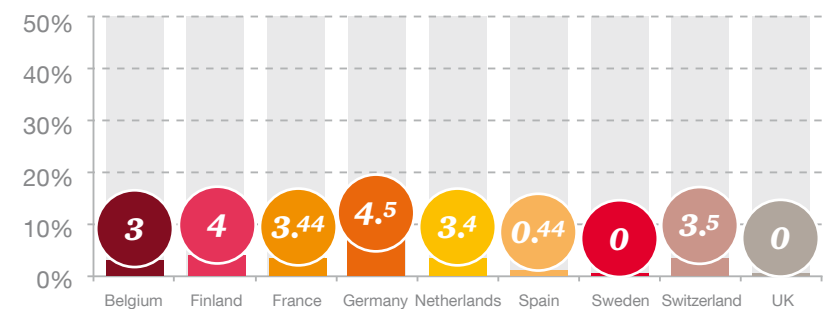


Figure 6 Effective tax rate with facilities (%)



Background to the business succession schemes

The fundamental reason for various countries having such schemes is essentially to ensure continuity of family businesses. Encouraging and protecting family businesses, including the employment they provide, are also arguments often put forward⁴.

To a lesser degree, the schemes serve to protect the heirs and hence to counter misuse. Without such a scheme, the heirs would face a substantial tax assessment on inheriting the family business. They might then feel compelled to sell the family business – quickly and under less favourable conditions – to a third party at a price below market value.

Given this backdrop and justification for the business succession schemes, the importance of such schemes for the family business has been clearly recognised in the legislative process. Not a great surprise, considering that family businesses constitute the majority of all enterprises in the national economies. It is an extremely important sector from an economic perspective. Accordingly, protecting it by means of a business succession scheme actually protects the economy on a broader front.

A particular consideration is reflected by the nature of the exemptions in Belgium. This country has deliberately chosen to encourage the succession of a family business while the owner is alive, by imposing a lower tax rate than after the owner has died. Hence, the transfer need not wait until the owner's death. The motivating idea is that, while the owner is still alive, the family will make a well-considered decision, which is even more beneficial for the continuity of the business.

⁴ These considerations are evident in the explanations of the various national legislative procedures, and are clarified by our PwC family business specialists in the countries concerned.



Conditions

To ensure that a business succession scheme can be applied correctly, a variety of conditions are now in place. In most jurisdictions with a scheme, these conditions fall into one of the categories of testator/donor, successor and company.

Figure 7 Conditions

Country	Minimum interest (%)	Continuity requirement (years)	Ownership requirement (years)	Active company
Belgium	50*	3	-	✓
Germany	25 / -	5	-	✓
Finland	10	5	-	✓
France	20 or 34**	4	2	✓
Netherlands	5	5	1 or 5***	✓
Spain	5 or 20****	10	-	✓
UK	-	-	2 (or 2 out of 5)	✓

* Together with family.

** Non-listed and listed, respectively.

*** Inheritances and gifts, respectively.

**** Direct and together with family, respectively.

Successor

In many cases, the successor shareholders – heirs or donees – have to ensure that a continuity requirement is satisfied. This does not mean that the successor has to be an active entrepreneur. Meeting the requirement in order to obtain the full benefit of the scheme calls for the successor to hold the shares for a specified period. For a specified period, the successor shares in the financial ups and downs, without actually working for the company. In the subject countries, the length of time that the successor must hold the shares varies from three to ten years. Belgium imposes an additional requirement applying to voting rights in the company.

Testator/donor

For virtually all the countries concerned, a minimum interest has to be transferred or exist for the business succession scheme to be applied. The range of minimum percentages is quite wide. Whereas the Netherlands specifies a minimum interest of five percent Belgium stipulates at least 50 percent together with family members, with a number of alternatives for a lower percentage (together with family members or otherwise) to apply, subject to certain conditions.

A few countries specify additional requirements relating to the testator/donor. Application of the gift tax scheme in Spain is subject to an age threshold of 65 or (partial) disability. The Netherlands imposes an additional requirement for length of ownership: one year preceding an inheritance and five years preceding a gift. The United Kingdom imposes a similar condition of two years in principle.

In France, the scheme applies only in the case of a joint shareholding. This is subject to a minimum of twenty percent or 34 percent, depending on the type of shares. There is an additional requirement in that the shareholder agreement must include a provision forbidding the transfer of the shares within two years.

Company

All the subject countries that have a succession scheme require the business to be an “active company”. Their various regulations define this term, with the activities broken down by specific industries in some cases. The company must often continue to operate unchanged for a certain period following the gifting or the inheriting.

Other tax schemes and special situations

Five of the subject countries (Belgium, Finland, the Netherlands, Spain and the United Kingdom⁵) also grant a capital gain exemption on the transfer of a family business. In this context, the gifting or inheriting of the family business is treated like an ordinary transfer on which a capital gain is realised. The countries concerned tax this – notional – capital gain, in some cases by levying income tax, and in others by levying wealth tax.

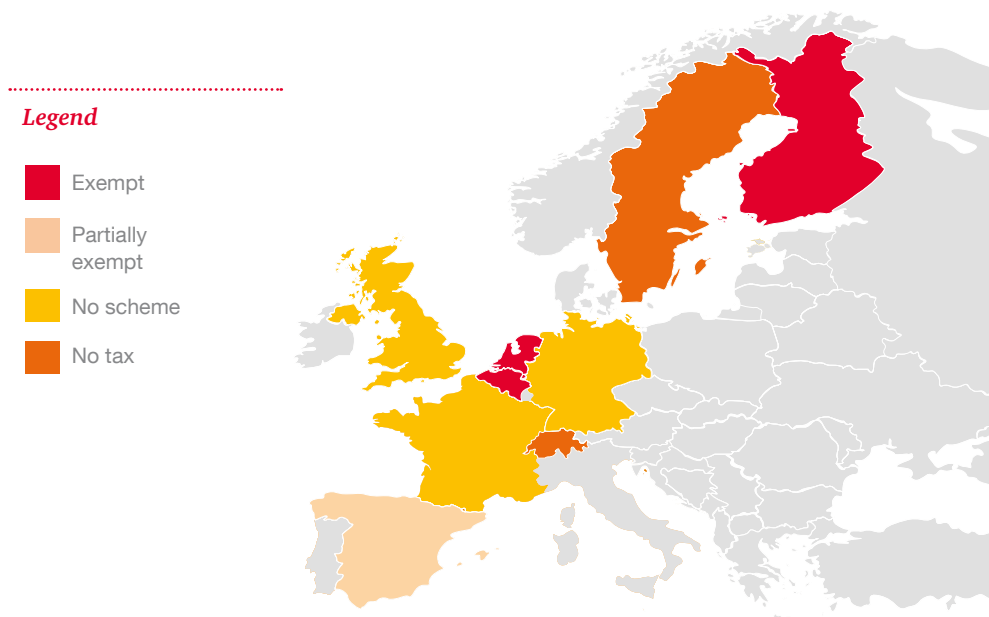
Germany and Sweden only tax actual realised capital gains. In Switzerland, no part of a gift or inheritance is subject to wealth tax or income tax, irrespective of whether a sum of money, company or other type of asset is transferred.

Only France fully taxes the capital gain on the transfer of a family business.

Two countries set almost the same conditions for exemption from gift and inheritance tax, and from capital gain tax. The Netherlands aligns the conditions for exemption from income tax (on the capital gain) with those relating to gift and inheritance tax. However, for a gift to qualify for exemption from income tax, an additional condition applies in that the successor has to have been in the employment of the family business for three years prior to the transfer. In Spain, the conditions for exemption from inheritance tax are the same as those for capital gain tax, with one exception. This extra condition is that the successor to the business has to hold the inherited shares for at least ten years.

What is striking about tax on family businesses in general is that Spain grants the company full exemption from capital gain tax, not only on a transfer but also during ownership. When a family business is inherited, the heirs have the option of valuating the acquired shares at the market value of the assets. As a result, the growth in value until the time of death is permanently exempt from capital gain tax on a subsequent sale, including a sale outside the family.

Figure 8 Levy on capital gains



Continuing this theme, something unusual concerning Sweden is that it taxes the sale of a family business to another family member more heavily than a sale to a third party. This is because the sale to a third party can qualify for special treatment, being that, subject to certain conditions, the gain on the sale is deemed private income ultimately taxed at a reduced rate of 25 percent. This treatment is not available for a transfer to the children. In such cases, the standard rate of 58 percent applies. Sweden is currently analysing whether this scheme needs amending because of discrimination between a sale to a family member and a sale to someone outside the family circle.

⁵ In the United Kingdom, only transfers in the form of a gift are subject to capital gain tax.

Political debate on business succession schemes

Apart from Belgium and the United Kingdom, a heated political debate is raging in the countries concerned about the continued existence of their respective business succession schemes.

Spain

Misuse of the scheme in recent years was one motivation for debate in Spain. Specifically, mixing active business assets with pure passive investment assets has led to calls for the scheme to be scrapped. However, an investigation commissioned by the Spanish government concluded that the exemption should be reduced from 95 percent to between 70 percent and 50 percent instead of abolishment.

Germany

The Federal Constitutional Court⁶ recently ruled that Germany's business succession scheme was partly in conflict with the Constitution. In the opinion of the Court, the present scheme is far too favourable towards large companies. Germany's legislative body must amend the scheme by 1 July 2016 at the latest. What the amendment will encompass is currently unknown. One possibility is to make the exemption dependent on the size of the family business.

Switzerland

In the summer of 2015, Switzerland will go to vote on the introduction of a federal gift and inheritance tax of twenty percent. The proposal refers to a reduction in tax at the national level for family business succession. It is still unclear, however, what form this will take.

Sweden

In Sweden, a few small political parties have actually proposed reintroduction of the gift and inheritance tax. In connection with this, it is interesting to see how these taxes came to be abolished in the first place. The motivation was to simplify the transfer of family businesses. Introducing a specific exemption was considered, but that would have created a huge difference between the acquisition of a family business (partially or fully exempt) and the acquisition of another type of asset (fully taxed). To avoid any further discussion in the future, Sweden opted at the time to do away completely with gift and inheritance tax.

Finland

The debate in Finland concerns the situation in which the successor to a family business has to pay a substantial amount in tax if unable to meet the conditions of the scheme. A key issue under discussion is the possibility of following Sweden's example and scrapping the gift tax and inheritance tax. This was the subject of various studies in Finland.

Netherlands

The Supreme Court⁷ ruled in 2013 that the scheme in its current form does not conflict with the principle of equal treatment. In 2014, the European Court of Human Rights⁸ ruled likewise. Despite this, the State Secretary hinted at making the scheme less generous. However, owing to the fierce opposition from politicians and employers' organisations, he withdrew the idea. He agreed not to tamper with the scheme during the term of the current cabinet (which in principle will last until 2018).

6 Federal Constitutional Court, 17 December 2014. The decision can be consulted via this [link](#).

7 Supreme Court, 22 November 2013, 13/01154. The decision can be consulted via this [link](#).

8 ECHR, 27 May 2014, Application no. 18485/14, BERKVENVS vs Netherlands. The decision can be consulted via this [link](#).

Conclusion and recommendation

The business succession schemes for family businesses represent a hot topic in Western Europe. In several countries, they are the subject of debate, motivated by the call to scrap them altogether or make them less generous because of misuse or conflict with the principle of equality. At the same time, the countries concerned realise from the justifications for the schemes that the business succession facilities are important for the growth and continuity of family businesses. Since the family business is the engine of the Western European economies, these facilities are essential not just for the companies themselves, but also for society as a whole.

The specific business succession schemes of the subject countries do not show large differences. Although the methods sometimes vary, the scheme in each country results in a substantial reduction of tax on the transfer of a family business. The conditions governing application of the schemes are broadly similar. Likewise, the effective tax rates do not differ that much. As such, there is a level playing field in Western Europe for the transfer of family businesses.

Something also striking is that the arguments the national legislative bodies cite for introducing the business succession schemes are identical in the overwhelming majority of the countries. Specifically, it is to guarantee the continuity of family businesses. Apparently, these countries are convinced that a substantial reduction in tax is indispensable for this continuity.

The reasons underlying these schemes and the explanations from our PwC family business specialists reveal a broad consensus on the necessity of the tax facilities for family businesses. As family businesses play a leading role in the growth and flourishing of the economies in Western Europe, the facilities are vital to the recovery of these economies, as well as for society as a whole.

Accordingly, we urge that attention be given to increasing the awareness of the impact of business succession schemes on family businesses, and advocate the retention of these schemes.





Clarification

For this study, we enlisted our PwC family business specialists from nine countries: Belgium, Germany, Finland, France, the Netherlands, Spain, Sweden, Switzerland and the United Kingdom. In this appendix, we explain the design of our study and our approach.

Research question

Our principle research question was:

What are the designs of tax schemes in Western Europe for family business succession, and what is the importance that Western Europe gives to family businesses based on the ratio for their tax treatment?

To answer the question, we drew up the following sub-questions:

1. What place do family businesses occupy in the national economy?
2. Is the succession (not sale) of a family business taxed in your country (e.g. personal tax, succession tax)? And if so, at what tax rate?
3. Do specific tax exemptions exist regarding the taxation of the succession of family businesses? If so, what is the rationale behind that facility? Can you describe the scheme? What conditions apply to it? What is the exempt percentage or reduced rate? What is the effective tax rate?
4. What differences do the specific schemes of the subject countries exhibit? What are the differences between the effective tax rates?
5. Is there a scheme for deferment of payment? If so, what is the scheme? Do the schemes differ from subject country to subject country?
6. Do other tax schemes or special circumstances apply?
7. Is the scheme subject to political debate? If so, what are the issues at stake?

Study method

We submitted a questionnaire containing ten questions based on the above sub-questions to our family business specialists in the subject countries.

We produced a summary of the answers to the questionnaire, and then submitted this summary to the subject countries for comment. Based on the responses, we requested answers to specific follow-up questions where necessary.

Calculation of effective tax rate

For the average minimum and maximum tax rates, without application of the business succession schemes, we based the calculation on the situation of inheritance of the family business by children. We disregarded Sweden, as the country has abolished the gift tax as well as the inheritance tax.

For the average effective tax rate after application of the business succession schemes, we calculated the maximum levy for each country based on the situation of inheritance of the family business by children. We disregarded Sweden here, too, as the country has abolished the gift tax as well as the inheritance tax.

Contact

For more information about a particular country, please contact the local family business specialist:

Belgium

Philippe Vyncke
+32 (0) 9 2688303
philippe.vyncke@be.pwc.com

Germany

Hartwig Welbers
+49 (0) 711 25034 3165
hartwig.welbers@de.pwc.com

Finland

Kari Stenqvist
+358 (0) 20 787 7000
kari.stenqvist@fi.pwc.com

France

Louis Pascal Brabant
+33 (0) 1 56 57 86 47
louis-pascal.brabant@fr.landwellglobal.com

Netherlands

Renate de Lange-Snijders
+31 (0) 88 792 39 58
renate.de.lange@nl.pwc.com

Spain

Maria Sanchiz Suarez
+34 (0) 915 684 715
maria.sanchiz@es.pwc.com

Sweden

Mikael Carlén
+46 (0) 10 2125212
mikael.carlen@se.pwc.com

Switzerland

Marcel Widrig
+41 (0) 58 792 44 50
marcel.widrig@ch.pwc.com

United Kingdom

Sian Steele
+44 (0) 122 355 2226
sian.steele@uk.pwc.com

For other questions, please contact:

PwC
Knowledge Centre Tax & HRS
Fascinatio Boulevard 350
3065 WB Rotterdam
Postbus 8800
3009 AV Rotterdam
Telephone: +31 (0)88 792 43 51
E-mail: knowledge.centre.taxhrs@nl.pwc.com

This publication was finalised on 31 March 2015. It does not take subsequent developments into account.

Authors

Renate de Lange-Snijders
Hartwig Welbers
Jan Nieuwenhuizen
Casper de Nooijer
Jan Willem Velthuijsen
Charlotte Zandvoort-Gerritsen
Pjotr Anthoni
Mitra Tydeman
Linda Jansen

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