European Family Business Tax Monitor

Comparing the impact of tax regimes on family businesses

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EFB EUROPEAN FAMILY BUSINESSES

KPMG cutting through complexity

FOREWORD

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Comparing the impact of tax regimes on family businesses

Businesses across Europe are increasingly aware of the impact of tax on their business strategy and Family Businesses are no different. Indeed, the range of taxes applicable to Family Businesses and their stakeholders mean the possible impacts and complexities are magnified. While much of the focus is on how taxation affects competitiveness, a country's tax regime can have a far wider impact, not least on succession, but also the future growth of Family Businesses.

European Family Businesses (EFB) and KPMG have joined forces to review tax regimes across 23 European countries and their impact on Family Businesses. The comparison of countries' tax systems is complex as all have differing tax exemptions and reliefs in operation. The range of reliefs and exemptions countries offer can mean the effective tax rate can be significantly different to the headline rate.

In this first report, we compare the tax impact of participating countries on Family Business transfers, through inheritance and retirement.

Our study has found that overall the burden of taxation on succession, specifically on passing a very simple Family Business from one generation to the next as a result of inheritance or retirement, can vary significantly dependant on the country of operation. In this study, we shed light on the fiscal regimes of the 23 countries, enabling a comparison of the tax impact on Family Businesses.

In the current environment it is important that the tax strategy underpins the wider commercial and business objectives. Tax is likely to be high on your agenda and, regardless of your role in your Family Business, understanding how different countries tax business succession could impact your future strategy.

We hope that you enjoy reading this first survey, which we hope will bring some transparency to the possible effects of the differing tax regimes upon one of the key concerns of Family Businesses – preparing for and dealing with succession.

1: FAMILY BUSINESS SUCCESSION THROUGH INHERITANCE

CASE STUDY

We asked tax experts from KPMG member firms in each country to consider the following facts:

John Smith has owned his Family Business, Oakwood, for over ten years.

He invested €1,000,000 to establish the company and has worked hard over the years to build it. The current balance sheet is shown below. The business is now valued at €10,000,000 on an arm's-length, third-party basis (which includes €5,000,000 of goodwill). All assets in the company are used for the purposes of the business.

John's wife, Sarah, died in 2010 and he has one son, David, who is 35 years old. Unfortunately John died in early 2013 and his will passed the business to David, who intends to continue the business for the next 20 years or so.

What is the tax impact of John's death?

Oakwood balance sheet as at date of transfer:

Manufacturing facility (real estate)	€3,000,000
Inventory	€2,000,000
Trade debtors	€2,000,000
Cash (used in the business)	€1,000,000
Total assets	€8,000,000
Share capital	€1,000,000
Distributable reserves	€4,000,000
Bank debt	€3,000,000
Total liabilities	€8,000,000

TAX DUE ON INHERITANCE

Tax due without exemptions and reliefs

Figure 1a provides an overview of tax levied across the 23 countries surveyed, excluding any exemptions and reliefs available. The range of €0 in Cyprus, Luxembourg, Poland, Romania, Slovakia, Slovenia and Sweden, to over €4m in France demonstrates the stark contrast across Europe. No less than 13 of the 23 countries have been rated 'green', as they would impose taxes of less than €1m. These countries may be seen as 'green', however a tax levy of over €250,000 represents a large amount for this size of organisation.

Four countries are flagged 'red' as they impose taxes of more than €3m. These red flagged countries may have been traditionally expected to have more favourable tax regimes, namely France, Ireland, the Netherlands and the UK.

The tax landscape does however change dramatically when you introduce country-by-country tax exemptions and reliefs.

Tax due with exemptions and reliefs

As demonstrated in Figure 1b, when exemptions and reliefs are available, qualification criteria met and applied to the business, the landscape changes dramatically. Those countries receiving a green, amber and red status changes from Figure 1a. When applying reliefs and exemptions to the case study, the number of countries which impose no tax increases from 7 to 13 with the Czech Republic, Germany, Hungary, Italy, Portugal and the UK joining the list.

The impact that exemptions can have on tax levied is further demonstrated by a further five countries – Belgium, Finland, Ireland, the Netherlands and Spain – reducing their tax bill to below the €500,000 level.

The exemptions and reliefs are not only complex but wide in their application, as are the taxes. Taxes levied include personal income tax, inheritance tax, real estate transfer tax, duty on documents and transfer levies. If this wasn't complicated enough, there are some geographies, such as Belgium, where different regimes are present within the country leading to some regions having their own approach within a country's tax regime.

Across the border in the Netherlands, the position is complicated by the ability of families to defer payment of part of the tax. In our example, this reduces the tax payable to €220,676. This is not strictly speaking an exemption as the tax may become payable at some point in the future, but in practice can reduce the tax bill significantly. This only goes to illustrate how complex the position can be!

Figure 1a: Tax due without exemptions based on December 2013 rates

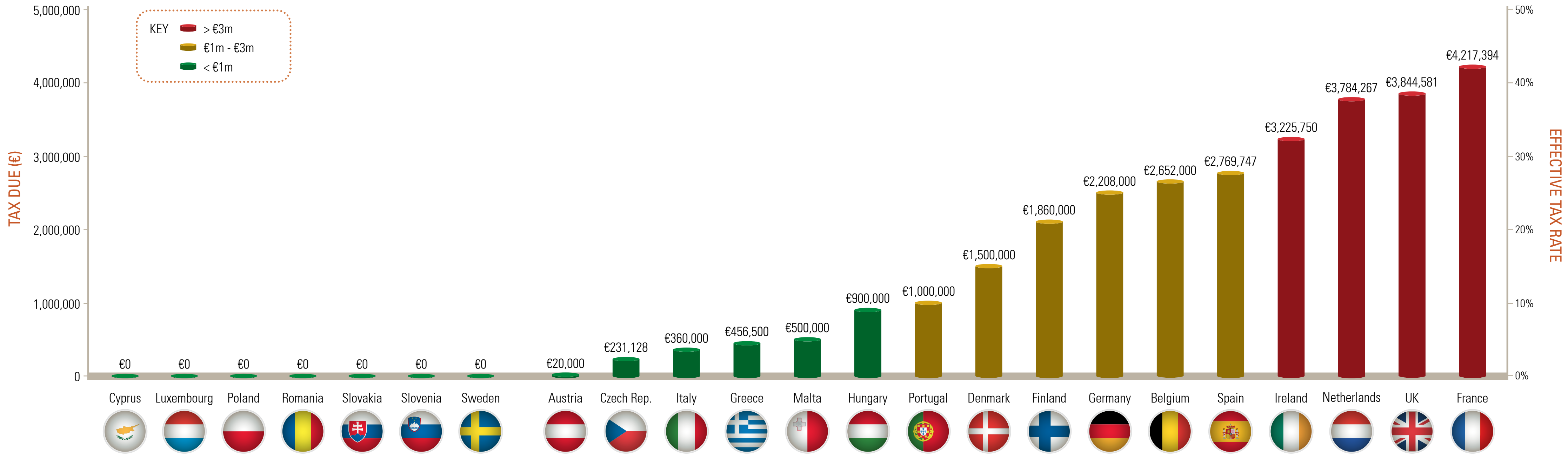
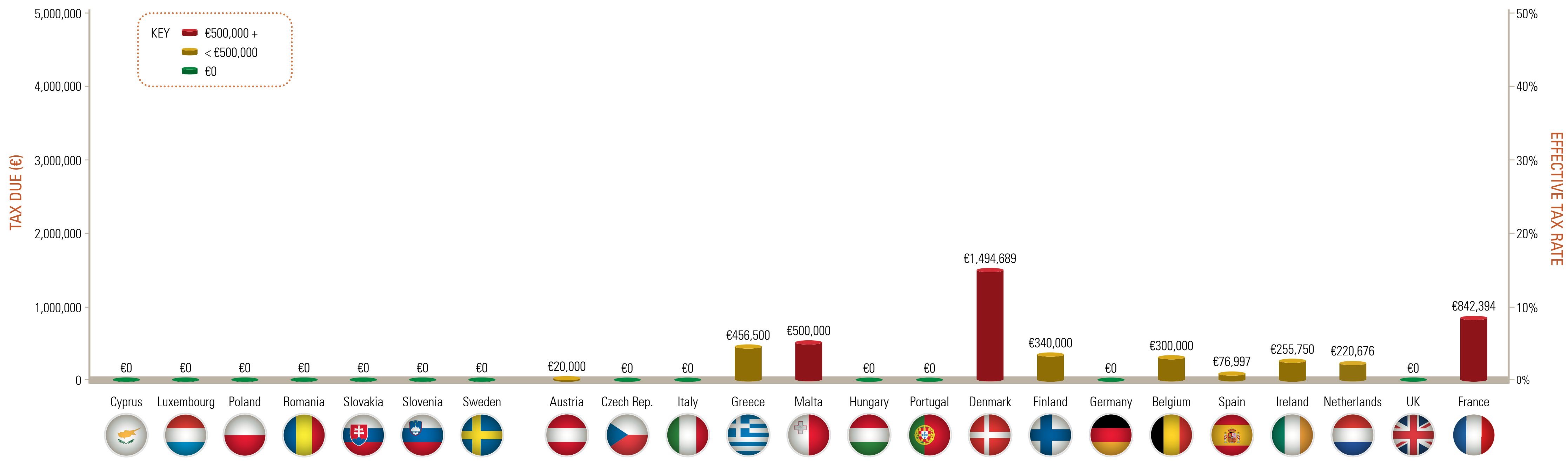


Figure 1b: Tax due with exemptions based on December 2013 rates



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TAX DUE ON INHERITANCE

Many Family Businesses operate internationally and their shareholders often have a choice on where to base themselves. Understanding the differences in tax regimes across borders can therefore be beneficial when making future investment decisions.

Figure 1c provides a snapshot of how the application of exemptions and reliefs can impact tax charges, with the most noticeable changes in the amount charged occurring in Belgium, Finland, Ireland, the Netherlands and Spain. Several countries fully mitigate the tax bill with full exemption available in the Czech Republic, Germany, Hungary, Italy, Portugal and the UK.

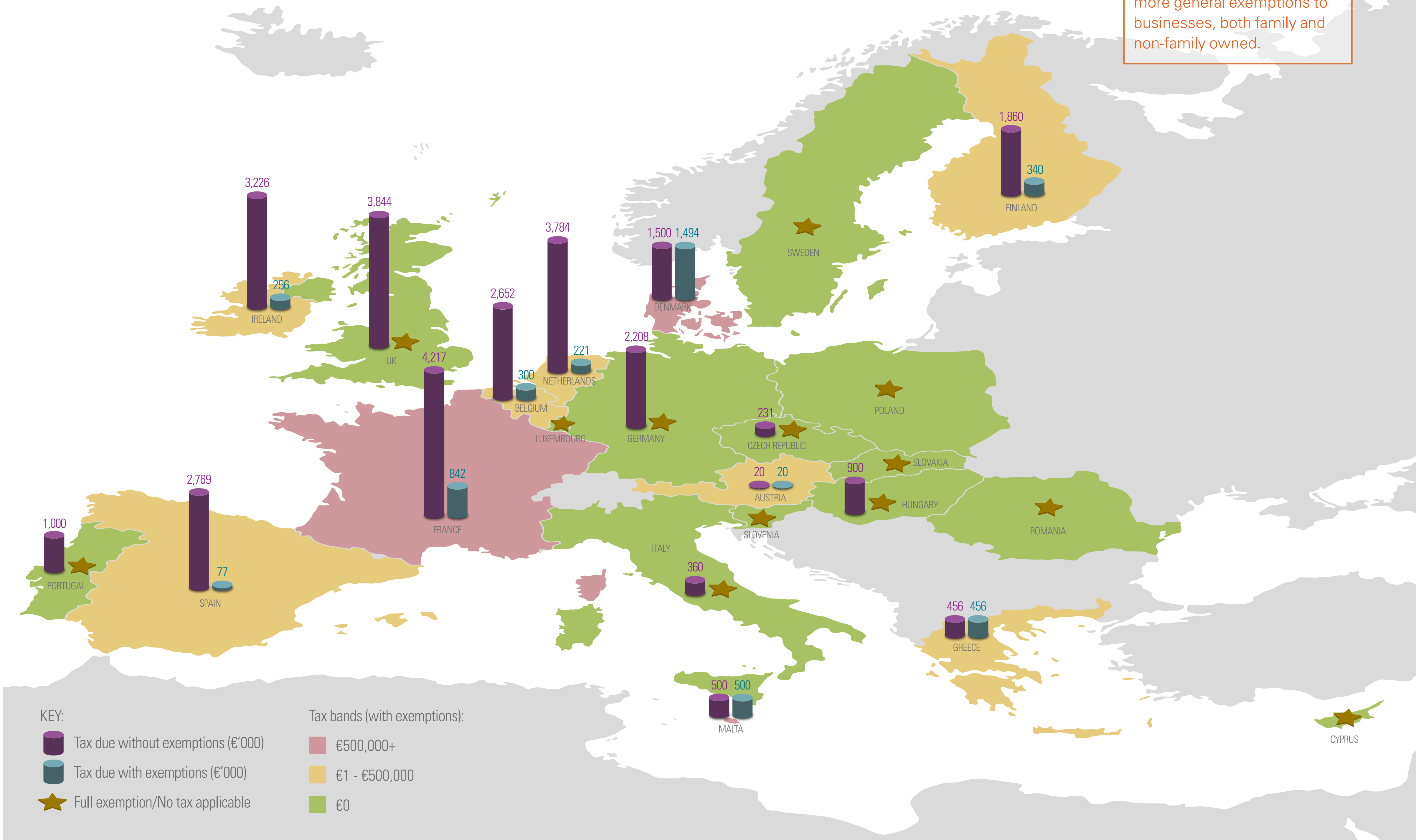
Looking at the data relating to the tax levied upon succession through inheritance, some countries' tax regimes offer a far more favourable landscape than others which may raise the question as to why there are such significant differences across geographies, with some offering widely different regimes across a common border. As many as five different types of tax can apply, and while this may not be surprising given that 23 countries are represented in the survey, it does show that systems across Europe are neither uniform nor simple to understand. One could argue that this could be a major hindrance to the proper functioning of the single market.

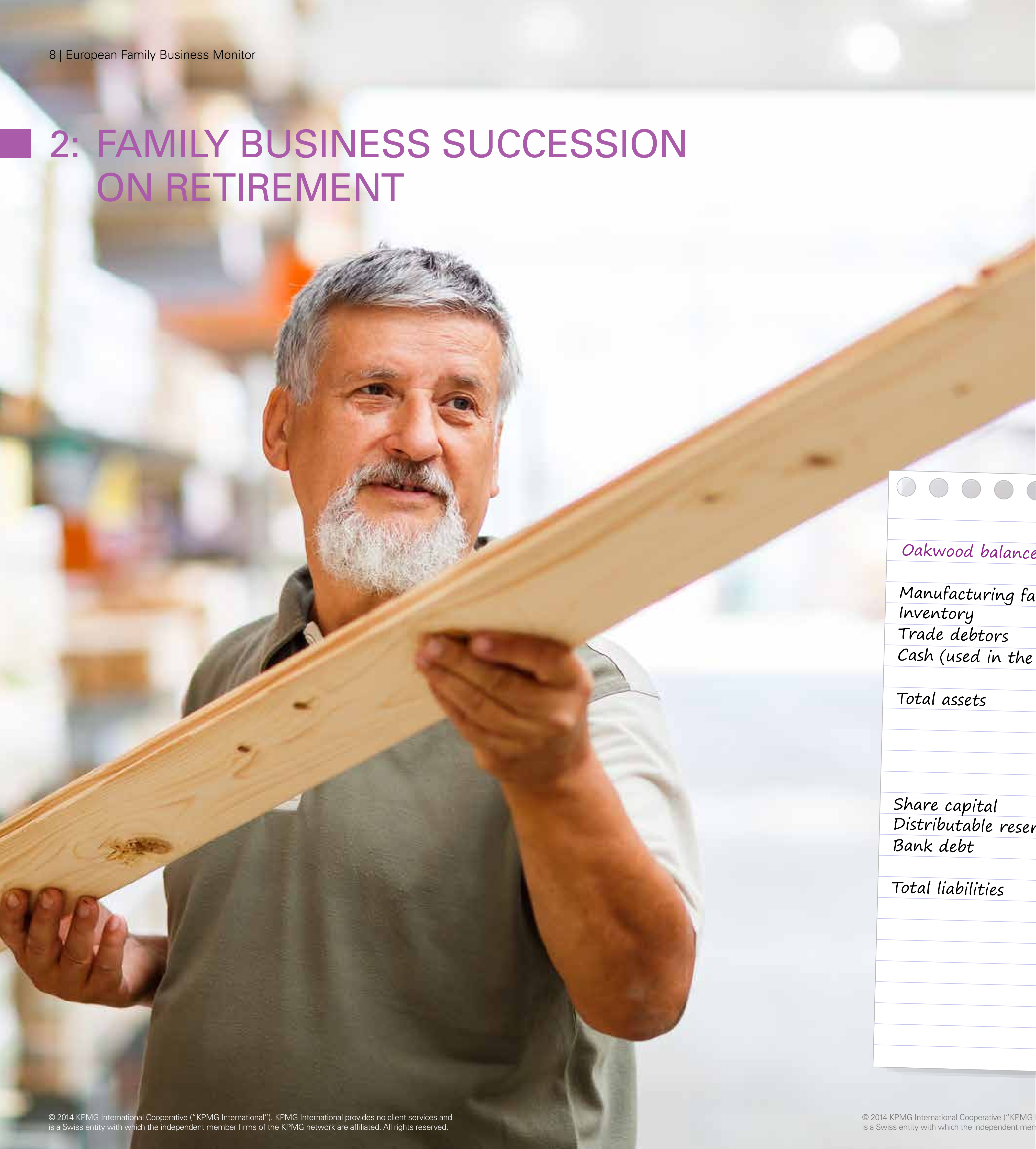
For Family Businesses, tax levied upon succession can have a real impact upon its future longevity. An analysis of the tax rates levied across the 23 countries based on the case study on page 3, delivers some startling results. In the countries covered by this survey, tax levied on succession ranges from €0 to just over €4.2m on a business valued at €10m. Given that no cash is generated by the individuals or the business as a result of the business transfer, the funds to meet the tax levy must be found from other sources. Paying significant amounts to Government Treasury departments may be a consequence of the tax laws, but that means the cash can't be used for other business purposes such as reinvestment for further growth.

Families with international business operations, and potentially with family members in different parts of Europe, have a complex situation to manage and plan for. It should not, therefore, be surprising to see Family Businesses located in those territories with the more favourable tax rates enjoying more success, and with seven countries imposing no taxes at all, businesses operating there are provided with a real competitive advantage.

Figure 1c: Country comparison of tax treatment pre- and post-application of exemptions and reliefs on inheritance, based on December 2013 rates

Of the 16 countries offering exemptions and reliefs, only 10 are specific to family relationships. The others offer more general exemptions to businesses, both family and non-family owned.





2: FAMILY BUSINESS SUCCESSION ON RETIREMENT

CASE STUDY

Again, we asked tax experts from KPMG member firms in each country to consider the following facts:

John Smith has owned his Family Business, Oakwood, for over ten years.

He invested €1,000,000 to incorporate the company and has worked hard over the years to build up the enterprise, the current balance sheet is shown below. The business is now valued at €10,000,000 on an arm's-length basis (which includes €5,000,000 of goodwill). All assets are business related.

In 2013 as John is getting older and wishes to retire he decides to gift Oakwood to his son, David, who is 35 years old. David intends to continue the business for more than 10 years.

What is the tax impact of John gifting the business to David in 2013 presuming that John is still alive for at least 10 more years?

Oakwood balance sheet as at date of transfer:

Manufacturing facility (real estate)	€3,000,000
Inventory	€2,000,000
Trade debtors	€2,000,000
Cash (used in the business)	€1,000,000
Total assets	€8,000,000
Share capital	€1,000,000
Distributable reserves	€4,000,000
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TAX DUE ON RETIREMENT

Tax due without exemptions and reliefs

The analysis in Figure 2a indicates that in six countries no tax would be imposed upon transfer of ownership due to retirement. Interestingly these are the same countries – with the exception of Luxembourg – that have no tax imposed on inheritance, namely Cyprus, Poland, Romania, Slovakia, Slovenia and Sweden. There remain 17 countries imposing taxes with France and Ireland once again appearing in the 'red zone', imposing a tax levy of between €2.8m and €4.2m upon a transfer of the business.

Tax due with exemptions and reliefs

Figure 2b once again shows that the exemptions and reliefs can have a dramatic effect on the tax landscape. Assuming all available exemptions and reliefs are applied, 13 countries apply no tax on retirement in our hypothetical Family Business. This is the same number as on inheritance, however Luxembourg no longer remains favourable (the tax due on inheritance is less) and is replaced by Belgium. The differing tax treatment of inheritance and retirement is interesting and such policy differences can often result in changes to the families' behaviours. For example, the leaders of Family Businesses may hold on to control of the business for tax reasons, which can be frustrating for the next generation and act as a constraint on business growth.

There are two countries in the red zone, with Malta appearing again due to a Duty on Documents (a transfer tax), highlighting that it's not necessarily the obvious taxes that increase the costs.

Again exemptions and reliefs apply to family situations in some countries, but in others are available to businesses regardless of family ownership.

Once more, it is worth highlighting the 'deferral' option available in the Netherlands as already explained on page 4. Here, if our family takes advantage of the deferral, the tax due would reduce to €288,283, although this could become payable at some point in the future.

In Denmark, once more reliefs and exemptions do little to the level of tax payable.

Figure 2a: Tax due without exemptions based on December 2013 rates

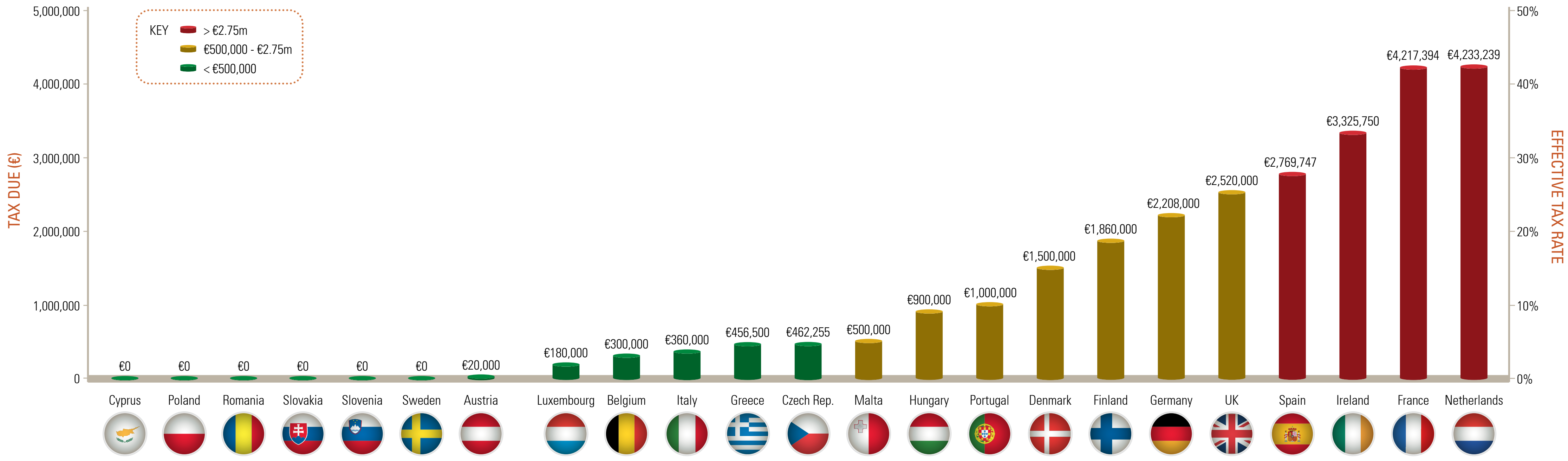
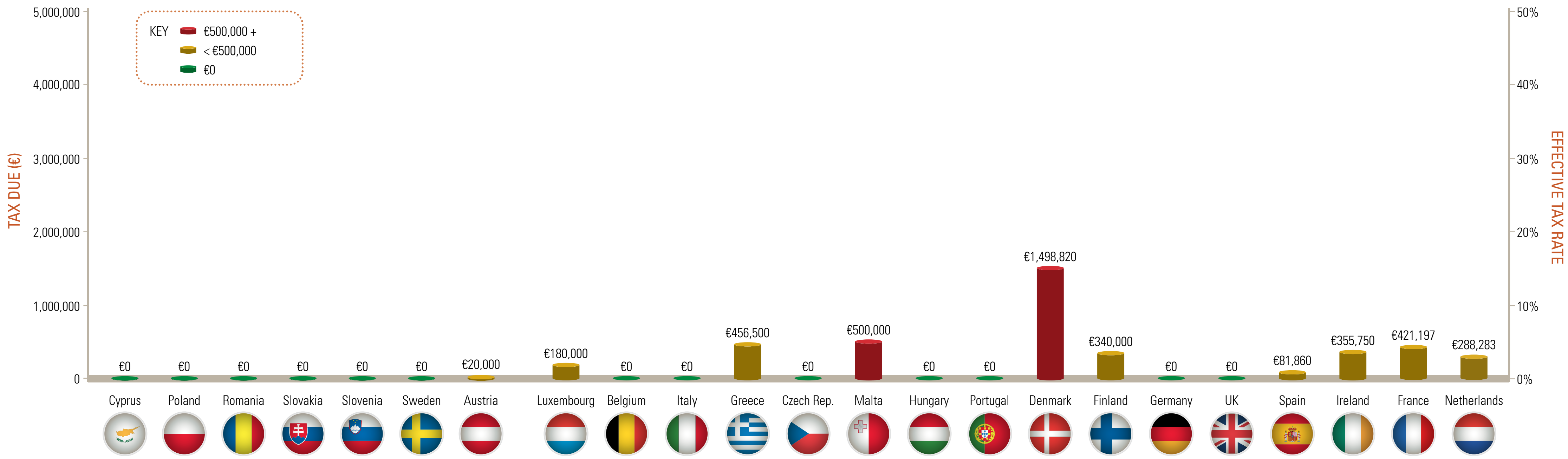


Figure 2b: Tax due with exemptions based on December 2013 rates



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TAX DUE ON RETIREMENT

Ensuring that a succession strategy is in place is often ranked as one of the top priorities of Family Businesses, alongside development of the next generation.

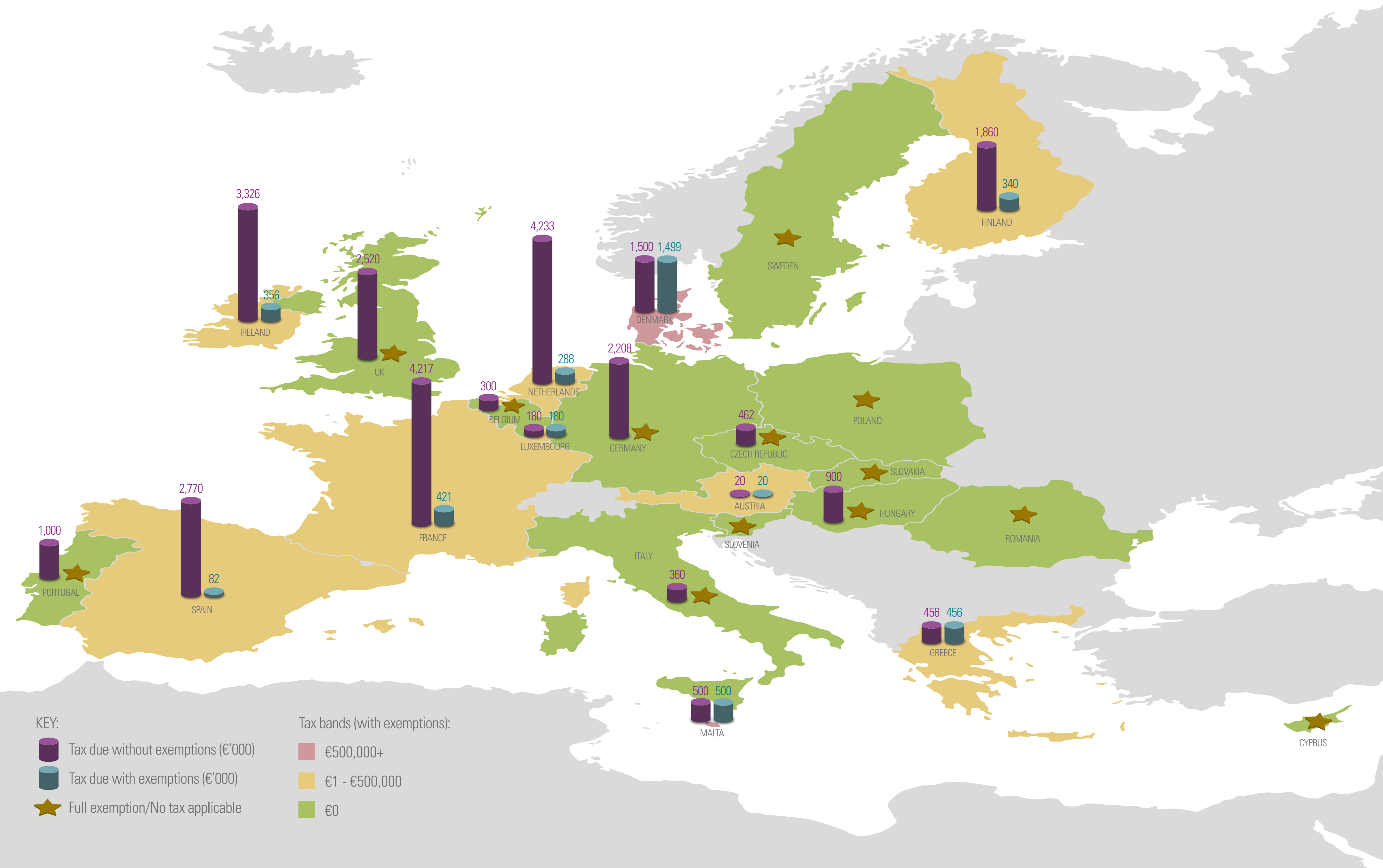
Tax being levied upon retirement can have an influence on the ability of a business to survive past the first generation. Again, tax is charged in many countries even though no cash has been generated as a result of the transfer. As illustrated in our section on inheritance, some countries have a more favourable tax regime than others.

The choice of location is of course influenced by a number of factors, and tax is only one of these. It is interesting to note however that choosing to base a family and business in Belgium, Germany, Luxembourg or the Netherlands could result in significantly different tax bills. The EU reality of freedom of movement of people and capital makes this an important issue for business owners.

Many of the issues highlighted on page 6 apply again. Individual decisions on retirement will inevitably be influenced by the tax bill but such important decisions should primarily be driven by considering personal issues and what is in the best interests of the business. Thought should be given to the economic effects of the taxes levied in this situation.

In general, a transfer of the business on retirement attracts more taxes than on inheritance, with Capital Gains Tax being added to the original four charges.

Figure 2c: Country comparison of tax treatment pre- and post-application of exemptions and reliefs on retirement, based on December 2013 rates



SUMMARY

Methodology

The European Family Business Tax Monitor is based on the findings of 23 countries who undertook a taxation review on two scenarios for Oakwood, a Family Business valued at €10m. This first Monitor has looked into the effects taxation can have on the transfer of the business to family members upon inheritance and retirement.

Each participating country was given two case studies and a questionnaire to complete providing details on how their country would tax each event. Further research and analysis was then undertaken to highlight key trends in relation to exemptions and reliefs. The 23 countries engaged in the study are:

- Austria
- Belgium
- Czech Rep.
- Cyprus
- Denmark
- Finland
- France
- Germany
- Greece
- Hungary
- Ireland
- Italy
- Luxembourg
- Malta
- Netherlands
- Poland
- Portugal
- Romania
- Slovakia
- Slovenia
- Spain
- Sweden
- UK

In these difficult economic times governments need to raise revenues, and therefore reductions in inheritance and gift taxes may be difficult. Tax policy is set by governments and is influenced by the decisions and approaches of previous governments as well as the current economic climate. Policymakers understandably want to balance the generation of tax to reinvest in local economies with an element of fairness. What this analysis shows however is that there is a lack of consistency across Europe in the levying of tax and that the tax literate – those who are aware of exemptions and reliefs and that qualify for them – can make large tax savings. It is therefore important that families ensure they understand and, where relevant, qualify for all exemptions and reliefs available. By way of an example, passing on the business upon retirement in Germany and the UK could cost a family €2.2m and €2.5m respectively if the families do not qualify for the exemptions, or nothing at all if they do. Quite an incentive to make sure that all reliefs and exemptions are understood.

Many countries do impose conditions on the past and future ownership of the Family Business, and where this results in continued family ownership in return for low or zero taxes this is to be welcomed. This applies in Germany, Ireland, Italy and the United Kingdom amongst others. Given the positive economic performance of many family owned businesses during the recent recession and their appetite for expansion, continued family ownership would appear a sensible policy objective, and should be encouraged.

One issue to address is where families and businesses have to fund tax liabilities arising as a result of events which are inevitable, and which result in no economic return to them. Financial resources have to be used to fund these liabilities resulting in less money for future business investment. Investment of course drives increased employment and growth, key issues for all governments and economies. In a recent survey undertaken by European Family Businesses and KPMG, many Family Businesses surveyed indicated that they believed simpler tax rules could have a positive impact on the future success of their business. With countries competing to be attractive to businesses, tax policy may determine not only the future of the Family Business, but also where they choose to do business.

We trust that you have found this first edition insightful.

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Roger Pedder   Gary Deans

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COUNTRY SUMMARY NOTES*

AUSTRIA

NO EXEMPTIONS AVAILABLE

- Inheritance and gift tax was abolished in 2008.
- A reporting obligation exists for gifts made during life.
  - Transfers between close relatives up to a fair market value of €50,000 per year do not need to be reported.
- Real Estate Transfer Tax ('RETT') is charged in this case study, based on a special tax value which is roughly 1/3 of the market value of the property.
  - RETT also applies if all shares in a company are transferred to one single recipient.
  - If transferring property to a child then a special rate of 2% applies.
  - RETT would not apply if shares were transferred to more than one recipient.

BELGIUM

REDUCED TAX RATES & PARTIAL EXEMPTIONS AVAILABLE ON INHERITANCE; FULL EXEMPTIONS AVAILABLE ON RETIREMENT

- Inheritance tax and gift tax rates depend on the region (Flemish, Walloon or Brussels – Capital) where the donator/deceased is domiciled.
- The donation of a family owned business is exempt from gift tax in the Flemish Region.
- A reduced inheritance tax rate of 3% in the Flemish Region applies for transfers to children, spouses or cohabiters.
- To benefit from such exemption (0% gift tax) or relief (3% inheritance tax), it is necessary that in principle 50% of the shares are fully owned by the donator/deceased and his family at the moment the transfer occurs.
  - Only applicable for companies who have their centre of effective management in the European Economic Area and which carry on an industrial, artisanal or agricultural activity.

CYPRUS

NO TAX APPLICABLE

- Cyprus has no inheritance or gift tax.
- No other tax is applicable in this case study.

CZECH REPUBLIC

FULL EXEMPTIONS AVAILABLE

- Inheritance and gift tax rates depend on the relationship to the deceased (the donor) and the beneficiary (the donee).
- Spouses, children, grandchildren, parents and grandparents, siblings etc. fall within categories 1 and 2 and are usually exempt from inheritance and tax.
- Changes to inheritance/gift tax legislation is effective from 2014.

DENMARK

REDUCED TAX RATES & PARTIAL EXEMPTIONS AVAILABLE

- Inheritance tax and gift tax charged.
- Inheritance tax is charged at 15% on the total net estate value exceeding the basic allowance of DKK264,100 if the estate is passed on to children.
- Gift tax is charged at 15% on the total value of the gift exceeding the basic allowance of DKK58,700 if the gift is made to children.

FINLAND

REDUCED TAX RATES & PARTIAL EXEMPTIONS AVAILABLE

- Inheritance tax and gift tax apply.
- Rate of tax depends on the proximity of relationship between the deceased/donor and the beneficiary/donee and the value of the estate/gift.
- Inheritance and gift tax vary for spouses, direct heirs and spouses direct heirs between 7-19% depending on the amount of the gift or inheritance.
- Under some circumstances a sale of the family business to the son for less than the market value can be exempt from inheritance tax as well as the proceeds being exempt from capital gains tax.

FRANCE

REDUCED TAX RATES & PARTIAL EXEMPTIONS AVAILABLE

- 75% of value of shares and assets in businesses is exempt from inheritance and gift tax.
- An additional 50% reduced rate is applied if the donator is less than 70 (concern only the gift tax).
- Shares (34% or 20%) have been held for at least 2 years prior to transfer and should be held at least 4 years after transfer.
- Certain holding commitment conditions must be met.
- At least one of the beneficiaries must undertake to run the business during 3 years.
- RETT would not apply if shares were transferred to more than one recipient.

GERMANY

FULL EXEMPTIONS AVAILABLE

- 100% exemption for transfer of business on retirement or inheritance if:
  - The business is continued for 7 years.
  - The sum of salaries in next 7 years is not lower than 700% of the average salary in the 5 years before succession.
  - No more than 10% of relevant business assets qualify as passive assets.
- 85% exemption available if business continued for 5 years and sum of salaries not below 400% within a 5 year period in comparison to the average salary of the 5 years before succession.
- If the preconditions are met then a reduced tax rate is applicable irrespective of the degree of relationship between transferor and transferee.

GREECE

NO EXEMPTIONS AVAILABLE

- Inheritance and gift tax charged.
- Tax rates depend on the proximity of the relationship between the deceased/donor and the beneficiary/donee and the value of the estate/gift received.
- Lowest tax rate for spouses, cohabiters, children, grandchildren and parents.

HUNGARY

FULL EXEMPTIONS AVAILABLE

- Inheritance tax and gift tax charged.
- Estates or gifts transferred to descendants, ascendants and spouses are exempt from tax.

IRELAND

REDUCED TAX RATES & PARTIAL EXEMPTIONS AVAILABLE

- Relief on transfer of business on retirement or inheritance.
- Business Property Relief.
- The value of business and agricultural property is reduced by 90%.
- Reduction clawed back if assets not held for 6 years.
- Higher personal allowance also available if transferred to children.

ITALY

FULL EXEMPTIONS AVAILABLE

- Inheritance and gift tax re-introduced.
- Transfers to spouse or direct descendant of companies or equity investments are not subject to tax if:
  - the business is continued for 5 years;
  - the business is controlled by the spouse or descendant.

  Otherwise a tax at 4% on the value of the estate or gift exceeding €1,000,000 is applicable.
- Real estate is subject to tax at 3% if specific exemptions are not applied. Full tax exemptions are applicable for the main house or the estate transferred along with the business.

*based on December 2013 rates

COUNTRY SUMMARY NOTES*

LUXEMBOURG

FULL EXEMPTIONS AVAILABLE ON INHERITANCE; NO EXEMPTIONS AVAILABLE ON RETIREMENT

- Inheritance and gift tax charged.
- Inheritance to direct descendants is exempt from inheritance tax to the extent that it does not exceed the amount that would have been received on intestacy. A reduced rate for direct descendants applies thereafter.
- Reduced rate of tax between 1.8% - 2.4% applies for gifts to direct descendants and ascendants.

MALTA

NO EXEMPTIONS AVAILABLE

- Inheritance and gift taxes are not applicable in Malta.
- The donor of shares in a Maltese company suffers no tax on capital gain where the recipient is the spouse, descendants or ascendants in the direct line and their relative spouses, or in the absence of descendants, brothers or sisters and their descendants.
- Duty on documents and transfers (inter vivos and causa mortis) is payable by the recipient at 2% or 5%. The 5% rate applies if it is a transfer of immovable property or a transfer of shares held in a company 75% or more of the assets (as defined) of which are immovable property or rights over immovable property.

THE NETHERLANDS

REDUCED TAX RATES & PARTIAL EXEMPTIONS AVAILABLE

- Inheritance and gift tax are applicable.
- The rate of tax charged depends on the proximity of the relationship between the deceased/donor and the beneficiary/donee and the value of the inheritance or gift received.
- Lowest rate of tax for spouses, partners and heirs in the direct line.
- 83% exemption on inheritance and gift tax available for business assets.
- Personal income tax also applicable at 25%. There is no exemption available but the personal income tax claim can be deferred/transferred to the next generation.

POLAND

FULL EXEMPTIONS AVAILABLE

- Inheritance tax and tax on gifts during lifetime are applicable.
- Inheritance and gifts from spouses, descendants and ascendants are exempt from inheritance and gift tax if declared with the respective tax office within 6 months.

PORTUGAL

FULL EXEMPTIONS AVAILABLE

- Inheritance and gift tax were abolished in Portugal in 2004.
- Instead stamp duty charges on various events including inheritances and gifts.
- Transfers to spouses, descendants and ascendants are exempt from stamp duty.

ROMANIA

NO TAX APPLICABLE

- Inheritance tax and gift tax are not levied in Romania.
- Notary fees and stamp duty may be chargeable in relation to inheritance.
- Romanian tax legislation includes a specific inheritance tax in case of real estate with some exceptions. For the transfer of the ownership right by inheritance, no tax should be applied if the succession procedure is debated and finalised within a 2 year term from the death date of the owner of the estate. If the succession procedure is not finalised within the term provided above, those who inherit are liable to pay 1% tax applied at the taxable base.

SLOVAKIA

NO TAX APPLICABLE

- Inheritance and gift tax were abolished in Slovakia in 2004.
- No other tax is applicable.
- Only applicable if the gift or transfer is not received in connection with an entrepreneurial activity of the individuals.

SLOVENIA

FULL EXEMPTIONS AVAILABLE

- Inheritance tax and gift tax are applicable.
- Inheritance and gifts to spouses and direct descendants are exempt from tax.

SPAIN

REDUCED TAX RATES & PARTIAL EXEMPTIONS AVAILABLE

- Inheritance and gift tax are applicable.
- General reduction available for descendants/ ascendants on the value of the assets inherited (i.e. no significant reduction, maximum €20,000).
- 95% reduction on the value of the shares inherited/ gifted, provided certain conditions are met. (Please note that Autonomous Regions may provide different reductions on other assets).
- Autonomous Regions may provide different allowances, reductions or exemptions. (i.e. case by case analysis required).

SWEDEN

REDUCED TAX RATES & PARTIAL EXEMPTIONS AVAILABLE

- Inheritance tax and gift tax are not applicable in Sweden.
- No other taxes applicable.

UNITED KINGDOM

FULL EXEMPTIONS AVAILABLE

- Inheritance Tax – 100% or 50% Business Property Relief available if it is a qualifying business.
- Transfer of relevant business property – Business assets have been held for at least 2 years prior to transfer.
- Capital Gains Tax – Gift Hold Over Relief:
  - No capital gains tax will be paid by the donor instead the gain is rolled-over reducing the recipient's base cost.
  - Entrepreneurs' Relief – 10% tax rate on first £10 million gain on disposal of business.

*based on December 2013 rates

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