2017 Global Family Business Tax Monitor

Preserve your legacy: a global study on inheritance tax for family business

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Marnix has more than 30 years of experience in the field of tax and specializes in issues relating to ultra-high-net-worth individuals (UHNWIs) with a business connection, (corporate) income tax; capital gains tax; wealth tax and estate tax planning — domestically and cross-border. He is Global Client Service Partner of a major internationally orientated Dutch family-owned business. His major projects include advising about foreign investments, succession planning, restructuring corporate and personal holding structure.

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Thomas Zellweger is Chair of Family Business at the University of St. Gallen, Switzerland, where he also directs the school's Center for Family Business. He was a research fellow at Babson College, US; a visiting professor at the University of British Columbia, Sauder School of Business, Canada; and is currently a visiting professor at the University of Witten/Herdecke, Germany. Thomas is a member of three supervisory boards of family firms in Switzerland, and advises family firm owners on governance and strategic issues.

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Do you know what taxes will apply when you pass your family business on to the next generation?

Smooth succession is at the heart of the health and longevity of family businesses. And a vital component of succession planning is inheritance tax planning, because the differences in inheritance tax rates between jurisdictions can have a very negative impact on the proportion of assets that a family business can pass on to the next generation.

You might be forgiven for assuming that, if a country offers a business-friendly, benign tax environment in which to start and scale a business, it will also allow the smooth transition of that business to the next generation. But this is not always the case. And, even though many countries have no explicit inheritance tax, they may instead impose a range of financial burdens or hidden taxes that apply to the transfer of a family business to the next generation.

The University of St. Gallen and EY have teamed up to compare 69 different countries' inheritance rules with regard to family business succession in order to identify the economies that offer the best conditions for family business transfer.

Equality or preservation?

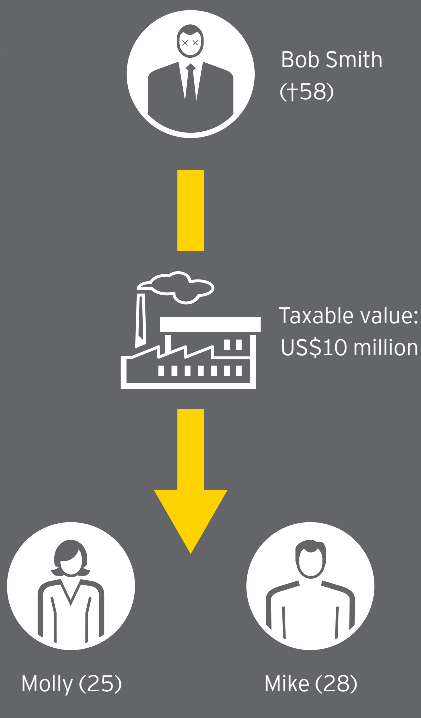
Inheritance taxes, like all taxes, are not only of interest to those who are directly affected by them. Differing approaches to tax may reflect cultural attitudes to wealth, and they will have an impact on society as a whole.

Some countries are committed to minimizing the degree of wealth that can be inherited. These jurisdictions typically promote an egalitarian society in which the gap between the very richest and the very poorest is minimized – or at least controlled. Inheritance tax is designed to spread wealth more widely and prevent a concentration of wealth in the hands of a few families. The consequence is that this can, and does, affect family business assets as much as personal assets.

Other jurisdictions are committed to supporting stable family networks in which wealth is preserved. But an analysis of our findings shows jurisdictions that, on the face of it, share similar approaches to wealth (Austria and the UK, for example) apply widely different tax rates to family business transfer.

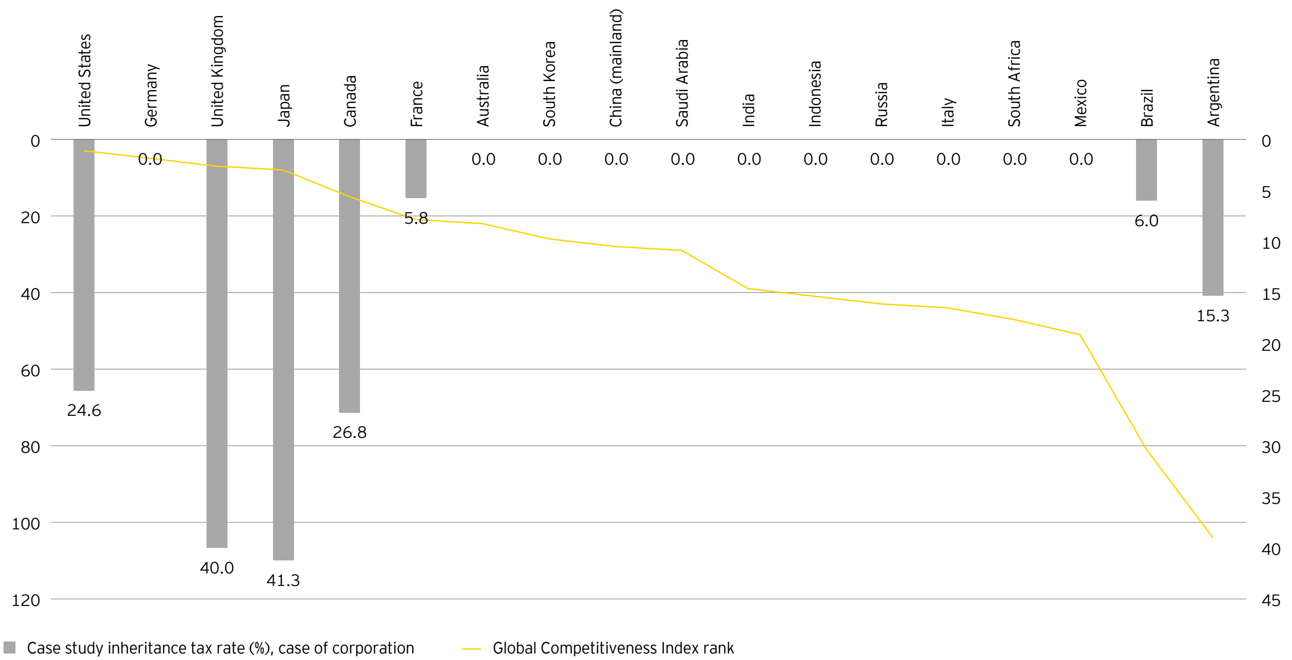
For the purposes of this study, we have taken a simple and universal example to illustrate global differences, based on the following scenario:

Bob Smith (58 years old) is a 100% owner of the business he founded and is a resident of the capital city of your country. The taxable value of the business is US$10 million. Bob has two children: Mike (28) and Molly (25). Unexpectedly, Bob dies and, through his will, the company passes to his children.



What inheritance tax will Mike and Molly have to pay?

Global Competitiveness Index ranking (left axis) and case study inheritance tax rate (%) in case of corporation (right axis)



Source: EY Family Business Inheritance Tax Survey; World Economic Forum *Global Competitiveness Report 2016–2017*; EY Knowledge analysis.

Ranked in order, Switzerland, Singapore, the US, the Netherlands, Germany, Sweden, the UK, Japan, Hong Kong and Finland comprise the top 10 best places in the world to do business, according to the World Economic Forum (WEF) *Global Competitiveness Report 2016–2017*. And yet, while Switzerland and Germany have zero inheritance tax, the rates in the UK and Japan are 40% and 41.3% respectively.

Across the G20 — the leading 20 economies in the world — a similar picture emerges: the countries that are highest ranked in terms of global competitiveness are among those that apply the highest inheritance tax rates.

When we compare jurisdictions' corporate tax rates with their inheritance tax rates, we see a lack of correlation.

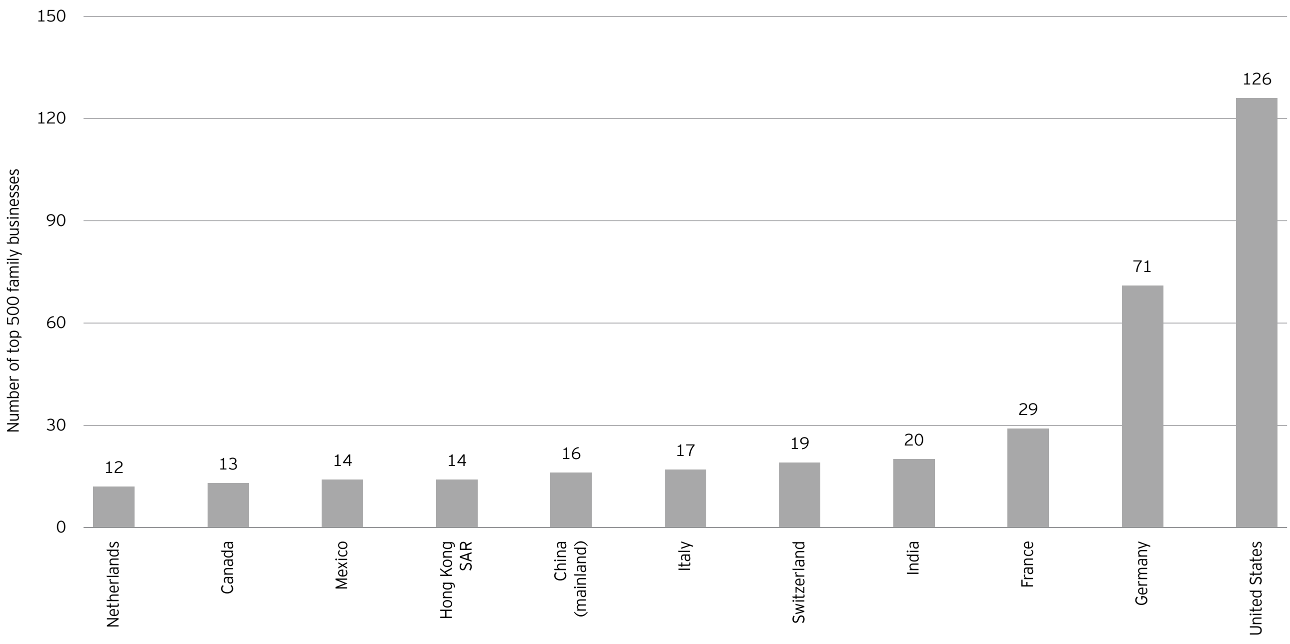
At the lower end of corporate tax burden percentages are Canada, Taiwan and the UK, but each of these jurisdictions applies a heavy burden on the transfer of family business to the next generation. The maximum inheritance tax rate is applied in Japan, while family businesses in mainland China, South Korea and Indonesia enjoy zero rates.

Where are the world's largest family businesses located?

The 2017 Global Family Business Index (Top 500)* ranks the world's biggest family-owned businesses — each of them with revenues of more than US$3.1 billion. "While there are many factors that combine to create a benign environment for family businesses," says Marnix van Rij, EY Global Family Business Leader, "We can see a correlation between low inheritance tax rates and high numbers of top 500 family businesses." For example, Germany and Switzerland together are home to almost 1 in 5 (19%) of the top 500.

* Source: familybusinessindex.com.

Number of top 500 family businesses by country



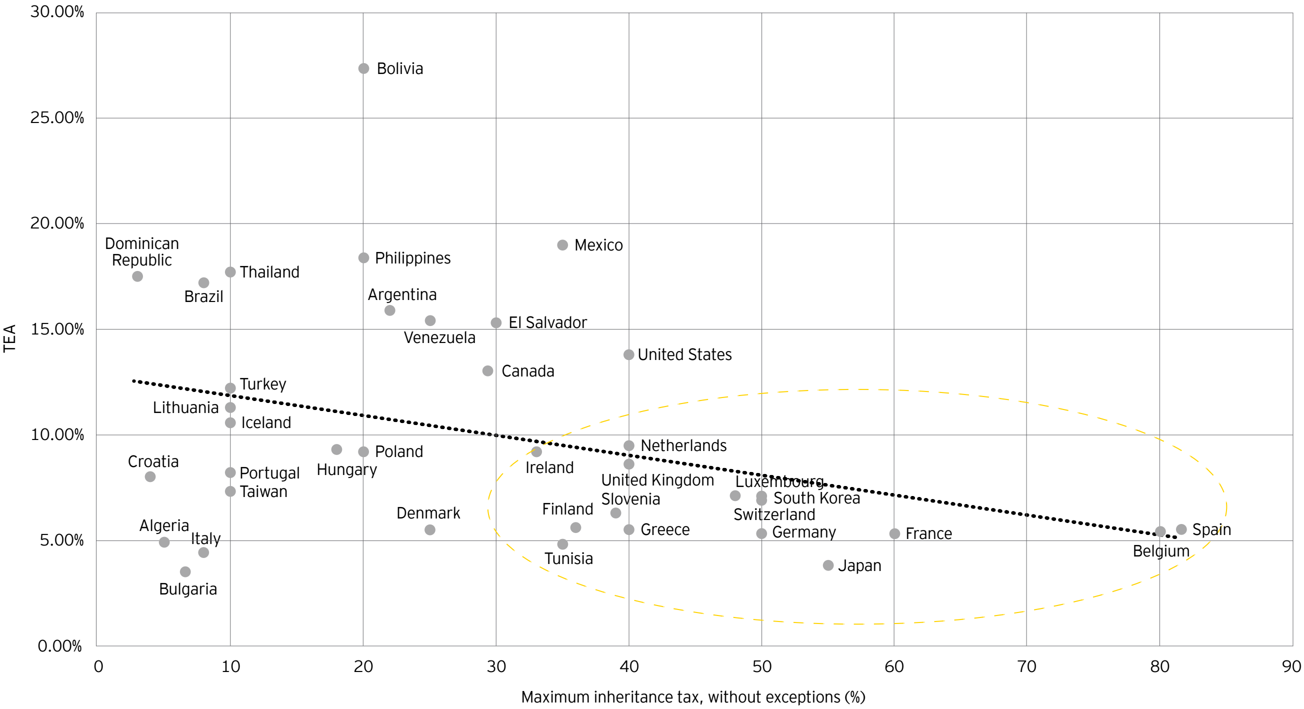
Source: 2017 EY Global Family Business Index.

Do countries with high entrepreneurial activity rates enjoy low inheritance tax?

Countries that score highly on the Total Entrepreneurship Activity (TEA) Index do, as a rule, appear to enjoy relatively low inheritance tax rates for business succession. While it is beyond the scope of our study to prove causation, we can see a correlation between countries that have proven strategies for encouraging entrepreneurial activity and low rates of inheritance tax (IHT) when the time comes to pass on that business to the next generation. The group of countries that apply a maximum IHT rate (before exceptions) of 30% and more all score below the 10% rate on the TEA scale.

There are as many differences between countries in the G20 as there are in the complete listing of 69 countries in our survey: being in a more mature economy is no guarantee of a low IHT burden.

Entrepreneurial activity



Regional comparisons

In Europe, where a median total tax burden of just over 35% applies, IHT burdens vary from zero (for example, in Switzerland, Poland, Spain, Sweden, Austria and Italy) to 40% (the UK), 20% (Denmark) and 10% (Iceland and Greece).

Across the Americas, where the region as a whole enjoys a median total tax burden of just over 20%, there are individual spikes in IHT at 15%, and more in Argentina, Venezuela, the US and Canada (which, at 27%, is the Americas' highest-taxed jurisdiction for passing on a family business).

Across the Asia-Pacific region, 10 in 13 economies apply zero inheritance tax to family businesses passing from one generation to the next, but the region also includes the world's highest inheritance tax economy in Japan. As a whole, the region enjoys a low rate of total tax burden at less than 20%.

In Africa and the Middle East, where maximum corporation tax levels vary radically, from the United Arab Emirates' zero to Saudi Arabia's 85%, the inheritance tax rate that would apply to our example would be zero across the whole region.

What does this regional picture tell us? It shows that inheritance tax rates vary at the country rather than the regional level, and that there is no correlation between IHT approaches and other prevailing taxes, be they corporation taxes or the total tax burden.

Implications for family business owners, policy-makers and legislators

The takeaway for family business owners is clear: if you want to protect your legacy and your heirs, tax planning is essential. The complexities of different countries' tax approaches to family business transfer are significant and often counterintuitive. You may think you are operating in a benign, pro-business jurisdiction, but that is no guarantee of a low IHT burden.

For policy-makers and legislators, these analyses offer some compelling evidence that high IHT rates can and do damage the longevity and growth rates of family businesses, to the ultimate detriment of the country's economy. "Family businesses are pivotal for economic growth everywhere," EY's van Rij points out. "This survey shows how important careful tax planning is to preserve the continuity of the family business and, with it, the health of the global economy."

To read the full interactive survey, visit familybusinesstaxindex.com.