EFB Position Paper:
European Fiscal Environment

Fiscal issues related to family businesses are of key importance to both the family businesses and society at large. This is due to, firstly, the major importance of family businesses in terms of fostering and creating new jobs, giving rise to tax revenues, cherishing renewal and innovation, as well as contributing to sustainable development. Secondly, there are several tax issues that are characteristic of family businesses and particularly affect them.

- For family businesses, taxation has three dimensions: business, owners and their family. **Currently, in most European countries income from equity is subject to at least partial or even full double taxation**: firstly at business level and secondly at owner level. Thirdly, when passed from one generation to another the business assets are often further taxed. The twofold or even threefold taxation represents a major burden on family businesses that most other forms of businesses do not face.
- In the current economic downturn, the importance of a strong balance sheet with a solid amount of equity is emphasized. One important factor contributing to the **retention of earnings** is taxation (see EU Commission Study on Effects of Tax Systems on the Retention of Earnings and the Increase of Own Equity, 15 February 2008; "the Study").
- According to a report by the High Level Group chaired by Wim Kok (Facing the Challenge: The Lisbon Strategy for Growth and Employment, November 2004), **company financing in Europe is currently too lending based and not enough equity based.**
- However, **in most European countries, in terms of taxation, debt is superior to equity** as business receiving the assets in form of debt is allowed to deduct the interest payments in its taxation. On the other hand, dividends paid on equity are not deductible for the payer. At the hand of the owner, dividend income is mostly only partly exempted from tax giving rise to partial double taxation.
- Long-term ownership and stewardship typical of family businesses encompass the goal of transferring the family business to the coming generations. Where **transfers of business** within the family trigger various tax consequences, they **often represent an unnecessary economic burden on the business and the family.**

EFB vision of the main desired qualities of the tax framework for family businesses:

1. Focus on entrepreneurial initiative

Entrepreneurial initiative is vital for the development and prosperity of the economy both on the European and national level. The entrepreneurial initiative intrinsic in family businesses is typified by the long-term responsible ownership, sustainable growth and constant innovation. Therefore, it is important that the applicable tax system reflects the entrepreneurial risk related to a family business in comparison to other forms of investments, e.g. speculative financial investments.

The incentive on entrepreneurial risk should be taken into account when considering the Total Effective Tax Rate (TETR) on income from equity flowing to the owner through the business. This can be achieved by reducing the tax burden of the income from equity, in comparison to income from other forms of capital, on either the business or the owner level or both.

2. Single economic taxation on income from equity

Based on the Equity Economy concept European Family Businesses advocates a tax system that is based on **single economic taxation** on income from equity, i.e. single aggregate taxation of income at the hands of both the business and the owner. Such tax system tends towards neutrality in several aspects (see below).

Furthermore, **European Family Businesses embraces a tax system imposing a moderate and competitive tax burden on family businesses that takes into account their capability of acting as the engine of the economy.** By means of a tax system incentivising the family businesses to develop and enabling them to retain earnings and thus manage financially harsher times as well, also the state can maximise its tax revenues on a sustainable long-term basis (see EU Commission Study on Effects of Tax Systems on the Retention of Earnings and the Increase of Own Equity, 15 February 2008the Study).

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3. Tax neutrality between equity and debt

Income from equity should not be subject to more severe taxation than income from other types of capital, e.g. receivables or real property. The **comparison between** the tax implications of **debt and equity** shall be made based on TETR on the income.

In addition to income, **tax neutrality between equity and debt shall cover wealth as well**. Wealth tax gives priority to debt-driven businesses over equity based businesses with good solidity. While taking into account the need for compensating measures to prevent the tax base of the states from eroding, **wealth tax should be abolished in countries where it still exists.**

4. Tax neutrality between dividends and capital gains

Dividends and capital gains should be subject to equal taxation. This form of neutrality **removes the incentive of the disposal of one's share** in a business instead of holding it and deriving profits from it on a long-term basis. Neutrality **promotes continuity and sustainable development of the business and its interest groups**, such as owners and their families, employees, suppliers, and the fiscal unity.

5. Supportive tax environment for transfers of business

Intra-family change in legal ownership rather envisages a change in the representative (the family member) of the owner (the family) than a true change of ownership. Therefore, even though leaving the civil law concept of change in ownership intact, **European Family Businesses considers that intra-family transfers of business should not be regarded as taxable events with regard to gift and inheritance tax, capital gains tax, transfer tax or similar other taxes on the transfer of a share in business**. This would enable the families to plan and execute intergenerational transfers of business free from the otherwise strongly steering and burdensome factor of taxation.

Where **inheritance taxes extract liquidity and assets from businesses** their short-term tax revenues might be more than outbalanced by long-term revenue losses resulting from the vdiscontinuation of businesses (see EU Commission Communication on the Transfer of Business, 14 March 2006). Therefore, the relief from various taxes on the transfer of family business is beneficial from the state tax revenue perspective as well.

6. Tax neutrality between different kinds of owners

As a combination of the above-mentioned points, E**uropean Family Businesses desires a tax system that treats the owners of family businesses equally in comparison to other kinds of owners**. The comparison shall be made on a three-dimensional basis (business owner family) and not merely on the owner level as often is the case. The owners of family businesses are not perpetual (i.e. foundations, cooperatives, states or municipalities), wherefore they are subject to the third level of taxation, the family level, as well.

Be it equity or debt, business assets or speculative investment assets, or the aim of long-term holding or short-term disposal of assets, the tax system should be neutral towards them all. **It should create a level playing field for all forms of savings and all types of owners.**

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European Family Businesses is a federation of 11 national family businesses associations. Our aim is to make political decision makers aware of the contribution of family businesses to society at large and to promote policies that are conductive to long term entrepreneurship. Our members represent turnover in excess of one trillion Euro, 9% of European GDP.

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