



# Spreading your bets\*

investing outside the family business

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*“Don’t put all your eggs in one basket” has long been the mantra of investment advisers. A balanced portfolio allows financial problems in any one investment area to be absorbed without fundamentally undermining the finances of the family. All well and good, but tough advice to follow when the lion’s share of the family’s capital is tied up in the family business. Paul George looks at the issues facing families wishing to diversify.*

Every family with an established and thriving business has to strike a balance between meeting the needs of the business and preserving the wealth of the family through prudent planning.

Most businesses retain an appetite for capital, and with focus and entrepreneurial expertise in the sector many are excellent wealth generators. But having a significant chunk of personal wealth invested in one unquoted company will make most investment advisers shudder. An entrepreneur may consider the risk part of the cost of building a business they control. For family shareholders however, some of whom may not be involved in running the business, it can feel less comfortable.

If a family builds a meaningful investment portfolio outside their core business, it can provide much needed balance to the family’s finances – and help reduce any strains that can be caused by non-working family members relying on the annual dividend.

So what are the obstacles? There are generally two: the commercial difficulty of extracting capital from the business; and the fear of losing the extremely valuable reliefs. These are issues, but often not the obstacles they are imagined to be.

## Funding

Many family businesses run their finances extremely conservatively, with little or no gearing and a modest dividend pay-out. Without strong shareholder pressure, working capital management is not always a priority and sometimes that shows in an overweight balance sheet. In many cases, capital extraction is perfectly achievable over a period of time. Even where this involves introducing some bank borrowing, the issues created for the company can be modest when set alongside the benefits to the family in creating a more balanced pool of investments.

Where it fits with the wider strategy, bringing in an outside investor may also make sense. This can work particularly well when the management team see an opportunity for growth opportunities – with extra demands on capital and inevitably higher risks than a steadier trajectory for the business. Specialist private equity investors are increasingly comfortable with taking a minority stake alongside a management team they believe in – and, contrary to received wisdom, are often happy to see their funding flow out of the business and into the family’s personal wealth in order to “de-risk” their financial position ahead of a push for growth

## Tax

So what are the tax issues?

A typical family business enjoys a number of important tax reliefs. As an unquoted trading entity, its long-term shareholders generally enjoy relief from inheritance tax through business property relief. Similarly, capital gains tax reliefs allow shareholders to gift their shares down through the

generations without triggering tax on increases in their capital value. Holding an investment portfolio within the same corporate structure as the family business muddies the water considerably as these reliefs are not available to investment companies.

With relatively small parts of the overall capital of the business invested, the reliefs may continue to work well, and sometimes offer tax protection to investment assets which would not normally be enjoyed. Often though, the investment capital needs to be extracted from the business and held separately to avoid “tainting” the tax position of the trading business, putting its reliefs at risk.

Taking cash as a dividend out of the business for investment purposes would usually be prohibitively expensive, as most family members would lose much of the capital extracted in income tax. Fortunately, with careful planning, it is often possible to take investment assets into a separate structure outside the main family company without substantial tax costs. So separation is often not the barrier it is assumed to be.

This is very much an area for bespoke planning, and solutions vary from case to case, but the sorts of approaches that can be taken are illustrated below.

Over a period of five years, a family we recently worked with had built a sizeable investment portfolio within their company. This mostly consisted of property, but there were also some financial investments. The investments had done well and now made up around 25% of the market value of the business. As advisors, we were concerned that the make-up of the asset base was now undermining the tax status of the shares of the holding company.

We advised the family to restructure the business through a reorganisation, moving the investment assets into a separate structure. Mechanically the process involved a number of steps, but most of the process was dealt with in a new temporary holding company created purely for the purpose of the reorganisation, minimising disruption to the commercial activities of the group. When the process was complete the family was left with parallel investments in the shares of two holding companies: one with the family business and one with the investment portfolio.

The whole plan was reviewed by HMRC and went ahead with their approval, giving certainty to the tax position. The tax costs were limited to a relatively small amount of stamp duty. In some cases such a split can be achieved entirely tax-free.

The family does not have tax reliefs, such as business property relief for their shares in the investment structure, and are planning their affairs accordingly. The separation of the two structures is allowing them the flexibility to manage the position independently of the way they handle the main investments in the family business itself.

Sometimes, structure guides commercial thinking. A year on from the separation, the family reports that some welcome clarity has developed due to the divide between the different processes of managing the family business and managing the family’s wealth.

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