



Transcript:

Private Enterprise Conversation Series

2020 Global Family Business Tax Monitor (GFBTM) KPMG South Africa

Introduction

Mel:

Hi there everyone and thank you for tuning in to our very first podcast for KPMG Private Enterprise, South Africa!! I must admit, I am realizing a childhood dream today of going into broadcasting (well sort of) My name is Melissa Duffy and I am the Lead Partner for Family Office and Private Client in South Africa and Africa. I also specialize in expatriate taxation.

I know many of our listeners have probably heard about KPMG but you may not have heard about KPMG Private Enterprise. I'll be joined by my colleague Creagh Sudding who is part of the KPMG Private Enterprise South Africa Leadership Team and he will help explain a bit more about KPMG Private Enterprise. More importantly – this is not about us, this is about you and today Creagh is going to help unpack for us KPMG Private Enterprise's Global Family Business Tax Monitor 2020 publication and tell you why, (small pause) you should take out some time to look through the insights for your family owned business.

Creagh welcome, to get started - why don't you share a bit about yourself and what KPMG Private Enterprise is all about.

Creagh:

Thank you Mel, it is great to be part of the first podcast and able to share some insights where I am fortunate to merge my International Tax and family business consulting experience for our audience. As to what is KPMG Private Enterprise. I usually try and keep it simple, and explain that we are a team of professionals that are dedicated to working with the owners of businesses to help them navigate challenges—no matter the size and stage of the business, whether an entrepreneur, a family business, or a fast-growing company. With our experience we understand what's important to the owner. What is also important is that we provide access to KPMG's

global resources through a single point of contact—being the trusted adviser.

Mel:

Thank you for that explanation. I like to sometimes summarise KPMG South Africa's approach as a local touch with a global reach. Talking about a global reach, many people know the global economy is driven by successful businesses. But do they know why family businesses are so important to an economy like South Africa?

Creagh:

One cannot appreciate enough what a family business brings to an economy Mel, more importantly society as a whole. The stats show that family businesses account for roughly two-thirds of businesses globally, in certain instances almost as much as 90 percent in certain countries, Germany being one. From a South African perspective, the stats are not as easy to gather given the private nature of such family businesses. But it is evident that South Africa aligns with the global trends in this regard, and it is these family businesses that also employ a significant portion of the South African workforce.

Mel:

South African family businesses have really shown their mettle and resilience and their ability to adapt to the needs of the country during the last few months. Another example is that more than 50% of the more than R3 billion pledged for the Solidarity Fund are from families and their family businesses.

Now that we have set the scene Creagh as to the importance of family businesses to any economy. Let's come back to our technical area of expertise and the Global Family Business Tax Monitor which I will just call the Tax Monitor as the official name is a mouthful.

Creagh:

Sure Mel, let's start with the proverbial saying I am sure many of our audience will have heard when it comes to inter-generational wealth transfer, shirtsleeves to shirtsleeves in three generations. Without going into the dynamics of the saying, the Tax Monitor is a survey that reminds family business owners of the tax costs associated with the inter-generational transfer of the ownership in the family business and may in fact contribute to some truth in the saying. For 2020, being the fourth edition, 54 of our member firms with KPMG Private Enterprise teams came together to share insights into the tax considerations of the transfer of ownership in a family business.

Mel:

It is always great when we collaborate with our global network, but surely the tax considerations are not the only considerations when a family is planning for ownership succession?

Creagh:

You are correct, there are many considerations, many non-financial, but the tax costs associated with ownership succession plays a key financial role. The Tax Monitor also talks to one of Benjamin Franklin's well known statements that "there are two certainties in life, death and taxes", and 2020 has also shown that there is a third certainty, being uncertainty. It is the uncertainty, highlighted with the impact of the Novel Corona Virus in 2020, that places heightened emphasis on, and in fact is accelerating the succession planning within a family business.

Mel:

Thanks Creagh, and let's remember that the Tax Monitor considers the tax costs associated with ownership succession in two scenarios, either on death and retirement, where the current generation will transfer ownership to the next generation.

Creagh:

Correct. As I explained to a client recently, the Tax Monitor assists with answering the question we get often "When is the right time to pass the business on to the next generation?". Specifically, the Tax Monitor helps to understand the tax costs associated with transferring ownership either during the owner's lifetime or on death. I know it is not nice to talk about, but the difficult discussions do need to be had, and it is unfortunate that we find where there is little or no planning when the tax costs are triggered on death.

Mel:

So what I am hearing is that the Tax Monitor shows the current generation of family business owners the tax consequences of either no planning, where ownership will only be passed on death, versus planning in advance and ensuring the tax costs of

transferring ownership are optimally managed.

Creagh:

Succinct Mel, I tend to take the long route when explaining these intricacies. I also need to include though that we generally find that one of the challenges is that the founders are living longer and don't necessarily want to relinquish control of the business, and ownership of the business. There can be many reasons for this, but sometimes ownership is the retirement plan, being to live off the future dividends from the business. Coupled with this is the next generation not wanting to step into the business without ownership. This leads to family disharmony. When one starts to question the succession planning and what is causing the disharmony, it generally comes down to communication, in fact the lack of communication between the generations. Although not a financial consideration, highlighting the financial implications of not planning appropriately, and communicating, often starts aligning everyone's understanding of the need to plan and communicate.

Mel:

Effective communication is key in all dynamics, and for a business family we know it is even more important. (pause) Creagh, please do explain a little more how understanding the financial implications, specifically the tax consequences of ownership succession, may actually help with family harmony?

Creagh:

Sure Mel, and it comes down to how the tax consequences may impact on the family wealth or in certain instances, the operating capacity of the successful family business. If there is little or no planning, or understanding as you eloquently noted Mel, the family generally only realise the cash flow difficulties when the transfer happens. The cash flow difficulties arise given that no cash changes hands on the transfer, but there is a tax cash outflow which is triggered. It is this illiquid transfer, but liquid tax cost that in many instances leads to some form of loss within the family wealth or the family business to settle the tax. Just to clarify the loss is essentially a function of where or how the family creates liquidity to settle the tax cost. What we have seen is that either the family has to sell some of the shares in the business (which has emotion attached) to create liquidity, or they manage to convince the board of the family business to utilize some of the working capital of the business. In either instance, there a loss in the family wealth or the family business's operating capacity.

Mel:

Thank you for clarifying Creagh. Can we quantify this loss looking at the results of the Tax Monitor?

Creagh:

Yes Mel we can, at the least the upfront tax cost for a South African passing on ownership of the shares in a family business to the next Generation. The news is unfortunately not positive.

Mel:

What do you mean Creagh, if I recall back to the 2018 KPMG study, we highlighted to our fellow South Africans, both the family business owners and the regulators (i.e. National Treasury and the South African Revenue Service), that the results were best referred to as “concerning”.

Creagh:

The unfortunate news Mel is that not much has changed, the 2020 results evidence the same concerns. To ensure our audience does not get lost in our tax nerd lingo Mel, the study looks at both the gross tax cost, before factoring in any tax exemptions that may be available for passing on ownership in a family business, and then the net tax cost, after applying such tax exemptions. Although South Africa does not stand out on a gross tax cost basis, the key differentiator is that many of the jurisdictions included in the study provide for significant tax exemptions for passing on ownership of a business, in some specifically a family business. For these jurisdictions, the net tax cost for family business owners plays an insignificant financial role in the succession planning.

Mel:

If you saying the results are concerning are you then saying that South Africa is not one of these jurisdictions?

Creagh:

Correct Mel. Similar to the 2018 results, South Africa again has the one of the highest, if not the highest net tax costs for an individual passing on the ownership in a business to the next generation, if we consider a family business valued at €10 million. The net tax costs being 35.6% on death and 36.5% on retirement. As we touched on earlier, the fact that the tax cost is higher for passing on ownership on retirement does not incentivize what we generally recommend, for transition of ownership to the next generation while the current generation is around to share valuable insights.

Mel:

There’s not much difference then between 35.6% and 36.5%. But it’s still a massive cost to manage. What other losses are created by the SA dynamic?

Creagh:

There are Mel, being the long-term implications of the upfront tax cost and the loss to the family wealth or operating capacity of the family business. The long-term loss being the loss of generating

perpetual growth of the family business, job creation and, in turn, the economy and the tax base to support the economy.

Mel:

I couldn’t agree more Creagh. What the Tax Monitor presents is not a great situation for South African family business owners, specifically those in the middle of ownership succession, many forced into it due the impact of Covid. As you are closer to the study Creagh, are there examples where jurisdictions pay particular attention to managing the impact on family businesses?

Creagh:

The study shows many jurisdictions where the net tax costs are minimal to none. If we consider one of the more recent changes, the United States is an example. Prior to 2017 the US was similar to South Africa in the tax costs associated with ownership succession. The United States government and the IRS have provided for a USD10 million exemption on the transfer of a family business, with the long-term view to not stunt the growth of the business and focus on earning the annual tax revenue on the profits of the businesses. It is, however, interesting to note that there is a sunset clause on this provision in 2026.

Mel:

It will be interesting to see whether the outcome of the US elections may impact on the sunset clause Creagh. What about our neighbours in Africa, any interesting results from the Tax Monitor?

Creagh:

It will be interesting Mel, removing the sunset clause would be a good outcome for the US. Regarding the feedback from our colleagues in the rest of Africa, the Democratic Republic of Congo has no net tax costs associated with the transfer of ownership, and Nigeria has a net tax cost of 5%.

Mel:

Creagh, we are almost at the end of our time, and I have thoroughly enjoyed being able to live my childhood dream of being a broadcaster, but before we close off, I think the question we are leaving our listeners with is whether there ways in which families can plan for the tax costs associated with ownership succession?

Creagh:

Mel, I hope I have helped make your radio host experience a good one, and our listeners will take away some valuable insights. As to your final question on planning, I may sound like a broken record but the simple answer comes down to exactly that planning. From a South African perspective, although relatively contentious in recent years in South Africa, and despite the tax provisions brought in to ensure Trusts do not create a tax avoidance vehicle, I believe the non-tax benefits of a trust do still provide the family with a structure that supports a well-designed family governance plan, incorporating wealth governance, while allowing for the longevity and protection of the family wealth, including the ownership of the family business.

Mel:

Well there you have it everyone – some interesting insight into the Global Tax Implications for family businesses and perhaps a lot more for you to think about. Please do have a look at the publication, we've placed a link in the description, and share with us your comments and thoughts with us– we would really appreciate your feedback on how we can make these podcast sessions more valuable and insightful for you. We'll be pressing ahead with new podcasts going forward. Please follow KPMG South Africa on our social media platforms. our website.

Mel Duffy here signing off. Take good care and stay true to your values.