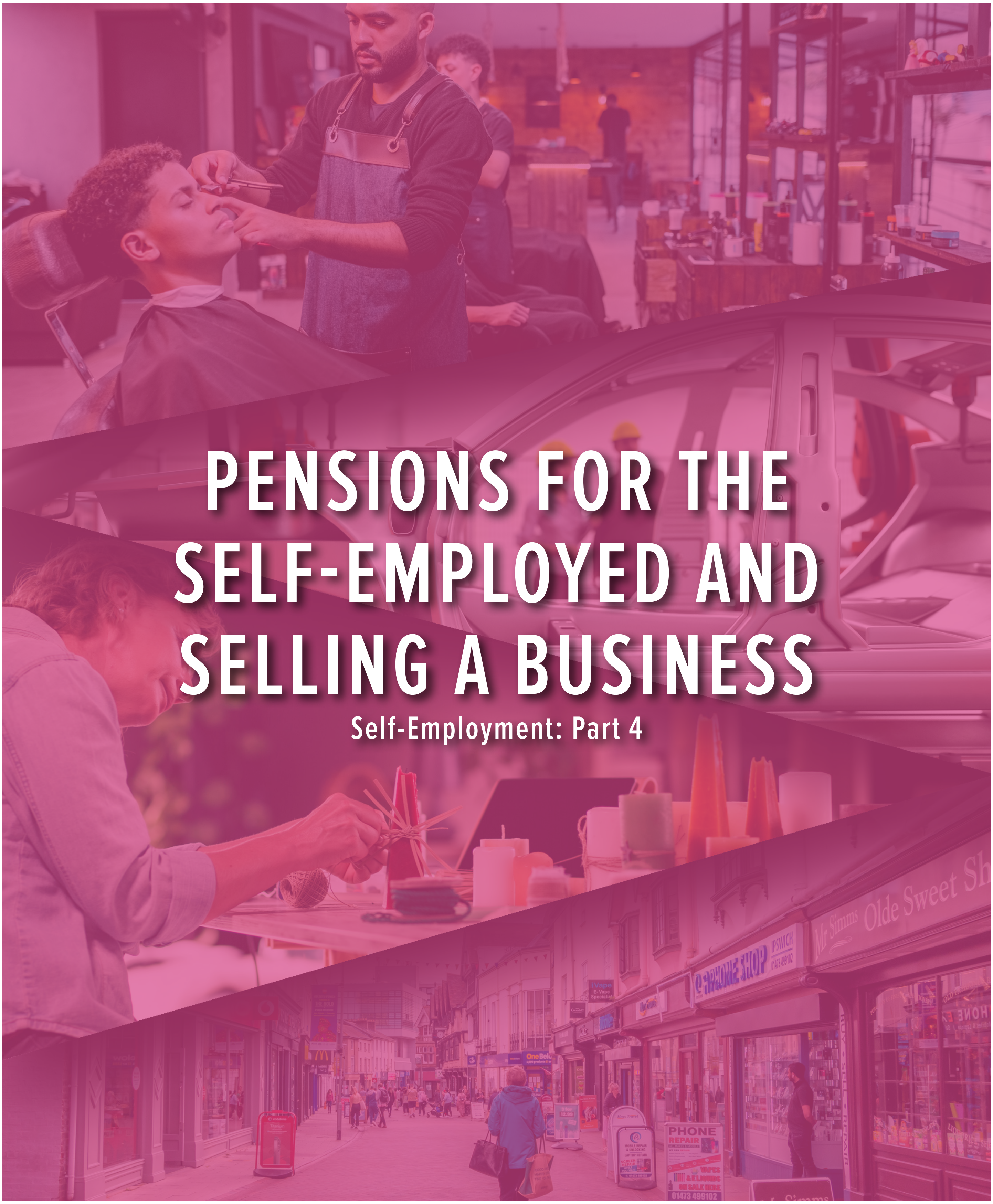

PENSIONS FOR THE SELF-EMPLOYED AND SELLING A BUSINESS

Self-Employment: Part 4

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Federation of Small Businesses

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WHO WE ARE

The Federation of Small Businesses (FSB) is the UK's grassroots business organisation. We are a cross-party non-profit body that represents small business and self-employed members in every nation and region. For over fifty years, FSB has been the authoritative voice on issues affecting the UK's 5.5 million small businesses, microbusinesses and the self-employed.

FSB is the UK's largest business group and leading business campaigner, focused on achieving change which supports smaller businesses to grow and succeed. We also provide our members with a wide range of vital business services, helping them to start, run, and grow successful businesses through high quality protection and support. This includes 24/7 legal support, financial expertise, training and events, debt recovery and employment/HR advice – alongside a powerful voice heard by governments at all levels.

Our local, national and international activism helps shape policy decisions that have a direct impact on the day-to-day running of smaller businesses. We work for their interests through research and engagement with our members and by effective campaigning - influencing those in power through policy analysis, government affairs, media and public relations activity. Our advocacy work starts with our expert external affairs team in Westminster, which focuses on UK and England policy issues, the UK Government, Parliament and media and communications engagement. Further to this, our teams in Glasgow, Cardiff and Belfast work with governments, elected representatives and media in Scotland, Wales and Northern Ireland.

CONTENTS

FOREWORD

The Federation of Small Businesses (FSB) was founded over fifty years ago to support small businesses and the self-employed. Over the decades, the challenges faced by entrepreneurs and our work has evolved, but one constant remains: the need to plan for the future.

For many entrepreneurs, the future remains uncertain when it comes to retirement. Some might prefer to cash in on their pension if they have one, and others might be banking on selling their business to fund their later years.

Auto enrolment has seen millions of workers enrolled into a pension scheme. However, the proportion of self-employed people saving into pensions has been in decline for some time. With the increasing number of self-employed, particularly those going into self-employment at an earlier age, policymakers cannot ignore the need to encourage and incentivise entrepreneurs to save for retirement.

This report shows the importance of making it easier for entrepreneurs to save flexibly through existing accounting or online banking applications, essentially, removing the bureaucracy and making the process easier.

Many rely on selling their business to fund their retirement because they struggle to access traditional pension plans. But that is not always easy to do. Entrepreneurs' Relief (now called Business Asset Disposal Relief), which reduces the Capital Gains Tax rate to 10 per cent on qualifying business sales, has been instrumental in allowing business owners to retire with financial security. While it is welcome that Entrepreneurs Relief was retained up to a threshold of one million pounds at the 2024 Budget, the plans to increase the rate payable upon sale of a business raises the risk that business owners will be less comfortable in retirement, and may be less inclined to invest in their business.

Some choose to pass their business onto a family member, and family-run businesses are an important part of our ecosystem. They should be allowed to continue doing that without the worry that future generations will need to break them up or sell them on to avoid a hefty tax bill.

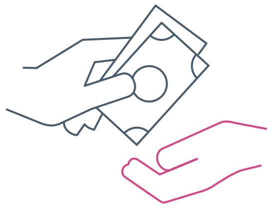
The final part of our report series highlights how the Government needs to make the UK a more – not less – attractive place to start a business.

Tina McKenzie
FSB Chair, Policy and Advocacy

PENSIONS FOR THE SELF EMPLOYED AND SELLING A BUSINESS

52%

of **sole traders** are **not saving** into a pension or Lifetime ISA



27%

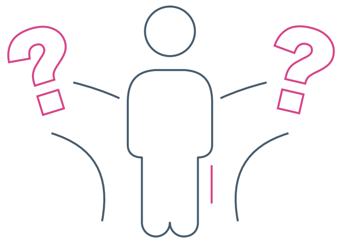
of **sole traders** that aren't saving into a pension say they **plan to rely on the state pension**

10%

of **entrepreneurs** aged between 16-40 **save into a LISA**

The **most common mechanism to improve saving** amongst entrepreneurs is the use of an **existing financial platform** such as an **accounting or online banking app (21%)**

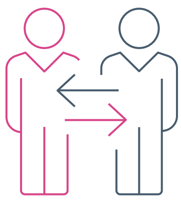
For those **planning to sell their business** in the next two years, **42%** are planning to sell their business (not including to a family member or to employee ownership) and retire



43%

of **entrepreneurs** aged between 61 and 64 find **succession planning challenging**

For those planning to sell their business in the next two years:



16%

are planning to pass their business onto a family member

11%

are planning to transfer it into employee ownership

RECOMMENDATIONS

Pensions for the self-employed

UK Government should:

- Tackle poor pension saving among the self-employed in the second phase of the pensions review, ensuring it aligns with the Small Business Strategy. Any future policy objectives should consider the following (i) barriers to saving for the self-employed, (ii) inclusion of appropriate safety nets (iii) reflect the varying needs of different groups within self-employment as identified in this report and (iv) consideration for those working in part time self-employment.
- Convene a group including the FCA, providers of accounting and finance software, and the pensions industry to explore ways that self-employed individuals can use existing software to manage their pension contributions, building on the work that Nest Insight has done and will do in future.
- Work with software providers to allow Making Tax Digital (MTD) to provide visibility of pension savings for the self-employed by 2030.

HM Treasury should:

- Make the Lifetime ISA more flexible in terms of its age-based eligibility criteria and the penalties which are imposed on withdrawals before retirement, to make it a more attractive savings product for self-employed individuals.

Pension Providers should:

- Promote the option for self-employed individuals to continue contributing to their previous workplace pension scheme after leaving employment. Some pension providers already allow self-employed people to continue to make one-off payments into former workplace pension schemes, in which case they could communicate this opportunity more clearly to self-employed individuals or those that have stopped contributing to a pension. Other pension providers could adopt this model to support self-employed to continue to save and to reduce the need for an individual to have so many small pots.[1]

1 FSB, Business lifecycles, accessed October 2024, https://www.fsb.org.uk/knowledge/fsb-infohub/business-lifecycles.html

Selling a business

The Money and Pensions Service (MaPS) should:

- Provide information, advice and guidance for self-employed individuals looking at succession planning. This should include signposting to the information that FSB provides to our members.[2] A total of 43 per cent of self-employed individuals aged between 61 and 64 identify succession planning as a challenge.

HM Treasury should:

- Commit to maintaining Entrepreneurs' Relief (now called Business Asset Disposal Relief) at 14 per cent in the long run. It is currently due to increase from 10 per cent to 14 per cent in April 2025 and then to 18 per cent in April 2026.
- Increase the 100 per cent allowance for agricultural property relief and business property relief from £1 million to £5 million.

The Department for Business and Trade should:

- Introduce legislation along the lines of the Italian Marcora Law, which provides a framework for employees to take over companies facing bankruptcy or liquidation. This framework has succeeded at ensuring business continuity, primarily through allowing workers to claim would-be future unemployment benefits in a lump sum to help them fund a buyout or rescue and capitalise their new co-operative.
- Provide additional funding to expand Ownership Hubs across the UK.
- Include succession planning as a topic covered by Help to Grow: Management, including the option of employee ownership. Succession planning should be included in the curriculum of other business courses too.

The Money and Pensions Service (MaPS) should:

- Provide information, advice and guidance for self-employed individuals looking at succession planning.

2 FSB, Business lifecycles, accessed October 2024, https://www.fsb.org.uk/knowledge/fsb-infohub/business-lifecycles.html

PENSIONS FOR THE SELF-EMPLOYED

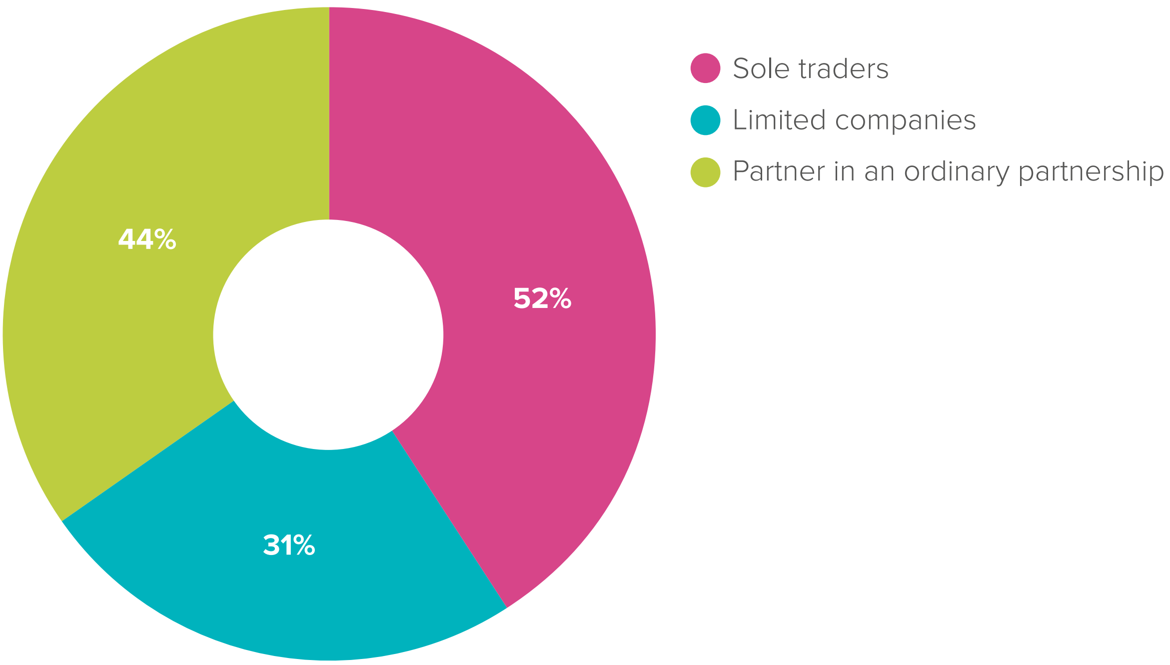
The proportion of working-age population starting their own businesses has more than doubled since 1997. Entrepreneurial ambition in the UK remains high and support has the potential to boost economic growth in the UK. However, behind this success is another story, —a story of decline.

Entrepreneurs are not making adequate provision for their later lives. The 2017 auto enrolment review found 17 per cent of self-employed people were saving into a pension in 2015-16, down from around 23 per cent in 2009-10.[3] As this report series has outlined the self-employed are not a homogenous group. There are differences in earnings, different legal statuses and, protected characteristics.

FSB research shows 37 percent of all entrepreneurs do not save into a pension, or a Lifetime ISA. Entrepreneurs in Wales (41%) are more likely to say they are not saving towards retirement. If we analyse the proportion of entrepreneurs that aren't saving by their legal status, the percentages begin to vary (Figure 1).

Figure 1: Proportion of entrepreneurs not contributing to a pension or Lifetime ISA

Source: FSB, Self-employment and start-up survey, 2023



Sole traders (52%) are most likely to not be saving into a pension. The percentage is even higher for female sole traders with 55 per cent stating they do not contribute to a pension. Lack of saving towards retirement also varies by age and years in business with 44 per cent of those aged under 40 not saving. This increases to 50 per cent for those that have been in business for less than two years.

3 Department for Work and Pensions, Automatic Enrolment Review 2017: Maintaining the Momentum, December 2017, https://assets.publishing.service.gov.uk/media/5a81e501ed915d74e3400a0b/automatic-enrolment-review-2017-maintaining-the-momentum.PDF

Reasons for not saving

Figure 2: Reasons for not contributing to a pension

Source: FSB, Self-employment and start-up survey, 2023

Reasons for not saving in 2022-23 tax year	All	Sole traders	Limited companies
Cash flow constraints	32%	39%	29%
It's too complicated	5%	8%	4%
Contribute to other savings arrangements for retirement (e.g. ISAs)	8%	5%	10%
Have enough saved in pensions or other savings	18%	12%	23%
Plan to sell property or use rental income	11%	10%	11%
Plan to sell my business(es)	13%	7%	14%
I would like to contribute, but lack the time to make arrangements	6%	8%	5%
Late payments or non-payments have meant I can't afford to	6%	5%	7%
Fallen victim to a pension scam and stopped saving into my pension	1%	3%	1%
Plan to rely on the State Pension	22%	27%	18%
Plan to rely on future inheritance	4%	5%	4%
Other	16%	14%	18%

For the third (37%) of entrepreneurs that are not currently saving into a pension or other long-term savings products, the most cited reasons are cash flow constraints (32%), relying on state pension (22%), and existing savings being sufficient (18%). It is notable that six per cent of entrepreneurs report that they would like to contribute, but lack the time to plan, and five per cent say that saving for retirement is too complicated.

Over one in five state they didn't contribute to a pension because they plan to rely on their state pension. The percentage is the same for male and female entrepreneurs. Concerningly, the number increases to 27 per cent for sole traders. The state pension in the UK is currently £10,600 per year (for 2023-24).

Confidence remains among entrepreneurs that wealth generated from property ownership will fund their retirement, with 11 per cent stating they intend to this – a fall from 16 per cent in 2016. This may reflect the fact the tax burden from owning more than one property has risen in recent years.

> **"I've not contributed to a pension since I have set up my business, mainly due to struggling financially, as the business's turnover has not been high enough and therefore it's not been enough of a priority. In the future, I would like to contribute to a private pension but, at the moment it's really hard to do without an increase in turnover in the business. I think it would be helpful if there was more clear information for business owners, and more prompts to contribute for those that are able to."**
>
> Alice Hastie, Sycamore Disability and Business, South West

The percentage that intends to sell their business to fund their retirement varies, with seven per cent of sole traders stating they intend to do this in comparison to 14 per cent that own a limited company. Moreover, it is significant that six per cent of respondents say that late payments meant that they could not save for retirement. FSB's Time is Money report[4] highlighted the extent of late payments. In September 2024, the Government announced an ambitious package of measures to further clamp down on late payments, which should help alleviate this problem as the measures are implemented.

Pension products available to the self-employed

Well over three fifths (65%) of entrepreneurs save into at least one type of pension product or Lifetime ISA. The self-employed pensions landscape in the UK is complex. The pension options available to those in self-employment depends to some extent on an individual's employment status and business structure.

While anyone can set up a personal pension or a Self-Invested Personal Pension (SIPP)[5], providers may have requirements for minimum contributions or regular contributions which some entrepreneurs will not be able to meet. In addition, Small Self-Administered Schemes need to be associated with a limited company, limiting access to those schemes to only certain business owners in specific legal business structures.

4 FSB, Time is money: the case for late payment reform, March 2023, https://www.fsb.org.uk/resource-report/time-is-money.html

5 SIPPs are explained in more detail here: https://www.moneyhelper.org.uk/en/pensions-and-retirement/pensions-basics/self-invested-personal-pensions

In some cases, company directors and limited liability partners are required to be enrolled in workplace pensions. This will depend on their employment status and the number of people with employment contracts in their business. In other cases, they may choose to be enrolled when there is no requirement for them to do so. Since 2018, Nest has been obligated to accept any self-employed person who wishes to access the scheme.

Figure 3: Summary of pension options for entrepreneurs by legal business structure

	Self-invested personal pension/ Personal pension	Small Self-Administered Scheme (SSAS)[6]	Workplace pension	Nest
Sole trader	X			X
Partnership	X			X
Limited company director (employee)[7]	X	X	X	X
Limited company director (non-employee)	X	X		X
Limited liability partnership	X		X[8]	X
Partner in a limited partnership				
Partner in an 'ordinary' partnership	X			X

6 SSASs are set up by limited companies for the benefit of their directors and employees, which can include family members. More detail at: https://www.moneyhelper.org.uk/en/pensions-and-retirement/pensions-basics/defined-contribution-small-self-administered-pension-schemes

7 A director who has an employment contract must be auto-enrolled in a workplace scheme if the company has at least one other person with an employment contract (including another director). A director who has an employment contract can choose to be enrolled in a workplace scheme even if they don't have to be. More information on the position for directors is available at: https://www.thepensionsregulator.gov.uk/en/employers/what-if-i-dont-have-any-staff/directors-and-automatic-enrolment-do-you-have-duties

8 A limited liability partner should be auto-enrolled if they are a jobholder for the purposes of pensions legislation, meaning that they have a worker's contract. See: https://www.gov.uk/hmrc-internal-manuals/partnership-manual/pm260600

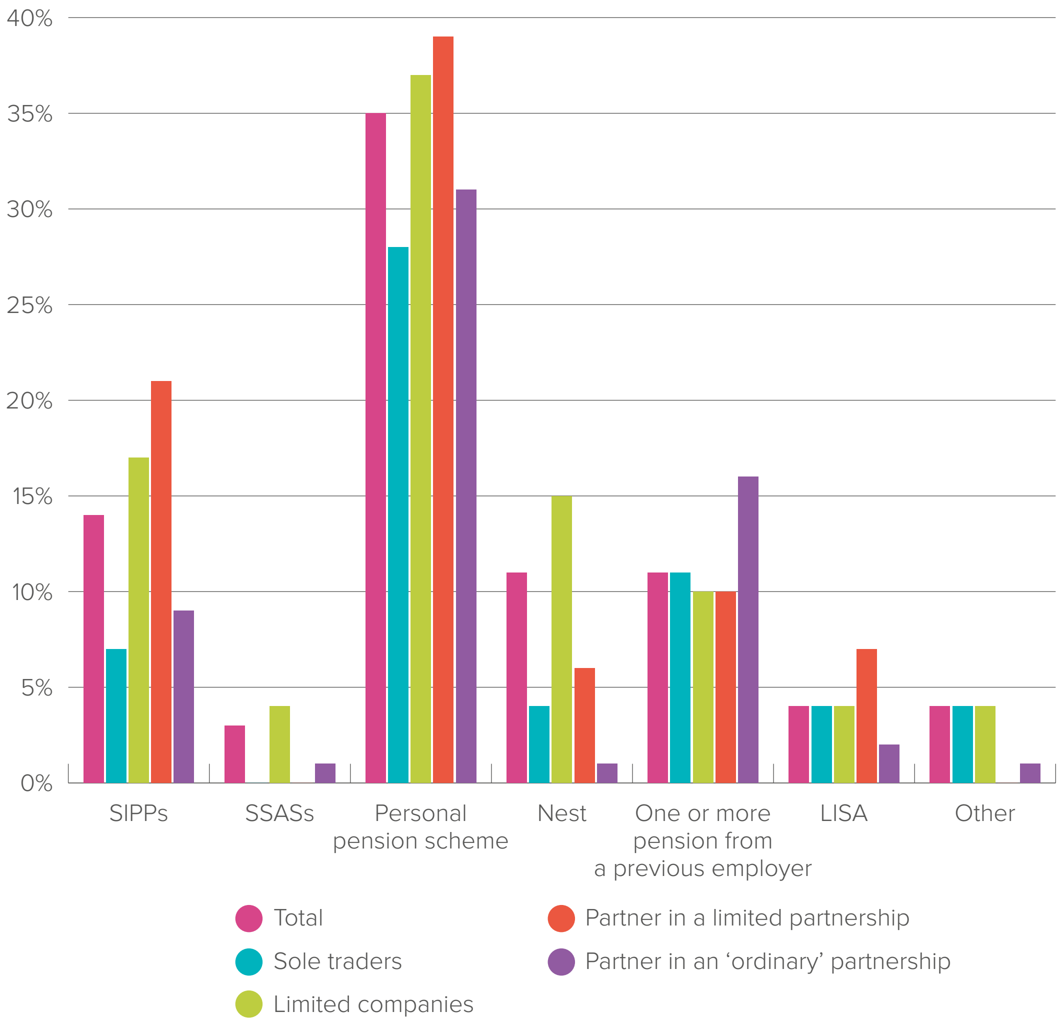
Saving for retirement amongst entrepreneurs

As discussed, above the legal business structure a business owner operates by determines which type of pension scheme is available to them (Figure 4). A personal pension is a private pension which can be obtained from a bank, building society, insurance company or unit trust. Personal pension schemes are the most common type of pension scheme used by entrepreneurs.

Eleven per cent of all entrepreneurs' state they contribute to Nest, which is open to the self-employed as well as to auto-enrolled employees. However, the number drops to four per cent for sole traders. This may highlight a lack of knowledge of Nest as a saving option amongst sole traders in comparison to those operating as a limited company (15%) who are more likely to receive advice on tax and regulation. In addition, it is likely that most of those using Nest are doing so because they are required to auto enrol their staff. This is to some extent confirmed by the fact that 93 per cent of those using Nest say their business had at least one member of staff.

Figure 4: Proportion of entrepreneurs that pay into or contribute to a pension or other long-term savings product by legal business structure

Source: FSB, Self-employment and start-up survey, 2023

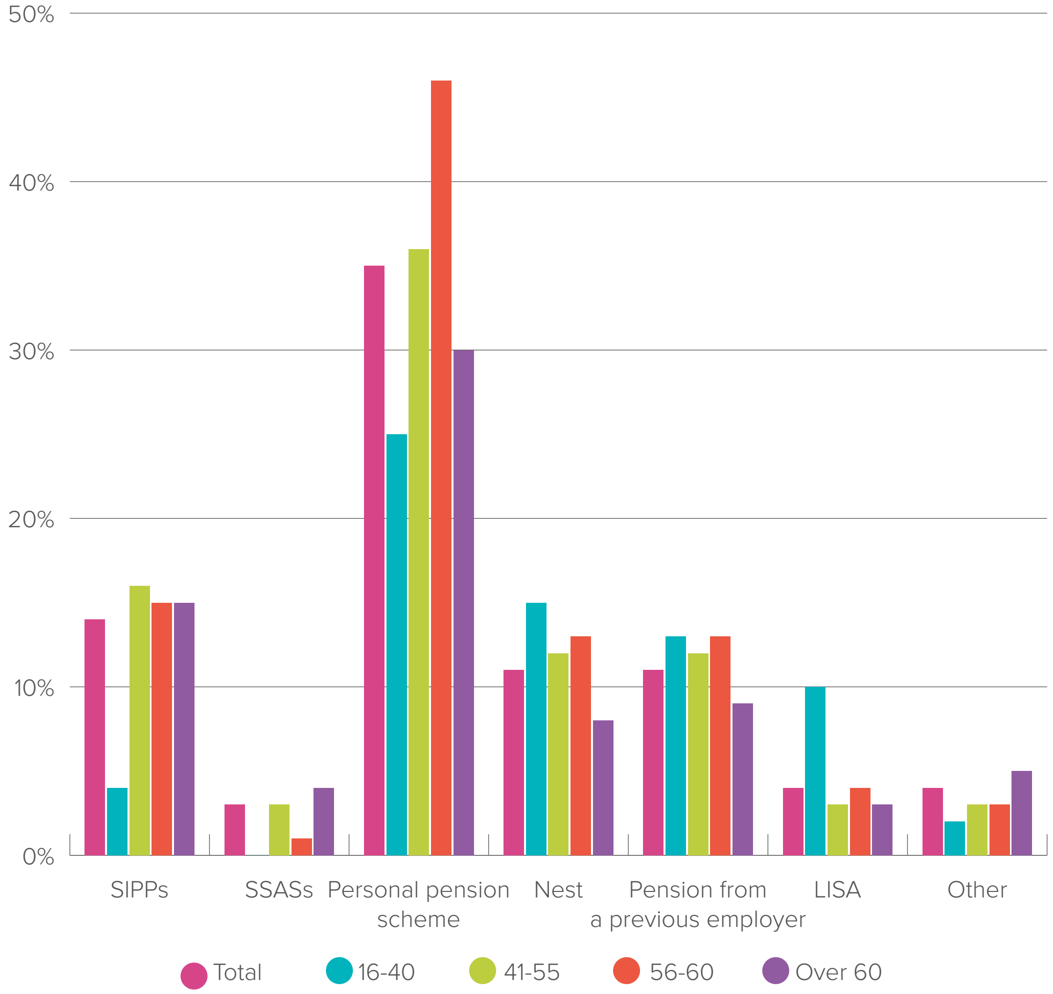


Lifetime ISA

In 2016, the Conservative Government announced their plan to introduce a Lifetime ISA stating its purpose is to 'help young people save flexibly for the long-term throughout their lives'.[9]

Figure 5: Proportion of entrepreneurs that pay into or contribute to a pension or other long-term savings product by age

Source: FSB, Self-employment and start-up survey, 2023



The Lifetime ISA has the potential to be a useful product for self-employed people, subject to changes being made to the rules to make it more flexible. At present, it is only possible to start a Lifetime ISA for those aged under 40 and no contributions can be made after the age of 50. Our evidence shows 10 per cent of entrepreneurs aged between 16-40 save into a LISA in comparison to three per cent of those aged 41-55.

9 HM Treasury: Lifetime ISA: An Updated Design Note, September 2016, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/553333/Lifetime_ISA_technical_note_September_2016_update.pdf

The Lifetime ISA is intended to work with existing ISA products and to 'harness the simplicity and popularity of the ISA model, where contributions are made out of post-tax income but investment growth on savings and future withdrawals are tax free'.[10]

There is a 25 per cent penalty on any withdrawals, except those made to purchase a house or after the age of 60, so the product is not particularly attractive to people who may need to withdraw money to cover fluctuations in their income. When the Lifetime ISA is used for a home purchase, the property must cost £450,000 or less. This figure hasn't changed since 2017. The Government should consider making changes to the Lifetime ISA to make it more attractive as a savings vehicle for the self-employed.

Recommendation

HM Treasury should:

- **Make the Lifetime ISA more flexible in terms of its age-based eligibility criteria and the penalties which are imposed on withdrawals before retirement, to make it a more attractive savings product for self-employed individuals.** The age limit for starting a Lifetime ISA and the age at which no more contributions can be made should be abolished or increased to the state pension age. The penalty on withdrawals should be reduced from 25 per cent to 20 per cent to make it fairer for the individual, and more attractive for self-employed people who often face income shocks. The limit on the price of a home that can be bought with the Lifetime ISA should also be increased or abolished, given that in some parts of the country £450,000 is significantly less than the average house price.

10 GOV.UK, The New Lifetime ISA, https://assets.publishing.service.gov.uk/media/5a806786ed915d74e33fa3ba/Lifetime_ISA_final.pdf.

Target group

In 2005, the Pensions Commission set out in its report that not all "self-employed non-pension savers should be a cause for concern".[11] FSB research shows 44 per cent of entrepreneurs aged 16 to 40 and 41 per cent aged 41-45 do not pay into a pension or Lifetime ISA (compared to a 37% average). This has confirmed our view that the government should focus on developing retirement savings interventions for those self-employed people who are most at risk of under-saving and for whom it would be most economically beneficial to save – in this sense those aged under 40.

Recommendation

UK Government should:

- **Include tackling poor pension saving for the self-employed in the policy remit in the second phase of the pensions review.** In July 2024, the Chancellor announced a landmark pension review to boost investment, increase pension pots and tackle waste in the pensions system. The Terms of Reference for the first review was published in August 2024. We encourage the Government to include the self-employed in the second phase of the review, and to draw the link with the Small Business Strategy. Any future policy objectives should consider the following (i) barriers to saving for the self-employed, (ii) inclusion of appropriate safety nets (iii) reflect the varying needs of different groups within self-employment as identified in this report and (iv) consideration for those working in part time self-employment.

11 The Pensions Commission, Pensions :Challenges and Choices, May 2005, https://image.guardian.co.uk/sys-files/Money/documents/2005/05/17/fullreport.pdf

Improving pension saving amongst the self-employed

In 2017, the Government published the auto-enrolment review which stated their intention to 'commit to scope, develop and test targeted interventions aimed at establishing what works to increase retirement saving among the self-employed.'[12] However, there has been little progress in this area.

FSB research shows the most common mechanism to improve saving amongst all entrepreneurs is the use of an existing financial platform such as an accounting or online banking app (21%).

Under three in twenty (13%) of all entrepreneurs say they favour automatically paying into a pension scheme through their self-assessment tax return. This was higher amongst sole traders (22%) and nine per cent of all entrepreneurs state they would favour the ability to continue contributing to a pension scheme from a previous employment.

DC Consolidation

According to the Pensions Regulator (TPR), the UK's occupational defined contribution (DC) pension market has consolidated by nearly 40 percent (38.64%) in a decade. In 2023, the then government sought to advance this further with the belief that several large, well-run schemes will result in better outcomes for members while boosting investment in UK productive finance.

Depending on the type of pension scheme an employer uses, it may or may not be possible for former employees who are now entrepreneurs to keep making contributions. Individuals who were part of a Group Personal Pension (GPP) scheme will have this converted to an individual personal pension when they leave employment, and this will sometimes allow them to continue making contributions. Some master trusts such as Nest and The People's Pension will allow self-employed individuals to make contributions, but others do not have this flexibility.

Employees who are part of an employer-specific pension scheme run by trustees will not generally be able to keep making payments into the scheme after they leave the employer.

The decision to adopt a multiple default consolidator approach could benefit entrepreneurs as this could provide them with more options to save into schemes that deliver good value for money. Our evidence suggests a small proportion of sole traders are saving into schemes such as Nest. This could be due to a number of reasons such as a lack of awareness that they can do so. However, following consolidation if an increased number of pension providers could take registrations and contributions from the self-employed, then it could provide more pension saving options.

We encourage the government to consider how their proposals to consolidate the pensions market could also be a vehicle to increase pension saving amongst the self-employed.

12 Department for Work and Pensions, Automatic Enrolment Review 2017: Maintaining the Momentum, December 2017, https://www.gov.uk/government/publications/automatic-enrolment-review-2017-maintaining-the-momentum Though mainly focused on auto-enrolment for employees, this review also looked at pensions for the self-employed.

Recommendation

Pension Providers should:

- **Promote the opportunity for self-employed individuals to continue making contributions to their prior workplace pensions scheme after they leave the relevant workplace.** Some pension providers already allow self-employed people to continue to make one-off payments into former workplace pension schemes, in which case they could communicate this opportunity more clearly to self-employed individuals or those that have stopped contributing to a pension. Other pension providers could adopt this model to support self-employed to continue to save and to reduce the need for an individual to have so many small pots.

Business software platforms

The use of existing business software has the potential to allow entrepreneurs to engage with pensions through a platform that they are generally familiar with and which they use on a regular basis. It would allow individuals to increase or reduce their contributions as their income fluctuates, as our evidence shows 32 per cent say they cannot save into a pension due to cash flow constraints so the introduction of liquid saving model could be highly beneficial.

Previous FSB research from 2021 found 'almost all (98%) small businesses use some form of software to record their transactions. This includes methods such as paid-for and free accounting software, spreadsheets, online bank statements, and bespoke accounting systems'.[13] This suggests that business software could be a good vehicle to introduce a retirement autosave mechanism for the self-employed, as advocated for by Nest Insight.[14]

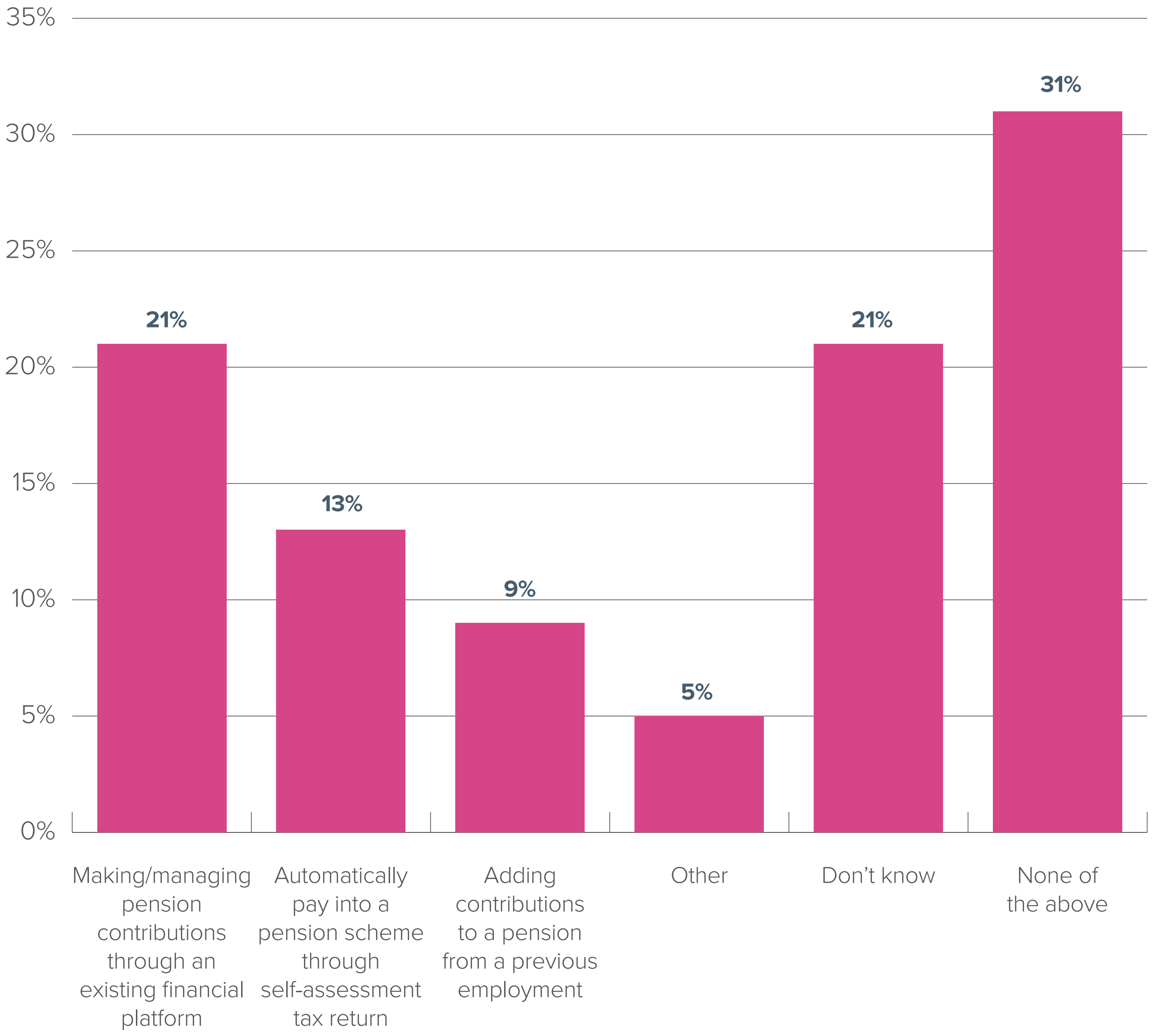
"I have not contributed to a pension since I've started my business but recently, I sought information from a financial adviser to discuss my options and start contributing. There were two main reasons as to why I've not contributed to a pension so far. Firstly, it's because I was focused on building a business and making sure I'm comfortable, and secondly, because along the way there were I had financial worries which took priority. I guess a pension is also an easy thing to kick down the line particularly if it's 20 or so years away.

"I think more information and guidance on the options available to them would help sole traders. A more automated process which would prompt sole traders to make contributions would also be helpful for example, either through self-assessment tax returns or a system where business bank accounts would automate putting money aside for contributions in the same way that they do for tax."

Nick Morrish, Morrish & Co, Cardiff

13 FSB, A Duty to Reform: Making tax work for small businesses in a digital world, October 2021, https://www.fsb.org.uk/resource-report/a-duty-to-reform.html
14 Nest Insight, Supporting self-employed people to save for retirement, accessed October 2024, https://www.nestinsight.org.uk/research-projects/self-employed-pension-saving/

Figure 6: Most useful intervention to help start/continue/improve saving for retirement through a pension
Source: FSB, Self-employment and start-up survey, 2023



This proposition does raise some regulatory and commercial factors for business software for providers, for example would the business software provider become the main contact for the self-employed individual regarding their retirement savings. Would this type of activity amount to regulated activity from the perspective of the business software provider in linking their software to a pension provider's service. Given the number of self-employed people that could benefit from innovation in this area, the Financial Conduct Authority (FCA) should also be involved in this process, and we note that the Government and the FCA are currently reviewing the advice guidance boundary which presents an opportunity to address this issue.[15]

15 See FCA, DP23/5: Advice Guidance Boundary Review – proposals for closing the advice gap, December 2023, https://www.fca.org.uk/publications/discussion-papers/dp23-5-advice-guidance-boundary-review-proposals-closing-advice-gap

"I started my canine hydrotherapy business in the last year and it's going well – so well that I've been a bit too busy to think about setting up a pension, but I intend to do this soon. Before setting up the business I was employed in three different places, so I have three pensions that I need to bring together, and I would then want to put my future savings into the pension pot that contains that money so that it's all in one place.

I'm only 28 so retirement is some way off, but I like the idea of having money put aside for retirement as I don't want all my eggs to be in one basket. I would hope to be able to sell my business in future which will also help fund my retirement, and my partner will also have a pension from his employment, but it's good to have multiple sources of possible income.

To help me choose a pension, I would seek advice from my accountant, but I would also do my own research as I think it's important to understand for myself what my options are rather than just accepting someone else's recommendation. The brand reputation of a provider will be of some importance, but as a small business owner I would also like to be able to support pension providers who aren't the big players.

My personal income is still volatile, as I only take out in salary what the business can sustain month-by-month. So, I would probably set a percentage of each month's income to put into my pension rather than a cash amount, while making sure that the percentage wasn't so high as to be an issue in terms of preventing me from being able to pay my bills or put some money into savings for more immediate needs. It doesn't really concern me that I can't take money out of a pension until retirement, because I plan to save only what I can afford to.

The accounting app I use in the business is very user-friendly and ideal for someone who is not trained in accountancy such as myself. It would be good if I could use this app to manage my pension contributions in the same way that I manage the incomings and outgoings of the business."

Tia Brookes, Director, K9 Hydro Care, West Midlands

Recommendation

UK Government should:

- **Convene a group including the FCA, providers of accounting and finance software, and the pensions industry to explore ways that self-employed individuals can use existing software to manage their pension contributions, building on the work that Nest Insight has done and will do in future.** This would allow individuals to more easily match their contributions to their available funds, given that self-employed people often have volatile incomes, through a platform that they already use for banking, accounting, or other financial purposes.

Potential impact of Making Tax Digital

Making Tax Digital (MTD) was initially rolled out in April 2019 for VAT-registered businesses above the taxable threshold. The Government delayed the MTD for Income Tax Self-Assessment (ITSA) until April 2026 (previously April 2024) and increased the gross income threshold from £10,000 to £50,000 in 2026, reducing to £30,000 in April 2027. Xero states that MTD for ITSA will provide the self-employed with improved accuracy, better tax planning and more manageable bookkeeping.[16] As our evidence shows, 45 per cent of sole traders have a turnover of over £50,000 so MTD for ITSA could lead to behavioural changes and increased pension saving for this group.

> **"I would favour compulsory pension saving (on an opt-out basis) for freelancers like me because it is something which people might not organise for themselves. I have pension pots from previous periods of employment which I have consolidated, but I have not saved into a pension since becoming self-employed."**
>
> Hannah Swierstra, IT & Communication, Scotland

However, our research also shows almost half of sole traders have a turnover of less than £50,000 so won't be obliged to adopt MTD ITSA in April 2026. Although more sole traders will fall under scope of MTD ITSA in 2027, the introduction of MTD for ITSA won't provide a solution for many self-employed especially for those that aren't saving into a pension.

There are also some drawbacks of using tax self-assessment system to contribute into a pension for example, engagement with the system is infrequent, so it does not offer the possibility of making contributions which can be varied as income fluctuates throughout the year, and it may be psychologically difficult to ask individuals to make pension contributions while they pay tax.

Recommendation

UK Government should:

- **Work with software providers to allow Making Tax Digital (MTD) to provide visibility of pension savings for the self-employed by 2030.** This will provide more transparency to entrepreneurs that don't use an accountant.

16 Xero, Making Tax Digital for the self-employed, accessed October 2024, https://www.xero.com/uk/programme/making-tax-digital/making-tax-digital-for-the-self-employed/

SELLING A BUSINESS

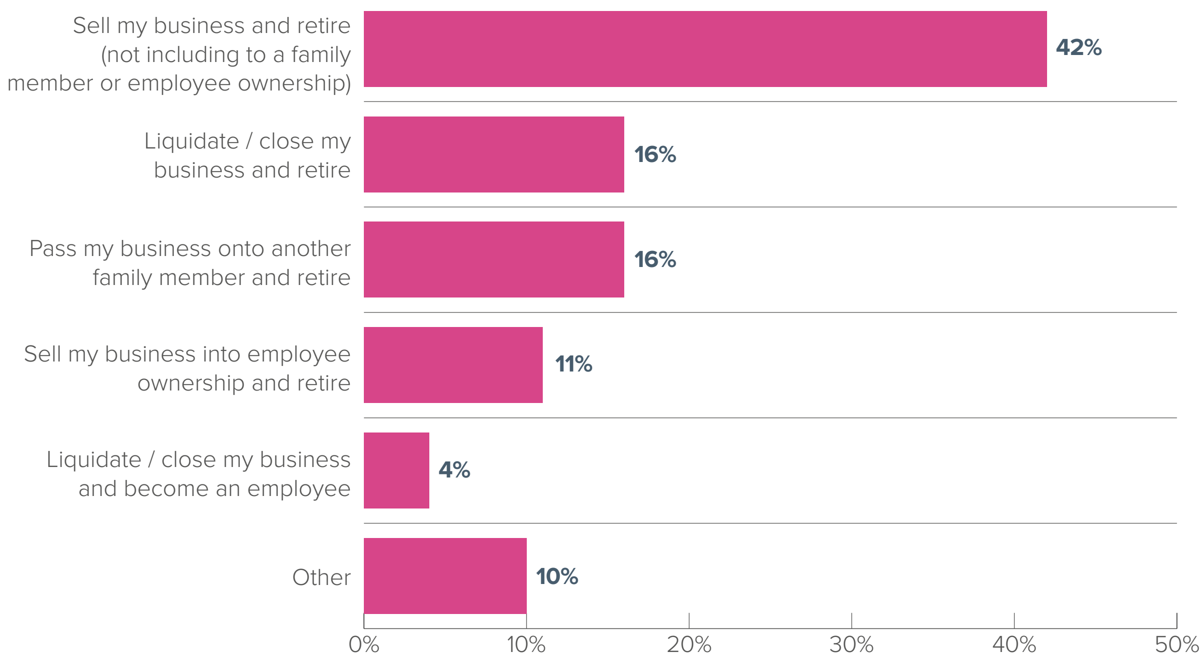
A successful business exit strategy is often overlooked, but is a key element within entrepreneurship. The change of business ownership often presents legal and tax considerations for small businesses, and as such requires significant thought and planning. Succession planning involves setting clear exit-related objectives and designing a comprehensive strategy considering various personal, financial, and legal aspects. A good succession plan is important not only for the individual selling but also for the business itself and safeguarding jobs.

FSB research shows that almost a third (32%) of entrepreneurs find succession planning challenging. Small business owners that operate as private company limited by shares (36%) and those limited by guarantee (41%) are more likely to report succession planning as a challenge; with sole traders (19%) least likely to state succession planning is a challenge. With a large proportion of entrepreneurs finding succession planning challenging, support offered by the public sector is welcome. An example of this is the Development Bank of Wales, which offers clear guidance and advice.[17]

Those entrepreneurs approaching retirement are more likely to identify succession planning as a challenge (43% of those aged between 61 and 64). In general, the older the entrepreneur the more likely they are to identify succession planning as a challenge. However, those aged 65 or older are less likely to identify this as a challenge (36%) compared to those approaching retirement age.

For those entrepreneurs that do plan to sell in the next two years, the most common method is to sell their business to a business partner, an investor, an external stakeholder, company, or single buyer, as outlined in Figure 7.

Figure 7: Plans for self-employed individuals looking to sell business in next two years
Source: FSB, Self-employment and start-up survey, 2023



17 Development Bank of Wales, Buying a Business, accessed August 2024, https://developmentbank.wales/business-need/buying-business

In a survey of business owners aged 43 or older in businesses with between 10 and 249 employees, the Employee Ownership Association found that 31 per cent are looking to sell their business in the next five years.[18] A total of 17 per cent of all the owners surveyed said they believe liquidation was the likely outcome of the upcoming ownership transition in the next ten years.

Recommendation

The Money and Pensions Service (MaPS) should:

- **Provide information, advice and guidance for self-employed individuals looking at succession planning.** This should include signposting to the information that FSB provides to our members.[19] A total of 43 per cent of self-employed individuals aged between 61 and 64 identify succession planning as a challenge.

18 Employee Ownership Association, Generation EO: The Great Employee Ownership Succession Opportunity, November 2023, https://ownershipatwork.org/wp-content/uploads/2023/11/Generation-EO-The-Great-Employee-Ownership-Succession-Opportunity.pdf

19 FSB, Business lifecycles, accessed October 2024, https://www.fsb.org.uk/knowledge/fsb-infohub/business-lifecycles.html

Entrepreneurs' Relief (now called Business Asset Disposal Relief)

Business Asset Disposal Relief (BADR), known as Entrepreneurs Relief before April 2020, reduces the rate of Capital Gains Tax (CGT) to 10 per cent on the disposal of qualifying business assets. The lifetime allowance for qualifying gains is set at £1 million, a reduction from £10 million under Entrepreneurs Relief.

Keeping Entrepreneurs Relief to enable small business owners to sell their business and have a stable retirement is a crucial aspect to enabling entrepreneurship and economic growth. Many small business owners have dedicated their entire savings, not paying themselves a salary into creating their business and developing independent stores, services and products in the UK. In addition, entrepreneurs may choose to recycle their capital back into the entrepreneur ecosystem through future ventures, encouraging the innovation economy to grow. Without Entrepreneurs Relief and other incentives, there is little reward to the risk.

In the run-up to the 2024 Autumn Budget, there was a degree of speculation about potential changes to Capital Gains Tax and to Business Asset Disposal Relief. At the Budget itself, changes were made to increase the lower and higher rates of Capital Gains Tax to 18% and 24% respectively. While Business Asset Disposal Relief was preserved up to the £1m threshold, the rates will increase from 10 per cent to 14 per cent in 2025, and to 18 per cent in 2026.

The following case study comes from an entrepreneur who, prior to the Budget, was anticipating a range of potential changes, including the risk of Business Asset Disposal Relief being abolished altogether.

> **"The potential double whammy of CGT hikes and BADR abolition has forced me to consider liquidating or selling up. I'm devastated that making people redundant might be the best thing for me financially if I can't find a buyer in time. It would make a material difference to me paying off some of my mortgage, putting towards the kids' university fund or saving for retirement.**
>
> **I'm nowhere near making millions, as these measures might have in mind, but had always thought that there was a trade-off between running your own business and financial reward. For me, that meant the responsibility of regular income to pay my team, the legal responsibilities of being a company director, and on a personal level never being able to truly switch off."**

> **"When politicians talk about growth, let's be real that in the background is an individual who has taken a personal risk to leave steady paid employment to start their own business which provides steady paid employment to others. That individual probably isn't doing it because they love risk and instability, but because they expect - if they are successful - that the economic reward will be greater than working somewhere as an employee.**
>
> **We shouldn't be ashamed of that. If you decouple wealth from growth then you remove an incentive that leads to job creation and a growing economy."**
>
> FSB member, Marketing, London

According to statistics from HMRC, 44,000 taxpayers used Entrepreneurs Relief in the 2022 to 2023 tax year.[20] These statistics would indicate that this is mostly small business owners who benefit from this relief rather than the owners of larger firms:

- 89 per cent of the taxpayers claiming Entrepreneurs Relief were claiming for gains of less than £1 million. Therefore, only 11 per cent of those claiming Entrepreneurs Relief were claiming on the first £1million of larger gains from selling their business.
- 77 per cent of the taxpayers claiming Entrepreneurs Relief were claiming for gains of less than £500,000.
- 66 per cent of the taxpayers claiming Entrepreneurs Relief were claiming for gains of less than £250,000.
- 20 per cent of the taxpayers claiming Entrepreneurs Relief were claiming for gains of less than £100,000.

For many small business owners, selling their business is a way to fund their retirement. FSB research shows that many self-employed business owners struggle to access pension products, so this relief is often important in ensuring that hard working small business owners have a comfortable retirement. As such, business owners may have consciously invested more into their business rather than their pension.

20 HMRC, Capital Gains Tax statistics, August 2024, https://www.gov.uk/government/statistics/capital-gains-tax-statistics

"For reasons beyond my control, I will sadly have to soon sell my company. I have employed a number of people over the years, and the current employees will retain their roles with the new owner. We were key workers during Covid and I have worked really hard to grow my business.

Without Business Asset Disposal Relief, I'll have to pay twice the amount in Capital Gains Tax or even more if the rate is increased. I have planned carefully my exit from the company and, whilst the sums involved are not great, the BADR will make a huge difference to whether I can manage after I sell the business. I will be looking for employment myself but, in my late fifties, I was relying on the proceeds from the sale to partially fund my retirement and pay my mortgage.

There are many small business owners in similar positions. We are not big corporates or multi-million enterprises, we have worked hard and generated employment and tax, and had anticipated that we would have a fair and reasonable level of return on our endeavours when we sell or close our companies."

FSB Member, Hospitality, South East England

"There will a be a lot of business owners trying to exit after the delays with Brexit and pandemic. Without BADR, they will not be able to exit with any reward for their efforts, which have greatly benefited the economy. Starting, running and growing a business will not be perceived as worth it.

I'm a mentor to younger entrepreneurs and students, and I find myself telling them not to start a UK PLC as there is no exit opportunity. If they found out that are heavy taxes that are payable on exit, they wouldn't start a business in the UK. A lot of people have been caught out by this issue.

There should be a retrospective angle put on this whereby if you have started your business before a certain date these rules should not apply – the rules shouldn't be able to change halfway through. I understand there are a lot of people that need support in society, that's why entrepreneurs are here too multiple the millions into taxable returns with trade, but also collect the tax for the government and duly pay it. I hear the new Chancellor wants to 'stimulate business', well they won't do it like this.

I can't exit this business unless I go abroad but I don't want to live abroad – I quite like it here."

Peter Waldron, Lithofin UK corporation, South East England

As outlined earlier, an entrepreneur having a good succession strategy is important for both the person selling their business and the business itself. A total of 32 per cent of small business owners are concerned about succession planning, Entrepreneurs Relief serves as a good motivator for them to consider a well-planned succession strategy.

There seems to be a misconception that only those who have been in business for a while are interested in the relief and it does not motivate individuals to start a business.[21] FSB research suggests this is not true. For those that had been operating for two years or less, FSB research on taxation found, 71 per cent see themselves as using the relief in the future if they were eligible. While this is not as high as the 83 per cent of all SMEs who see themselves as using BADR in the future if they were eligible, it disapproves the perception that the relief is only of interest to those businesses that have moved beyond the start up phase.

At the 2024 Autumn Budget, the Government announced that the rate of Entrepreneurs Relief will change from 10 per cent to 14 per cent from 6 April 2025 and will then match the lower rate of Capital Gains Tax of 18 per cent from 6 April 2026.[22] While it is positive that the relief is not being abolished, we believe that the Government should reconsider its plans to increase the rate to 18 per cent in order to maintain the incentive to invest in a small business. Maintaining this relief to enable small business owners to sell their business and have a stable retirement is a crucial aspect to enabling entrepreneurship and economic growth.

Recommendations

- **Commit to maintaining Entrepreneurs' Relief (now called Business Asset Disposal Relief) at 14 per cent in the long run.** It is currently due to increase from 10 per cent to 14 per cent in April 2025 and then to 18 per cent in April 2026. Our research finds that of those who are planning to sell their business in the next two years, or exit self-employment, 42 per cent plan to sell their business and retire and 16 per cent plan to pass their business onto another family member and retire. FSB research shows that many self-employed business owners struggle to access pension products, so this relief is often key to funding their retirements. Government should encourage more business owners to think about responsible exit or succession strategies. Increasing capital gains tax at the point when they sell or hand on their firms would not help that and send the wrong signal to the self-employed population.

21 For instance, see: Institute for Fiscal Studies, Capital gains tax reform, October 2024, https://ifs.org.uk/publications/capital-gains-tax-reform
22 HM Treasury, Autumn Budget 2024, October 2024, https://www.gov.uk/government/publications/autumn-budget-2024

Family businesses

FSB research shows 16 per cent of those small business owners planning to sell their business in the next two years are planning to pass their business onto a family member. Agricultural and business reliefs on inheritance tax were introduced in order to support family-owned businesses and farms to continue after a death, without the need for the whole business or farm to be sold to pay inheritance tax. It is important for these reliefs to remain with the purpose of supporting this small family firms being passed on from generation to generation.

At the Autumn Budget 2024, HM Treasury announced that they will "reform agricultural property relief and business property relief from April 2026. In addition to existing nil-rate bands and exemptions, the 100% rate of relief will continue for the first £1 million of combined agricultural and business assets to help protect family farms and businesses, and will be 50% thereafter."[23]

This has concerned many small business owners as well as those who operate small farms. From our qualitive research, we have found many small business owners concerned about the low level of the allowance and have said this has deterred them from investing in their business. While we recognise the concern HM Treasury has about these reliefs being used by those who are not the intended beneficiaries, the £1 million allowance is set too low and dissuades growth.

If a land-based business, for example a farm, is inherited, then the imposition of inheritance tax means that this business will be subject to tax burdens that comparable businesses with a different ownership model will not face. Furthermore, for many business owners, the only way to meet the liabilities of an inheritance tax bill will be to sell some or all of the business off, which means that the changes to the thresholds for Business Property Relief and to Agricultural Property Relief will make it more likely that businesses will end up being broken up or discontinued.

According to HM Treasury, even though only two per cent of the claims for Business Property relief are over £5million, these claims represent 41 per cent of the proportion of tax cost to the Exchequer.[24] Therefore, increasing the allowance to a rate that is not over £5 million, should not be disproportionately expensive for Government to implement.

23 HM Treasury, Autumn Budget 2024, October 2024, https://www.gov.uk/government/publications/autumn-budget-2024

24 HM Treasury, Summary of reforms to agricultural property relief and business property relief, October 2024, https://www.gov.uk/government/publications/agricultural-property-relief-and-business-property-relief-reforms/summary-of-reforms-to-agricultural-property-relief-and-business-property-relief

Recommendations

HM Treasury should:

- **Increase the 100 per cent allowance for agricultural property relief and business property relief from £1 million to £5 million.** It is important for small, family-run businesses to be able to keep the business intact when someone passes away. Since the publication of the Budget, it has been clear that the new rules around these reliefs could result in the break-up of these small firms due to large inheritance tax bills. Increasing the allowance for 100 per cent relief, while ensuring that these rules are only used by small businesses and/or small farms, would be a sensible way forward.

Employee ownership

Around one in ten (11%) of small business owners planning to sell their business in the next two years are planning to transfer into employee ownership.

Interestingly, this figure increases for small businesses with a higher turnover. 23 per cent of self-employed planning to sell their business in the next two years and have a turnover of over £1 million are planning to sell their business to employee ownership.

These numbers indicate that the level of interest in employee ownership seems relatively high. Measures introduced in 2014 to simplify employee ownership trusts and incentivize business owners to explore this option seem to have been quite effective.[25] According to the Employee Ownership Association (EOA), in October 2023 there were over 1,650 employee-owned Businesses in the UK, growing by over 30 per cent across the previous year.[26] EOA found numerous benefits of employee ownership:

- Most employee-owned businesses see profits grow after becoming employee owned. They are 25 per cent more likely to have seen profits grow over the last five years.
- Because of higher investment in wellbeing and changing business practices, most (73%) employee-owned businesses report increased employee satisfaction after becoming employee owned.
- Employee-owned businesses are found to be 8 per cent to 12 per cent more productive per employee than other businesses.

25 Legislation.gov.uk, Finance Act 2014, accessed October 2024, https://www.legislation.gov.uk/ukpga/2014/26/contents
26 Employee Ownership Association, Unlocking the Potential of Employee Ownership: The Why and How for People Powered Growth, May 2024, https://employeeownership.co.uk/Site/Site/content/News-and-Insights/Policy/Manifesto/Manifesto.aspx

"Having operated for 20 years we became employee-owned in 2021, as the other owners and I wanted to ensure we retained our company culture, and we wanted the business future determined by our talent. These two things wouldn't necessarily happen if we sold the business to someone with the funds to buy the owners out. This type of structure gives our team have a mammoth incentive to continue to drive forward the performance of the practice, and they're driven for that success. Architecture is a collaborative field, but this business structure promotes it even further.

The transition process to employee ownership took six to seven months. It was a relatively straightforward process for the business because we'd done a lot of the research ourselves beforehand and had the guidance of specialists. We also consulted with our employees, received their feedback and ensured that staff had a good understanding of the new structure. It does take a mindset shift when you've been used to running a company as a shareholding director."

Joan McCoy, Director of White Ink Architects, Northern Ireland

"While there's a growing interest in employee ownership, there's still a limited understanding among business owners. I only found out about it through meeting a parent at my son's rugby match. It was a lot less complicated than I was expecting, with the whole process taking about three months in total."

Unlike most companies that go for employee ownership, I needed to convince the previous owners of the benefits and entrepreneurs relief was helpful in making this case. This relief has led to increasing awareness of employee ownership amongst business owners.

However, for most business owners the main driver for going down the employee ownership route is philanthropy. The capital gains tax relief is important, but the crucial factor is business owners wanting to leave a legacy.

Some of the key infrastructure related to running a business is often missing. Banks, for example, can be more unwilling to lend to employee-owned businesses often because they confuse Employee Owned Trust's with overseas registered Trust funds. This doesn't make sense as employee-owned businesses are often more secure than privately owned businesses. We need to think how best to build understanding of the benefits of employee-ownership; when talking with business owners, finance providers and educationalists."

Neil Wright, Managing Director at TensCare Limited, South East England

The Labour Party's manifesto for the 2024 General Election outlined the ambition "to double the size of the UK's co-operative and mutuals sector."[27] Similarly in 2022, the Welsh Government set themselves an objective to double the number of companies in Wales that are employee owned. This target was met in June 2024, two years ahead of schedule.[28] The new UK government should look at the action taken by the Welsh Government to see what lessons they could learn.

Recommendations

HMRC and HMT should:

- **Maintain the current rules that exempt the sale of a business to Employee Ownership Trusts (EOTs) from Capital Gains Tax and exempt the sale of a EOT from the CGT allowance for Business Assets Disposal Relief.** There has been an increase in the establishment of EOTs in recent years, this is in part due to the simplification of setting one up but also due to tax relief for business owners. Maintaining these incentives are important to see continued growth in EOTs.

The Department for Business and Trade should:

- **Introduce legislation along the lines of the Italian Marcora Law, which provides a framework for employees to take over companies facing bankruptcy or liquidation.** This framework has succeeded at ensuring business continuity, primarily through allowing workers to claim would-be future unemployment benefits in a lump sum, to help them fund a buyout or rescue and capitalise their new co-operative. Additionally, the law established a state-backed investment company to provide finance to newly founded co-operatives as well training and advisory services for these newly formed co-operatives.
- **Provide funding to expand Ownership Hubs across the UK.** Ownership Hubs are jointly run by Co-operatives UK and the Employee Ownership Association to raise awareness among business owners and others of the benefits of worker and employee ownership. They also support business to explore and adopt employee ownership models. Ownership hubs are currently running in three combined authorities in England.
- **Include succession planning as a topic covered in Help to Grow: Management, including the option of employee ownership.** Succession planning should be included in the curriculum of other business courses too. 32 per cent of entrepreneurs, 43 per cent of those approaching retirement, identify succession planning as a challenge. Despite some clear benefits of more companies being employee owned, there remains little understanding of this option.

27 Labour Party, Change: Labour Party Manifesto 2024, June 2024, https://labour.org.uk/change/
28 South Wales Argus, Double growth for employee ownership model in Wales, accessed August 2024, https://www.southwalesargus.co.uk/news/24402766.double-growth-employee-ownership-model-wales/

METHODOLOGY

This report is based on the views of FSB members as well as the wider self-employed population across the UK. FSB undertook a mixed research approach consisting of a quantitative online survey, three focus groups which took place in November 2023 on Zoom. Interviews took place between November 2023 and November 2024.

The survey was nationwide in its reach and participants were invited to complete the survey via email and social media channels. The survey was administered by the research agency Verve and was in the field from 23 October 2023 to 2 November 2023. The survey questionnaire was completed by a total of 1,378 self-employed individuals. The survey findings are all weighted according to FSB membership weighting (to reflect the demographic balance of FSB members throughout the UK).

All percentages derived from the survey are rounded to the nearest whole number, which is why some percentages presented in the figures do not sum to 100 per cent. The focus groups took place via Zoom and purposefully drew from a variety of regions, sectors, and population demographics.

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