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International Family Business Succession Planning

Recent Developments in Germany and Spain

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Abstract

This paper deals with intergenerational successions of family enterprises both in Germany and on an international level. Entrepreneurs face an unavoidable succession dilemma: they must make strategic decisions about transitioning ownership of the family business. The main alternatives are to sell the company to someone outside the family or to make arrangements for an interfamily succession. In the latter case, there are many transition modes, e.g., through a gift of shares, a will or a mixed marriage / succession contract. The choice of succession mode is the outcome of an interaction process between generations, with civil and tax laws determining the transactions costs of the different succession alternatives. This paper concentrates on successions of ownership within the family. It illustrates the nature of this intergenerational problem and discusses how a specific legal system - the German one - influences the choice of succession. The paper begins with analyzing the most common methods used to transfer ownership to the next generation. Although succession problems are universal, transition methods adopted vary around the world as each country has its own tax system. This influences the choice of laws in international successions. Consequently, the second part of the paper focuses on the conflict of laws perspective of succession treaties for family businesses. One conclusion of the paper is that it is important for a society to provide a legal system that facilitates transitions of family companies because the legal system will, among other positive factors connected with family businesses, preserve idiosyncratic knowledge of family character.

Keywords: Family business, Succession, Choice of law, Succession Tax, International Estate planning, Germany, Tax law Germany, Agreement as to future succession, Green Paper on Succession and Wills

Palabras clave: Empresa familiar, Modalidades de transmisión, Derecho aplicable a la transmisión, donación internacional, Impuesto sobre sucesiones y donaciones alemán del 28.11.2008, Pactos sucesorios, derecho internacional privado, derecho interregional, conflicto de leyes, Libro verde de sucesiones y testamentos

Stichworte: Familienunternehmen, Unternehmensübertragung, Erbschaftsteuerreform 2009, Erbverträge in Deutschland und Spanien, Das Internationale Privatrecht der Verträge zum Zwecke der Unternehmensübertragung im Wege vorweggenommener Erbfolge, Grünbuch Erb- und Testamentrecht der Kommission 2005

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1. Challenges for Succession Planning

1.1. Introduction

Family entrepreneurs face an unavoidable succession dilemma: they must make strategic decisions about transitioning ownership of the family business. The main alternatives are either to sell the company to someone outside the family or to make arrangements for an interfamily succession. In the latter case, there are many transition modes, e.g., through a gift of shares, a will or a mixed marriage / succession contract. The choice of the succession mode here is the outcome of an interaction process between generations, with civil and tax laws determining the transactions costs of the different succession alternatives. Almost 90% of all Family Business Succession Plans fail in the third generation.² This is known as the Buddenbrooks principle, according to which a fortune is destroyed at the latest by the time it falls into the hands of the third generation.³ This is considered to be due to the finding that the descendants realize that they are going to inherit a fortune, but are at the same time unfortunately not at all interested in or committed to the company. Perhaps the single most important element in the success or failure of a family business is the relationship among key members of the business family.⁴

Most businesses can survive the threats of competition, economic cycles, changes in technology etc., but the deterioration of interpersonal relationships will devastate the business and tear apart any or all of the family ties. Family businesses are unique because, in addition to the usual technical business and estate planning issues, the business is interrelated to a multitude of family factors. ⁵Lack of planning does lead in many cases to high tax demands and the division of the family assets or the destruction of the life's work of the testator and disputes among family members. This lack of preventative provisions can only be corrected after death to a very limited degree. A targeted transfer of assets cannot be rendered possible with such corrections. The following text concentrates on successions of ownership within the family. It illustrates the nature of this intergenerational problem and discusses how a specific legal system – in this case the one present today in Germany – influences the choice of succession. Although succession problems are universal, transition methods which are in fact adopted do vary around the world as each country has its own tax system. This influences the choice of laws in international successions.

1.2. Definition of Family business

There exists at present no standard definition for a family business. However, main criteria include: a) a strong link of a family with the business through the owner by means of the capital

² Harris, Jeff Small Business Informer, 22.08.2007 – www.sbinformer.com

³ Huber, Germany's inheritance tax disputes continue, 03.02.2004, Credit Suisse online – emagazine.credit-suisse.com

⁴ Bengel, Manfred Unternehmen vererben – Rechtliche Strategien für die geregelte Unternehmensnachfolge in: Internationale Familienunternehmen, Rödl, Scheffler, Winter (ed.) C.H.Beck, München 2008

⁵ Ambrecht, California Trusts and Estates Quarterly, published by the Estate Planning, Trust and Probate Section, Vol. 4, No. 3, Fall 1998. <http://www.taxlawsb.com/resources/FamBus/enterpri.htm>

being held by the family or the management through family members; b) strong influence of the family with regard to strategic decisions of the company; c) the intergenerational desire to maintain the business as an asset within a small circle of owners (the family) and to guide the development of the business, including the naming of a successor.⁶ The term "Family Business" usually evokes the image of a small firm with the owner and his spouse running the business. However, the reality in the 21st century is quite different. Among the Top-100-firms in Germany, 38 are family-owned. These firms include Porsche, BMW, Aldi, Langenscheidt, Quelle, INA (Schaeffler), Haniel, Beisheim, Bosch; Bertelsmann.⁷

Certain key values may be found to differ in "family" companies when these are compared to "regular" companies. A long term focus is usually aimed for vs. a shareholder-value strategy on a quarterly or yearly basis. Non-listed companies are not obliged to make their results public, even on a yearly basis. This allows for a long-term tactic. A closer look at the balance sheet of many family businesses reveals that a high liquidity and a high rate of accrued gains are predominant. This results in a low ratio of external capital.

1.3. Market share and problems

Family businesses comprise 80-90% of all business enterprises in North America; 50% in Spain and 80 % in Germany.⁸ Family-run businesses employ 57.3% of Germany's workers. About one third of family businesses in Germany are expected to turn to the next generation over the next 5 years. By 2010, most of the closely-held and family businesses will lose their primary owner due to death or retirement. 25% of senior generation family business owners have not completed any estate planning "other than writing a will" while eighty percent want the business to stay in the family whereby it is only twenty percent who are confident that it will ever happen.⁹

Problems faced by the family business regarding succession include the need to maintain the ownership of the business in the family circle, to find a suitable heir capable and interested in running the business.¹⁰ There are good reasons why succession planning is one of the most challenging to-dos on a family business owner's checklist. To begin with, the stakes are high – so high in fact, that most family businesses fail to negotiate the transition – and are thus sold either to pay taxes or because no one in the family is willing or able to take over here.¹¹ Management succession planning frequently faces the problem of too many offspring wanting the top job. When that happens, current leadership often has to dispense with the ideal of giving everyone equal power and to offer controlling interest to the person or persons best suited for a particular job. On the other hand, it is possible that no-one from the next generation is interested in or capable of leading. In that case, the owner may have to go outside the firm itself and find the

⁶ Landtag von Baden-Württemberg, Bericht der Mittelstandsenquete, Drucksache 12/5800, Stuttgart 2000

⁷ <http://www.familienunternehmen.de/top500/>

⁸ For a worldwide overview see Klein p. 1-14, in Internationale Familienunternehmen, Rödl, Scheffler, Winter (ed.) C.H.Beck, München 2008

⁹ INSTITUT FÜR MITTELSTANDSFORSCHUNG BONN, Press notice 05g/2007 www.ifm-bonn.org

¹⁰ Huber/Sterr-Köln, Nachfolge in Familienunternehmen, p. 1, Stuttgart 2006

¹¹ Bengel, p.227

best-matched candidate. Additionally, the communities of stakeholders involved in the process can be numerous and are often in conflict. Other perils to the family business are the risk of forced sale of the family business due to: divorce, succession tax payments and litigation on succession, especially in regard to the portion of the estate reserved. The compulsory portions of a testator's estate are a particular problem in Germany in the event of death.¹² The example of a standard case of a businessman with three children may illustrate this. Only one of the children wishes to join the family business. However, if the father dies, the other two children will still be entitled to their compulsory portions (Pflichtteil). If they insist on payment of their inheritance, this could put serious liquidity strains on small and medium-sized enterprises.

1.4. Establishing a succession strategy

There are, on the other hand, numerous advantages for international family companies. Common core values are a key factor of success in expanding internationally, since coordination costs are lower than in non-family-owned businesses.¹³ A family network abroad helps to maintain cultural unity in the company, enabling compensation of distance from the main company in a country overseas through family ties.¹⁴ Attorneys, accountants, and financial advisors often focus exclusively on the tax and legal aspects of transfer strategies. They seldom address the underlying emotional and psychological issues that are involved.¹⁵ To find a solution for the next generation, it will be necessary to redefine the family's and the company's strategy. What do they want to do together? Who are their clients? What are their resources? What could they do better than their competitors? It is crucial to establish first the shared values of the family, and thus the family's shared dream in general, before coming to the vision for the family business. This translates into strategy and at the last step to the structure. The details of the dispositions mortis causa shall primarily reflect this structure with regard to civil and company law and in a second step shall be optimized with regard to tax considerations.

2. Tools of transmission in Germany

Succession entails three aspects: management, ownership, and taxes. Ownership succession is usually split off from management succession because next-generation members may want to retain their equity in the business, but not take on any significant operating roles at the company.¹⁶ The current owner may want to give exactly equal shares to everyone, but those who work in the business may feel they are entitled to more. Likewise, those who don't work in the business may feel the same way about their own shares. After all, they may reason, they're not drawing salaries, so they should get a bigger share of dividends and profit-sharing. Furthermore,

¹² Bengel, p. 240

¹³ Klein, p. 14.

¹⁴ Rödl, Christian, Rechtsformwahl internationaler Familienunternehmen in Internationale Familienunternehmen, Rödl, Scheffler, Winter (ed.) C.H.Beck, München 2008

¹⁵ Ambrecht, cf. supra

¹⁶ J.O.Hutcheson www.businessweek.com 30 July 2007

those not participating in the succession of the company (the spouse or children not continuing the family business) may have a legitimate interest in compensation. This compensation may be settled with assets of the private property of the testator or through transfer of company assets upon death, a usufruct on those assets or regular lifelong pension payments. Tax implications will determine the exact choice of the compensation payment.

Different tools of transmission are used for family enterprises which include property or production sites abroad. While careful succession planning is a long process, usually taking several years for a transition to the next generation, emergency measures should be taken even at a young age of the family business owner as a mere precaution. A standard emergency precaution is a power of attorney post mortem.

2.1. Power of attorney post mortem

A power of attorney acknowledged before a notary public is valid as such; it does not cease upon death of the principal according to German law, § 672 BGB¹⁷. It may also be established as a pure power of attorney post mortem, thus having effect only after the death of the principal. It serves as a mere precaution for ad-hoc measures. It is most commonly used for transactions which are time-critical after the death, such as sales of stocks or bank transactions. In an international context, the use of this power of attorney is doubtful. In most countries, any power of attorney ceases to be valid upon death of the principal. Although a choice of law may be expressed in the power of attorney, it will not be widely accepted abroad. In Spain for example, a power of attorney post mortem will not be recognized since this was at one time a common means of avoiding succession tax by means of prescription.

2.2. Joint will

If the family business constitutes the main source of income and has been created by the spouses jointly, a joint will (known in German as gemeinschaftliches Testament) may be written down. Married couples can establish a Berliner Testament, a special form of joint will together with binding destination of the property to the surviving spouse and, upon his or her death, to the children.¹⁸ Therein it is often the case that the spouse who survives the other may not change or may only reduce the testament. Such clauses should be taken up however only after consultation with the Civil Law Notary as they may lead to profound result if incidents, unforeseen to the spouses, incur. After the death of one spouse, a mutual testamentary disposition of the other spouse can, generally speaking, not be revoked anymore and remains binding¹⁹. However, if the surviving spouse renounces the inheritance, he is free to change his will, § 2271 II 1 BGB. A joint will does not guarantee the continuity of the family business since the children may still claim their forced portion of the inheritance.

¹⁷ For a translation of the German Civil Code cf. <http://www.iuscomp.org/gla/statutes/biblst4.htm>

¹⁸ Frieser in Handbuch des Fachanwalts für Erbrecht, Chapter 1, 543, Wolters Kluwer 2005, München

¹⁹ <http://legal-succession.com/pages/er/er-germany2.html>

2.3. Contract on inheritance

The testator may conclude a contract of inheritance (Erbvertrag) with another person (not just the spouse), § 2274 ss. BGB.²⁰ The contract of inheritance requires notarisation.²¹ The testator may also make binding bequests in the contract of inheritance. It is through this contract, with the participation of the children as prospective heirs with right to a forced portion of the family business, that further binding dispositions such as a predistribution of assets may be combined with a rejection – from the future heir – of his right to a forced portion of the estate (Pflichtteilsverzicht).

2.4. Prior heir / subsequent heir

The classical instrument of maintaining the family business in the family for several future generations is a last will containing the nomination of subsequent heirs. A testator may leave his estate to a Vorerbe (prior heir) and a Nacherbe (subsequent heir) in the way that a person first becomes heir after someone else, at a particular time or the occurrence of a particular event, the later being referred to as the subsequent heir, § 2100 BGB. In the usual case, maybe the family house and all business-related assets go to A for life, and when A dies, then to B. The institution is similar to the English ‘settlement’.²² The particularity is that both prior heir and subsequent heir are heirs of the testator for a certain time, thus being single heir of the testator for a certain time. The prior heir’s own right to dispose of the items in the estate is subject to restrictions (§§ 2112 – 2115 BGB) and he is obliged to hand over the estate to the subsequent heir in such a condition as accords with proper administration, § 2130 BGB.

This construction enables the exclusion of certain persons from the estate (mostly the new spouse after the death of the testator) and it protects the estate against the claims of forced portions as it is considered separate property from the spouses. It is furthermore useful for young entrepreneurs who do not yet know who they might be able to appoint as a successor as their children are still under age. Together with detailed instructions for the executor of the will, a succession strategy for minors as final heirs of the business can be established this way.²³

2.5. Family Holding

The most common form elected in Germany for a family business is the “GmbH & Co. KG” mostly for succession tax reasons (see below 3). This popular fusion of a private partnership and joint stock company is suitable for entrepreneurs wishing to combine limited liability, with the advantages of a privately orientated corporate structure. The general partner is the private limited company (GmbH), which bears liability solely to the extent of its share capital. The limited partners are individuals; they form a private limited partnership (KG) with calculable

²⁰ <http://dejure.org/gesetze/BGB/2274.html>

²¹ § 2276 BGB, <http://dejure.org/gesetze/BGB/2274.html>

²² Fisher, *The German Legal System*, 3rd Edition, p. 89

²³ Bengel, p. 232.

liability. While the KG does have advantages tax wise, there needs to be not only at least one owner with limited liability (Kommanditist), but also at least one with unlimited liability (Komplementär). According to German Tax law (§§ 12 para. 6 Erbschaftsteuergesetz and § 9 Bewertungsgesetz), a participation in a foreign company is valued with its common value. However, foreign capital companies, real estate property and production sites may be considered for inheritance tax purposes with their German tax balance value. The European Court of Justice considers the different evaluation of foreign and domestic business property for succession tax purposes contrary to Art. 54 and 56 of the EU-Treaty.²⁴ Therefore it is generally highly advisable to opt for capital companies rather than personal companies in the structuring process of the international family business.

2.6. Family Foundation

If the purpose is to keep the company intact, a German family foundation (Familienstiftung²⁵, § 80 BGB ss.) might equally be considered suitable. There are no direct tax advantages to this, but if a company is brought into such a foundation and the founder lives for another ten years, no forced portions of the estate can be claimed by the heirs. The company will then belong to the foundation. Of course, this means that the father/mother must while still alive overcome any resistance on the part of the children.²⁶ The motives for establishing a foundation are as numerous as their forms and the determination of aims. In connection with the transfer of assets to a foundation the question must be asked to what extent provisions for the benefactor and his family can be made possible through the foundation and which consequences this may have concerning tax on income and the substance of property. Besides the transfer of assets against provision payments the testator (more precisely, the benefactor to the foundation) may set up the reserved usufruct to basic and capital assets, as well as classical beneficiary payments and employment relationships with the foundation. The first two methods for provisions are relevant for the taxation of the transfer of the assets already, whereas beneficiary payments and employment relationships are only of interest within the framework of the regular taxation.²⁷

(i) Two models of Foundations

Two models are possible since 2002: A Family Foundation with the main aim of participation in the family business through holding the shares and distribution of the annual surplus to more than 50% to the family members or a non-profit foundation which must aim at distributing its earnings to a very narrow, specific non-profit goal.²⁸

²⁴ ECJ 17.01.2008, C-256/06 (“Jäger”)

²⁵ Familienstiftung established through Gesetz zur Modernisierung des Stiftungsrechts in 2002

²⁶ Familienunternehmen: Recht, Steuern, Beratung, p. 236 Hannes/Kuhn/Brückmann (ed.), Berlin 2007

²⁷ Seibold, Die Versorgung des Stifters und der Stifterfamilie bei Vermögensübertragung auf eine gemeinnützige Stiftung, Familienstiftung oder Doppelstiftung und deren ertrag- und substanzsteuerlichen Auswirkungen, Diss 2008, p.XV <http://www.opus-bayern.de/uni-wuerzburg/volltexte/2008/2801/>

²⁸ § 58 No. 5 AO [Abgabenordnung, German Fiscal Code] regulates the taxation of the non-profit foundation.

(ii) Taxation of foreign foundations and trusts

Income of foreign family foundations, associations and trusts is attributed to the founder/settlor or the beneficiaries regardless of a distribution of trust funds. Thus, these persons are discriminated in relation to founders and beneficiaries of German family foundations who are only taxed if they receive funds. The German supreme tax court had fixed the premises, under which a family foundation has been set up and endowed effectively under the gift tax act.²⁹ Even if a foundation has been effectively set up and endowed in terms of foreign law, the transfer of assets may not be taxed if the founder has reserved himself special powers, so that the foundation cannot effectively and legally dispose of the funds. Such special powers can for example be the right to instruct the board of directors of the foundation concerning the administration of assets, the right to claim the reassignment of funds, the possibility to change the articles or to recall members of the board at any time. However, foundations within the European Community are excluded from January 2009 onward.³⁰ This entails a considerable improvement for founders, settlors and beneficiaries of a trust located in the EU or the EEA. They will be only taxed if they actually receive funds and thus will be prevented from “double taxation”. Foundations and trusts under Liechtenstein law do not fall under the newly created dispositions for lack of exchange of information.

3. German Inheritance Tax reform of 2009

In Germany, inheritance tax is conceived as a tax that accrues by way of succession, that is, the inheritor must pay tax on the assets received. As of January 1, 2009, a reform of inheritance tax legislation³¹ exempts family homes and business enterprises from taxation under certain circumstances.³² The reform has a major impact on all future inheritance and gift cases related to Germany or German citizens.

3.1. Unfair discrimination of real estate property

Until 2006, German real property was generally subject to the inheritance tax, yet very low assessments of the value of real estate lowered the tax burden significantly. The Federal Constitutional Court vitiated the regime as being unconstitutional.³³ Germany's Constitutional Court ruled that the present system for calculating the tax was unfair since it taxed the transfer of real estate property more favorably than the transfer of cash instruments, such as stocks.³⁴ If one

²⁹ BFHE 217, 254 of 28. June 2007

³⁰ § 15 Abs. 6 Außensteuergesetz, reformed on 25. Dezember 2008, effective 1. Januar 2009 (Art. 39 Abs. 1, 8 G vom 19. Dezember 2008) http://bundesrecht.juris.de/astg/_15.html

³¹ Gesetz zur Reform des Erbschaftsteuer- und Schenkungsteuergesetz, Dec. 31, 2008, BUNDESGESETZBLATT [BGBl.] I at 3018, § 13, available at http://bundesrecht.juris.de/erbstg_1974/BJNR109330974.html

³² Palmer, Global Legal Monitor 25.03.2009 http://www.loc.gov/lawweb/servlet/lloc_news?disp3_1159_text

³³ (Bundesverfassungsgericht, Nov. 7, 2006, Docket No. 1 BvL 10/06, available at <http://www.bundesverfassungsgericht.de/entscheidungen/2006/11>.

³⁴ For an overview of Inheritance in Europe:

followed the idea of the ability-to-pay principle in this context, it would no doubt have been worth considering integrating inheritance tax into income tax – while at the same time reducing the tax rates and offering appropriate deferral options. The starting point was considering how to improve the general taxation conditions for inheriting a business, in order to strengthen and preserve companies and to safeguard jobs. This is an important matter for family-run industrial SMEs, which have been waiting for this reform for three years. The Federal Constitutional Court ruled that by 31 December 2008 the legislators must remedy the unconstitutional unequal treatment in the valuation of individual types of assets, otherwise inheritance tax will cease to be collected. However, as inheritance tax has been abolished in some of the neighboring countries, demands for a abolition had been voiced. Valuations Above all, new approaches to the values were needed in the areas of business assets and real estate.

3.2. New exemptions and valuation rules

The major changes are: new valuation rules for business assets, agriculture and forestry assets, stocks, and real estate; • broader general personal allowances; • a partial tax exemption for the transfer of a company; and • tax exemption for owner-occupied real estate. The new, 2009 legislation taxes real estate at market values, but exempts the heir of an owner-occupied family dwelling from inheritance tax if the decedent was his spouse, parent, or grandparent. The exemption applies only if the heir lives in the house for ten years, and, for children and grandchildren, only 200 square meters (2,150 square feet) of a single home or condominium are exempted.

The exemption for the heir of a business attempts to preserve domestic business or agricultural enterprises and domestic employment. If, over a seven-year period, the heir pays out wages amounting to 650 percent of the annual payroll at time of death, 85 percent of the inheritance tax is waived. If, over a ten-year period, the heir pays out 1,000 percent of the annual payroll at time of death, the entire inheritance tax is waived. These exemptions, however, apply only if the financial assets of a business do not exceed certain percentages.³⁵ In any event the provisions on keeping the business in operation are very restrictive, even though they are linked with a reinvestment clause. Furthermore, the tax-exempt portions have been raised. Most property inherited and used by spouses and children will remain free of inheritance tax. The spouse is entitled to a tax-free portion of 500.000 Euros while children receive 400.000 Euros tax-exempt.³⁶ Civil partners receive the same tax allowance as do spouses. Even though Class Two (Steuerklasse II) recipients, i.e. siblings, nieces, nephews, divorced spouses, step parents, parents-in-law and children-in-law, will generally benefit also from a general increase of the personal exemption amount from 10,300.00 Euros previously now up to 20,000.00 Euros, this will be generally be overcompensated by the steep increase of inheritance tax rates for Class Two recipients up from previously 12 through 40 percent to now 40 through 50 percent, so in most cases the German government will take a significantly deeper tax bite in the case of Class Two

<http://www.agn-europe.org/htm/firm/news/ttf/2008/inheritance.pdf>

³⁵ Palmer op. cit.

³⁶ Kessler / Eickie , Tax Notes Int'l, January 19, 2009, p. 233

recipients after December 31, 2008.

3.3. Preferential treatment for shares

Besides agricultural and forestry property as well as business assets, it is also shares in corporations which will qualify for the preferential treatment in case of a shareholding of more than 25%, including pools of share-holders. However, the assets named only qualify for preferential tax treatment if no more than 50% of the relevant assets are qualified as “passive” non-operating assets (e.g. real estate let to others, widespread shareholdings). Apart from that, “passive” assets must have already been part of the transferred business 2 years before the transfer to be part of the privileged property. Foreign business property is subject to the preferential treatment as long as the property is effectively connected with a permanent establishment in a state of the European Union. The preferential treatment of shares in corporations requires that the company’s seat or effective place of management is located in Germany, the European Union or the European Economic Area. The sale or abandonment of a business as well as a private withdrawal of essential assets within the following 15 years after the transfer will cause a complete loss of the tax privilege and thereby trigger a subsequent taxation. However, an exemption is made if the sale of an independent division of the business or of essential assets is not aimed at the retrenchment of the business.

3.4. Conclusion

The reform of the Inheritance Tax 2009 is a clear relief for family-run businesses, and necessary to keep and safeguard jobs in Germany. After all, one of the most prestigious and prominent tasks of the government in this legislative period has found its way to the tax code. With the Reform of the Inheritance Tax and Valuation Law, the German Government is attempting to bring about a constitutional valuation of all categories of assets which will comply with the ruling of the Federal Constitutional Court. The new law brings much legal certainty for heirs of family businesses, even though some questions regarding the sum of salaries and the holding period remain.

4. Recents reforms in Spain

4.1. Family Protocols in the Código Civil

(i) Definition

There are different methods for the transfer of the ownership of family firms in Spain. Some of them are devoted to maintain the enterprise within the family. One of those tools designed for the planning succession are the so-called succession agreements or agreements as to a future succession.

Successions agreements aim to achieve a predictable outcome for the business in the event of death of the founder or death of the shareholder . Certainty in the intergenerational succession is essential for the future of the firm. As per definition, a succession agreement is an agreement between two or more persons, creating, modifying or terminating the rights of those persons to succeed to the future estate.³⁷

(ii) Family Protocols in the Código Civil

Recently it has become quite common among the Spanish family businesses to make a “Family Protocol”³⁸. Defined by the new Law on Family Protocols³⁹, this is a “shareholder’s agreements or agreements between the shareholders and third parties with family links, with regard to the family business in order to achieve a model of communication and decision-making to regulate the relationships between the family, the ownership and the company”. It is therefore a tool for the corporate governance of the firm and specially addressed to achieve a planned intergenerational succession of ownership of the firm⁴⁰. To that end the family protocol organizes and regulates the relationships between the family owner and the enterprise.

(iii) Prohibition of contracts on future inheritance - Art. 1271 II Código Civil

Spanish common civil law (Código Civil), in line with others influenced by Roman law, has a general prohibition of succession agreements, arguing that the will of the human being may vary until death. Based on the principle of **autonomía de la voluntad**, the possibility to modify the person’s will until the moment of death⁴¹ exists, as wills are fully revocable,. This revocability principle conflicts with the principle of certainty inherent to any succession agreement. Another argument behind this prohibition is the so-called *votum mortis*, i.e. the potential desire of the beneficiary of the succession agreement regarding the death of the contractual party in order to inherit from him/her as soon as possible. *Art. 1271.II CC* prohibits contracts on “future inheritance” or on “future succession”. Furthermore, according to *Art. 658 CC* there are two ways of estate succession: by testament or in its default by law. It is true that the Spanish civil code foresees some exceptions to the general principle of prohibition, but they are not really suitable to be used for the purpose of the transfer of the business⁴². On the contrary, an important outcome has come by the case-law⁴³. Case-law has allowed for such agreements when they deal with

³⁷ Egea Fernández, J., “Protocolo familiar y pactos sucesorios. La proyectada reforma de los heredamientos”, *InDret*, julio 2007, in www.indret.com; González Bou, E., “Los heredamientos como forma de ordenación de la sucesión por causa de muerte de la empresa”, en Garrido Melero, M. – Fugardo Estivill, J.M. (coord.) *El Patrimonio familiar, profesional y empresarial. Sus protocolos*, Tomo II, Bosch, 2005, pp. 733-766.

³⁸ Commission Recommendation 94/1069, 7th December 1994

³⁹ Fernandez del Pozo, L., *El protocolo familiar. Empresa familiar y publicidad registral*, Cuadernos Civitas 2008.

⁴⁰ Statute RD 171/2007, 9 February, on the publicity of family protocols (BOE num. 65, 16th March)

⁴¹ Gomà Lazón, I., “El Protocolo familiar”, in Garrido Melero, M. – Fugardo Estivill, J.M. (coord.) *El Patrimonio familiar, profesional y empresarial. Sus protocolos*, Tomo II, Bosch, 2005, p. 655.

⁴² Espejo Lerdo de Tejada, M., *La sucesión contractual en el Código Civil*, Universidad de Sevilla, 1999, p. 28.

⁴³ See Arts. 826 y 827 CC; Art. 1341 CC

⁴⁴ STS of 4 May 1910 (see footnote 33 in Sanchez Arisi, R., *Dos alternativas a la sucesión testamentaria: pactos sucesorios y contratos post-mortem*, ed. Comares, Granada 2003), STS 16 May 1940 (RJA, marg. Núm. 416 bis).

known and existing items of property when the contract is executed. Therefore, the prohibition only affects when the agreement is made for the entire inheritance.

4.2. Family Protocols in the New Catalan Civil Law

(i) Book IV of the Catalan Civil Code on Succession Law

Catalonia has recently passed a new Law (Book IV of the Catalan Civil Code on Succession Law) which aims to a reform of the Law of succession.⁴⁴ Although agreements as to the future succession have always been accepted under Catalan law, their regulation was based on a different conception of family relationship and society. The new law is more flexible and open and adapts the regulation of succession agreements to the needs of the actual society. For instance, before the reform, agreements as to the future succession were only possible between spouses and through (pre-nuptial) matrimonial agreements.

(ii) Legal evolution

Law 10/2008, of 10 July, on volume IV of the Civil Code of Catalonia, regarding inheritance, incorporates this part of law into the CCCat. Until now, Catalan inheritance law was contained in Law 4/1991, of 30 December, on the Inheritance Code, which already regulated in autonomously, completely and systematically. Volume IV took these regulations as a starting point and, on the occasion of its revised version in the CCCat, it was then updated and modified in accordance with what was considered necessary for the modern and changing society in which it has to govern. The new rules respect the traditional classic principles of Catalan law, in a system based on the freedom to make wills, and introduces significant changes to a system that, during the fifteen long years it was in use, has been very positive for practice. The new Inheritance Law for Catalonia came into effect on 1 January 2009.

(iii) Aims

Amongst the most significant innovations of Volume IV, which is divided into six paragraphs, the following must be highlighted: those relating to regulation of inheritance agreements, those concerning the rights of the widow in cases where there is no will, as well as those involving a cohabiting partner in a stable relationship, reforms relating to the widow's rights to a share or a quarter of the estate, the abolition of reservation, as well as new regulation of those who are inheriting and their responsibilities. As the Preamble states, the new Law aims to cover those agreements devoted to the transfer of the family business where several generations of relatives might be involved:

Entre el mantenimiento del esquema tradicional y la apertura de los pactos a cualesquiera contratantes,

⁴⁴ Código Civil de Cataluña: = Codi civil de Catalunya. Libro IV, relativo a sucesiones (Ley 10/2008, de 10 de julio) = Llibre IV, relatiu a successions (Llei 10/2008, de 10 de juliol)
<http://www.boe.es/boe/dias/2008/08/07/pdfs/A33735-33788.pdf>

el libro cuarto ha optado por una solución intermedia prudente: los pactos solo pueden otorgarse con el cónyuge o conviviente, con la familia de este o con la familia propia, dentro de un cierto grado de parentesco por consanguinidad o afinidad. Esta regla tiene en cuenta el mayor riesgo de los contratos sucesorios entre no familiares, pero a la vez es suficientemente abierta para amparar los pactos que a veces se estipulan con ocasión de la transmisión de empresas familiares, en los que pueden llegar a intervenir varias generaciones de parientes en línea recta y otros miembros de la familia extensa. La restricción legal en cuanto al grupo de personas que pueden convenir pactos sucesorios no rige para ser favorecido. Los pactos pueden contener disposiciones a favor de terceras personas, pero estas no adquieren ningún derecho hasta la muerte del causante. Sangrados sucesivos de texto para ampliar información sobre un punto, para aclarar una idea o para aportar referencias.

5. Conclusion and Outlook

Family businesses play a growing role on an international level and this translates into legislative action in various countries with different approaches. Viable approaches have been chosen by the German and Spanish / Catalan legislative bodies, both entering into effect on 1 January 2009. However, these changes have not yet been taken into account fully by the respective rules on conflict of laws.

On a European Level, the commission published in 2005 a green Book on Succession and Wills⁴⁵, recognizing the need for a harmonization on this subject matter. There is still a long way go in order to harmonize the conflict of law rules applicable to agreements as to the future succession⁴⁶. A harmonization could strengthen the position of family businesses, thus recognizing their vital role for the economy.

⁴⁵ http://eur-lex.europa.eu/LexUriServ/site/en/com/2005/com2005_0065en01.pdf

⁴⁶ See for an indepth study: La ley aplicable a los pactos sucesorios, *Albert Font i Segura*, INDRET 2/2009, 30/04/2009 http://www.indret.com/code/getPdf.php?id=1244&pdf=635_es.pdf