

The Assessment of Fiscal Aspects in the Generational Transition of Family Businesses

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Abstract

The assessment of fiscal aspects in the generational transition of family businesses is fundamental for most small and medium-sized Italian enterprises. The family character of the companies constitutes a value in an economic sense, as recent studies underline, which highlight a higher profitability of family businesses compared to larger companies. Family businesses have an ethical value for their historical significance in the Italian economy, as recently reported in the newspaper "The Economist", that includes 8 Italian companies, among the 15 (enterprises) of world renown, with more than 500 years of life. In Italian practice many legal instruments allow planning in an orderly way the generational transition of the family business, among them: the will, the donation, the family pact, the trust. It is expected a favorable tax treatment for these instruments, contained in article 3 (b) of Legislative Decree 346/1990, aimed at facilitating the generational passages which, under certain conditions, provides for the exclusion from taxation for transfers inter vivos or mortis causa (transfers of companies or branches of company, shares and shares). The Italian legislator has provided for this legislation to prevent the tax systems from damaging the companies during the inheritance, that is to say that the payment of taxes on succession or donation may endanger the financial balance of the company and therefore its own survival. This important facilitation in the field of tax on donations and successions was introduced under the Financial Act for 2007, art. 1, paragraph 78. The subject of this study are the fiscal aspects in the generational transition of family businesses taking into consideration the most widespread legal instruments in Italian practice in the management of the generational transition, in particular: the will, the donation, the family pact, the trust for which is provided a favorable tax treatment under the financial law of 2007, art. 1, paragraph 78.

Key words: tax treatment, generational transition, family businesses, legal instruments, financial law.

1. INTRODUCTION

The term “generational transition” in the economic legal language, means a series of operations, that are useful to guarantee the succession, *inter vivos* or *mortis causa*, in the direct or indirect exercise of the enterprise (Note 1).

In the literature and in the good practices, it is highlighted that in order to adequately address the generational passage of the family business, it is necessary to plan the succession in time, managing the crucial moments of the succession with the help of the consultant (Note 2), which has the fundamental task of evaluating the legal instruments to implement the generational change, also with regard to the fiscal impact.

In order to avoid burdening the business succession with an excessive tax burden, both in terms of risk and tax burden lose sight of family goals (Note 3).

The generational transition concern the Companies but also the Institutions (Government, Regions, Local Authorities), Chambers of Commerce, Universities and Consultancy and Training Companies, which can play a fundamental role in fostering and promoting business continuity.

2. ITALIAN SMALL AND MEDIUM-SIZED BUSINESSES

Most Italian small and medium-sized businesses (Note 4) are family businesses (Note 5). This aspect is a value in the economic sense, as recent studies point out, which show a higher profitability of family businesses compared to larger companies (Note 6).

The family character of Italian companies is also an ethical value for their historical importance in the Italian economy, as recently reported in the newspaper "The Economist", which includes 8 Italian companies, among the 15 (companies) of world renown, with over 500 years of life (Note 7).

The generational transition of Italian family businesses that, on the one hand, presents risks, including the one that does not happen, thus determining the interruption of entrepreneurial activity, with consequent loss of jobs; on the other hand, it offers opportunities that may concern the strategic, managerial and financial aspects of the company.

3. THE LEGAL INSTRUMENTS IN THE MANAGEMENT OF THE GENERATIONAL TRANSITION

There are several legal instruments available to offer concrete solutions for planning the generational shift of the family business in an orderly manner, each of which has different characteristics and makes it possible to converge towards the realization of the needs of the Italian family business which, according to the research data, indicates the following:

- (a) maintaining the unity and integrity of the family and the business;
- (b) passing on the material and immaterial wealth through the generations;
- (c) maintaining the economic destination of certain assets and in particular the business;
- (d) ensure the growth and success of the family business (Note 8).

The most widespread legal instruments in the Italian practice in managing the generational change are: the will, the donation, the family pact, the trust (Note 9).

It is important to underline that for these instruments is applied a favorable tax treatment, contained in art. 3 paragraph 4 ter of legislative decree 346/1990, aimed at facilitating generational transitions and that, under certain conditions, the exclusion from imposition for *inter vivos* or *mortis causa* transfers (transfers of companies or business units, of social quotas and shares) (Note 10).

The Italian legislator has provided for this legislation to prevent tax systems from harming companies during the hereditary transmission, that the payment of inheritance or donation taxes could endanger the financial balance of the company and therefore its survival (Note 11).

This important tax relief for gifts and inheritance tax was introduced with the 2007 Financial Law.

4. THE WILL: GENERAL CHARACTERISTICS, PURPOSE, FORM

The will is a unilateral written document, revocable, with which a subject identifies the destination of his property (or part of it), for the moment following his death (Note 12).

Through this tool, a person chooses who to attribute his assets by appointing as heirs also strangers (Note 13).

If there are legitimate and legitimate heirs, which necessarily participate in the inheritance (for example, the children), the testator can decide the fate only of the so-called available share of his patrimony.

In case of violation of this bond, the injured heirs in the own share or ousted from the inheritance will be able to obtain what the law gives them.

The will, in order to be able to express its effects, must have the written form, which can, however, cover different forms; it can be holograph or cover the form of the public act that can be presented as a public will or a secret will (Note 14).

5. THE DONATION: GENERAL CHARACTERISTICS, LIMITS, FORM. INDIRECT DONATION: GOALS AND LIMITS

The donation is a contract that is perfected with the consent of the donor and of the donee with whom, in a spirit of liberality, one party enriches the other, placing in favor of this one of his right or assuming towards it a bond (Note 15).

The acceptance of the donee can be contextual to the donation or subsequent. The donation can not harm the rights of the subjects who necessarily participate in the inheritance, that can resort to the law to obtain what is rightfully attributed to them.

The so-called donations of use are not included in the legal regime of donations, that is, those that are used in services rendered (for example, a gift to return a favor) or in any case in accordance with customs (for example, birthday gifts) (Note 16).

If the donation relates to mobile things, these must be specified exactly with the indication of their value: the specification can be contained in the same act of donation or in a separate note signed by the donor, by the donee and by the notary.

An asset allocation granted in a spirit of liberality can also be implemented indirectly through a different negotiating framework.

In this case, it is not subject to all the rules laid down by the Civil Code regarding donation: for example, the notarial deed is required, which is necessary for the donation contract (Note 17).

It allows one party, in a spirit of liberality, to enrich the other, arranging for one of its rights or assuming an obligation towards it. The donation can't harm the rights of the subjects who necessarily participate in the inheritance and can resort to the law to obtain what is rightfully attributed to them.

The instrument of the donation lends itself to operations of "accommodation" of the property, allowing the subdivision of family assets and therefore, the targeted destination of the business assets.

6. THE FAMILY PACT: GENERAL CHARACTERISTICS, ADVANTAGES, FORM, PURPOSE

The family pact is an institution introduced by Italian legislator in 2006 in order to encourage the generational transition of family businesses (Note 18).

It consists in the transfer of the company or the participation in a company to one or more descendants through a contract, in whole or in part, without consideration.

The advantages offered by the tool consist in the fact that the entrepreneur, during his life, can verify if the attribution to one of the descendants corresponds to his expectations, reserving the possibility to dissolve and modify the contract, involving the same people who they have concluded; in addition, in subtracting the assigned assets and the liquidations made for a reduction or collation action by the heirs who are not beneficiaries of the family pact, also by any legitimates who have survived after the death of the entrepreneur.

These can only request the liquidation of the sum corresponding to their legitimate share.

Tax exemption is envisaged on the transfer of shares to the beneficiary of the agreement, if certain requisites required by law are respected (the beneficiaries of the pact continue the exercise of the business activity or hold control for a period of not less than five years from the date of transfer, making, at the time of the donation, a special declaration to that effect).

The family pact is a contract (Note 19) that requires the form of the public act. The parties to the contract are those persons who would qualify as "heirs", if, at the time of stipulation of the same contract, the succession in the entrepreneur's assets was opened (It realizes a kind of early succession). Ensures the stability and continuity of companies already operating in the market, while ensuring a certain succession in the interest of the company owned by the individual entrepreneur.

7. THE TRUST: GENERAL CHARACTERISTICS, PURPOSES, LIMITS, ADVANTAGES. THE PROTECTED SUBJECTS

The trust is a unilateral act, as a rule, irrevocable, with which a willing subject entrusts the family assets to the trustee (Note 20) that it must manage and administer it, based on the indications of the settlor (Note 21).

With the trust it is possible to plan the generational shift and the future functionality of the companies, organizing their ownership structure with the presence of the most qualified and competent family

members (Note 22).

The assets entrusted to the trustee constitute a patrimony separate from the patrimony of the latter and are bound, exclusively, for the realization of the generational transfer of the family business, insensitive to any affair that does not strictly concern the Trust.

The entrepreneur will be able to:

- a) organize the generational change without losing control of the situation or undergo any limitation in the activity of the company, immediately arranging that the assets of the family business are destined for unified management and subdivided in a timely manner at the end of the trust between the beneficiaries indicated in the trust deed;
- b) to prevent conflicts and grounds for dissent and to protect against any future interference by third parties in the life of the company;
- c) rely on the confidentiality of their needs in order to maintain the contract strength of the family business towards third parties, banks and their creditors;
- d) be sure that everything will take place as planned, sure that even when he is gone, the heirs will continue to respect his will.

The protected subjects are the beneficiaries. They will have the power to demand from the trustee the execution of the provisions contained in the trust act and the protection of the purpose of the trust.

8. THE 2007 FINANCIAL LAW, ART. 1, PARAGRAPH 78: TAX TREATMENT ON DONATIONS AND SUCCESSIONS

An important tax relief for gifts and inheritance tax was introduced with the 2007 Financial Law (Note 23) provides that donations (mortgage and cadastral taxes) transfers of companies or branches thereof, also through the family agreements referred to in Art. 768-bis Civil Code in favor of the descendants, or of the spouse (Note 24).

From a subjective point of view, the rule presents some uncertainty regarding its application, in fact, the reference of the facilitated transfer to the descendants, as beneficiaries “also made through family agreements in favor of the descendants”, indicated by the rule, would seem circumscribed only for transfers made through family agreements.

However, the wording of the law does not exclude an interpretation aimed at recognizing the operation of the facilitation in comment for the transfers of companies, quotas or actions, carried out in succession or with deeds of donation, and also in favor of subjects different from the descendants of the entrepreneur, such as the spouse, the sisters and the brothers or relatives in collateral line (Note 25).

The C.M. 6 August 2007, n. 48/E stated that “pursuant to art. 3, paragraph 4-ter, Legislative Decree of 31st October 1990, No. 346 introduced by art. 1, paragraph 78, Finance Law 2007”, the trust placed in favor of the descendants is not subject to tax, if it relates to companies or branches of them, quotas and shares (Note 26).

From an objective standpoint, the exemption applies to transfers of companies and business units in the sense that the object of the transfer must be a set of assets that constitutes a production unit pursuant to art. 2355 Civil Code; from the generic nature of the reference, it can be deduced that the activity carried out can be both commercial and agricultural.

The exemption for the transfer of shares of companies or shares is to be considered the shares of companies of all kinds, that is of both people and capital (Note 27).

In this sense, the exemption in question is only due if the transfer of shares or shares allows the heirs or donors to take over a control situation, or to carry out such control if they already hold shares or shares of the same company (so-called integration of control): this condition, evidently, represents a strong limit to the operation of the facilitation.

In the case in which there is more than one beneficiary, that is, when the shareholding transferred is split between them, the advantage is exclusively for the allocation that allows the acquisition or integration of control (Note 28) reverse, in the hypothesis in which the participation is co-owned, the facilitation to transfer is always up to date.

According to this law, the assignees (or the heirs, legatees or donors) for at least five years, starting from the transfer date, must continue the business activity (in the case of transfer of business) and keep control of the company (in the case of transfer of shares or units).

If this condition is not respected, the forfeiture of the benefit is envisaged with the consequent application of the tax in an ordinary manner, of the related default interest and of the administrative penalty of 30% of the unpaid amount provided for by art. 13, Legislative Decree 471/1997.

The assignees must provide a specific declaration, together with the declaration of succession or the signing of the deed of gift or of the family pact, through which they indicate their intention to continue the business activity or to want to maintain control over at least five years.

However, there is no forfeiture of the concession in all those cases in which the possession of the assets acquired by succession, donation or through the family pact is lost due to reasons not attributable to the will of the heir, legatee or donor; for example, in cases of foreclosure of the assets themselves or in the case of bankruptcy of the company.

9. CONCLUSION

The results of this work show the particular attention of the Italian legislator to companies at the time of hereditary transmission, through the favorable tax treatment protects the financial equilibrium of the company and therefore its survival does not suffer any repercussions.

The family nature of the corporate structure stimulates greater personal involvement and the sharing of common interests and objectives, in defense of company assets.

The management of the generational change carried out in a coordinated way with the use of the most appropriate juridical and economic instruments favors the attainment of the typical objectives of maintaining unity and integrity of the family and of the enterprise, passing on the material and immaterial wealth through the generations maintain the economic destination of family assets and the growth and success of the family business.

All the instruments analyzed satisfy the needs of the family business to guarantee the growth and success of the family business allowing the descendants to enjoy the profits of the company but preventing them from having the company that will remain in perpetuity, from generation to generation, a prerogative of the family.

However, it is noted by some that: “there are actually few entrepreneurial families that endow themselves with the formal rules of a family pact, but they certainly do the older and larger ones by” population” and the size of their assets, confirming the effectiveness of the approach.

However, their number is growing all over the world, not only in Italy, and it turns out that many families owners of medium and small companies are attracted by this approach and undertake more or less formalized family governance processes, with the help of their professionals and advisors” (Note 29).

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Sitography

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Note

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issues: “updating the original entrepreneurial formula, the retention of people who hold” key “roles, the training of family members and the assignment of operational powers, the structuring of an appropriate governance model, the evaluation of the company, the rationalization of the organizational model”.

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- [4]. Italian Development Cooperation Ministry of Foreign Affairs - Embassy of Italy Tirana. (2018). <http://www.italcoopalbania.org> - “Italy supports the socio-economic development of Albania and its path of integration in the European Union with initiatives for the development and strengthening of social, educational and health institutions and services. Italian small and medium-sized companies are Albania’s leading commercial partner in the construction, textile and footwear sectors, in commerce and services, in the agro-food industry, in the health sector, in the metalworking sector”.
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- [15]. Art. 769 e ss. Civil Code.
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- [17]. Supreme Civil Court (2018). (Ordinance No. 4682/18, 10 January - 28 February): "for the validity of indirect donations, however, the form of the public deed is not required, as compliance with the forms prescribed for the typical store used to achieve the purpose of donation, given that the Art. 809 of the Civil Code, in establishing the rules on donations applicable to other acts of donation made with shops other than those provided for by Art. 769 of the Civil Code, does not recall the Art. 782 of the Civil Code, which lays down the public deed for the donation; has specified that the co-signing, with signature and availability disjoined, of a sum of money deposited with a credit institution, is qualificable as indirect donation if said sum, at the time of co-certification, appears to have belonged to only one of the joint holders, noting that in this case, by means of the bank deposit agreement, the enrichment without payment is made by the other joint account holder: on condition, however, that the existence of the "*animus donandi*" is verified, "consisting in the finding that the owner of the money had, at the time of co-signing, another purpose than that of liberality. In this regard, it is emphasized that since in the indirect donation the liberality is realized, rather than through the typical donation shop, through the accomplishment of one or more acts that, preserving the form and the cause that is proper to them, realize, in indirect, the effect of the enrichment of the recipient, the intention to donate emerges not directly, directly, from the act or the deeds used, but only indirectly from the necessarily rigorous examination of all the circumstances in fact of the single case".
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