AN ANALYSIS INTO THE DEFINITION OF A ‘FAMILY BUSINESS’ IN THE FAMILY BUSINESS ACT

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Introduction

1.1 The scope of the research

The basis on which this term paper's question is set is the analysis of the legal definition introduced in the Family Business Act[1], to evaluate and consider if it caters for the needs of family businesses in the specific Maltese scenario. It is estimated that in Malta, as many as ninety-eight percent (98%) of businesses are Small or Medium Enterprises and the vast majority of such businesses are family-run[2].

In his message to introduce the White Paper in preparation for the enactment of this Act, Minister Christian Cardona noted that this legislation "clearly defines a 'family business' and how family businesses can be structured to acquire the same label and remove the ambiguity that presently exists around this sector.[3]" This follows an EU report[4] on family businesses in Europe which acknowledged that there is currently no "legal binding, simple and harmonized European-wide definition" of a family business and called on the EU Commission to adopt an EU-wide definition of family businesses and on the member states to support and back family businesses through support initiatives.

Article 3 of the Act, which has come into effect as of 1st January 2017, recognises nine different methods of ownership of a family business and takes a more specific approach in comparison to the definition adopted by the Expert Group on Family Businesses set up by the EU Commission[5]. Dr. Nadine Lia, legal advisor to the Ministry for the Economy, Investment and Small Business, noted that one of the challenges posed while drafting the Act included the creation of the right definition when considering what constitutes a

[1] Family Business Act, Chapter 565 of the Laws of Malta
[2] PricewaterhouseCoopers, 'Bridging The Strategy Gap In Maltese Family Business' (2016)
[3] Ministry for the Economy, Investment and Small Business, 'The Family Business Act White Paper' (2015).
[4] European Parliament, 'EU Report On Family Businesses In Europe' (2015).
[5] European Commission, 'Final Report Of The Expert Group, Overview Of Family-Business-Relevant Issues' (2009).

family; looking at family logic, dimensions of family continuity, family values and family relationships and their business models[6].

1.2 Research and Methodology

During the bulk of this term paper, the phrase ‘Family Business’ required extensive desk research in order to fully understand the definition as found in Article 3 of the Family Business Act. A number of documents such as online articles, journals, books, publications and news portals have been used to study factors connected to the context of the aforementioned definition as found in the Family Business Act.

The comparative method has also been applied, most notably in the second and fifth sections, in order to compare the various legal instruments linked to family business legislation from all over the European Union. The latter method has proved to be extremely beneficial, as it helped the author bring to light various cross-border issues which would otherwise have gone unnoticed had research been limited to the local scenario.

[6] 'Malta Enacts Family Business Legislation' (*Financemalta.org*, 2017) <http://www.financemalta.org/publications/articles-interviews/articles-and-interviews-detail/malta-enacts-family-business-legislation> accessed 15 March 2017.

1. A preliminary insight into the definition in the Family Business Act

1.1. What differentiates a family business from other businesses

In defining a '*family*' in a family business, one studies the components of the individual family members and which traits are considered to be a essential in this definition. There is no clear-cut definition of what a family is, but the United Nations uses the following description:

"*Any combination of two or more persons who are bound together by ties of mutual consent, birth or/and adoption of placement and who, together, assume responsibility for, inter alia, the care and maintenance of group members, the addition of new members through procreation or adoption, the socialization of children, and the social control of members.*[7]"

Family businesses are often assumed to take the form of a sole trader in a father-sibling trade, though this is a misinterpretation of what a family business represents. Family businesses vary from the smallest to the largest of forms and what defines a family business is attached more to the involvement and management of the business.

Prior to evaluating the Maltese definition in the new legislation, an understanding of the theoretical basis of a family business is necessary before moving forward to the Maltese scenario. Around the world, family businesses come in different shapes and sizes: sole proprietorships, limited liability companies, partnerships, publicly listed companies amongst others. Even though no definition has been widely-recognised as of yet, most pertain to the indispensable role of the family in that business.

Astrachan and Shanker (2003) provide three definitions of family businesses**:** a broad definition entailing a degree of family participation and control of strategic direction, a

[7] 'Dáil Éireann - 14/Feb/1995 Ceisteanna—Questions. Oral Answers. - Definition Of Family.' (*Oireachtasdebates.oireachtas.ie*, 2017) <http://oireachtasdebates.oireachtas.ie/debates%20authoring/debateswebpack.nsf/takes/dail1995021400012?opendocument> accessed 15 March 2017.

middle definition narrowing the field by adding the requirement of the business owner's intention to pass on the business to another family member, and a narrow definition requiring multiple generations to have a significant impact on the family business[8]. In his research, Lansberg (1988) makes use of the over-lapping three-circles model; with each circle referring to family, business and ownership[9]. Burkart et al (2003) note how the different rates of inheritance tax in different jurisdictions affect the type of family business which succeed in a given jurisdiction[10]. In anticipation of the drawing up of the Family Business Act, Borg Cardona (2014) suggested that the definition adopts a general approach which will guard against potential abuse whilst striking a balance between a very narrow approach, addressing small micro-organisations, and a very wide approach, capturing almost all Maltese businesses[11].

In the Final Report of the Expert Group on Family Business commissioned by the EU Commission, the expert group claimed that there is generally a consensus on three essential elements being the family, the business and ownership; and proposed the following definition, basing itself on the Finnish working group:

"A firm, of any size, is a family business, if:
1) The majority of decision-making rights is in the possession of the natural person(s) who established the firm, or in the possession of the natural person(s) who has/have acquired the share capital of the firm, or in the possession of their spouses, parents, child or children's direct heirs.
2) The majority of decision-making rights are indirect or direct.
3) At least one representative of the family or kin is formally involved in the governance of the firm.

8 Joseph Astrachan and Melissa Shanker, 'Family Businesses' Contribution To The US Economy: A Closer Look' (2003) 16 Family Business Review.
9 Ivan Lansberg, 'The Succession Conspiracy' (1988) 1 Harvard Business Review.
10 Mike Burkart, 'Family Firms' (2003) 58 The Journal of Finance.
11 Etienne Borg Cordona, 'Family Businesses: A Case For Special Treatment At Law?' (Degree of Master of Arts in Financial Services, Faculty of Laws, University of Malta 2014).

4) Listed companies meet the definition of family enterprise if the person who established or acquired the firm (share capital) or their families or descendants possess 25 percent of the decision-making rights mandated by their share capital."[12]

The same report examined 90 different definitions, with the main elements being ownership, managerial or strategic control, active involvement in everyday activities and inter-generational considerations.

Definitions applying in other EU member states often include the requirement of either share ownership or management of the business by family members. It would be beneficial to examine a number of the definitions investigated by the European Commission in preparing for this report.

- The Italian Civil Code defines a family business as an enterprise in which members of the family unit (the husband, wife, high degree of kinship) work and have ownership[13], thus emphasising on the ownership and employment aspect of the criteria;

- In terms of Romanian Law, a family business is defined through law[14] as an enterprise established at the initiative of an individual and comprising his or her family members (husband, wife, children over 16 years as well as their relatives, including relatives 4 times removed);

- Austrian regional law on shop hours explicitly makes reference to family business and defines them as enterprises where the business owner and 2 more family members (husband or wife of the business owner, other people who are relatives to the business owner in a direct family line) work[15], whilst Austrian regional agricultural legislation

[12] European Commission, 'Final Report Of The Expert Group, Overview Of Family-Business-Relevant Issues' (2009).
[13] Italian Civil Code, Article 230
[14] Romanian Law No. 300/2004 (Art.1 - 4)
[15] Shop Opening Hours of 1991, BGBI.No.50/1992, (Öffnungszeitengesetz 1991, BGBI.Nr. 50/1992)

defines an agricultural family business as any autonomous economic entity regularly and sustainably providing for the farming family's income[16];

- Croatian law defines a family agricultural enterprise as an independent and social unit based on ownership or use of production resources, where the enterprise is managed by the family[17];

- The German definition relates to a scenario featuring enterprises where the owner or a member of the owner's family also manages the enterprise. The Institut für Mittelstandsforschung (IfM) Bonn defines a family enterprise as an enterprise where up to two natural persons or their family members have at least fifty percent (50%) ownership of the company, and where these natural persons are also involved in the management of the company[18].

- The French definition includes enterprises where families exercise significant control over both the property and the management[19].

- Other EU countries take different approaches. In Bulgaria, family businesses are seen as those which are co-owned by both spouses, and in the case of sole proprietorship or self-employment, such co-ownership is presumed[20].

1.2. An overview of the legislation

Before attempting to commence an analysis of the entire definition found in the Family Business Act, it is crucial to briefly understand the raison d'être behind this chapter in

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[16] Agricultural residential regulation in the region of Vorarlberg (Bäuerliches Siedlungsgesetz LGBI.Nr. 37/1970, 20/1977)
[17] Law on Agriculture, Official Gazette no. 66/2001 (www.nn.hr)
[18] 'Family Enterprises As Defined By Ifm Bonn' (*En.ifm-bonn.org*, 2017) <http://en.ifm-bonn.org/definitions/family-enterprises-as-defined-by-ifm-bonn> accessed 31 March 2017.
[19] European Commission, 'Final Report Of The Expert Group, Overview Of Family-Business-Relevant Issues' (2009).
[20] Succession Training for Family Business Transfers, 'Report On State-Of-The-Art In Family Business Transfers' (2016).

Maltese law. One must first and foremost keep in mind the Government's pledge to introduce a Family Business Act, listed in the Electoral Manifesto as:

"Indaħħlu Family Business Act, liġi mmirata biex tiffaċilita u tinċentiva t-trasferimenti ta' negozju bejn membri tal-familja. Il-liġi għandha tinkludi definizzjoni ċara ta' x'inhu negozju tal-familja sabiex ma jitħalliex lok għal abbuż."[21]

The focus in this pledge can be said to entail the facility for the transfer of the family business between family members and the clear definition of what a family business is. These two factors are closely connected to each other since adequate definition is necessary to provide for a system which is just, and that the allocated measures and benefits are directed at those enterprises that actually need them. With this mind-set, abuse would be minimized and the legislation would achieve its maximum potential.
A preliminary examination of the Family Business Act shows that this piece of legislation focuses on the definition, registration of such businesses and the function of the regulator. All three elements are crucial to fulfil the legislator's intention to create a transfer-friendly regulatory framework.

In understanding the reasons for the need of a family business legislation, one should primarily understand the current prevalent problems in the field. Generally, we are facing a scenario where most family businesses wait for a family member who runs the family business to pass away and transfer the business to the other family members *causa mortis*. This is due to problems of lack of succession planning and financial planning, which are unfortunately leading to the current situation where many family businesses do not succeed to transfer their family business beyond the second generation[22]. The main problem one is faced with when affecting a transfer *causa mortis* is that the passing away of this family member is usually sudden and inevitably costly, as most are caught off-guard. On the other hand, a transfer *intervivos* is generally regarded and manifested in this piece of legislation as beneficial, transparent and favourable when considering the family business's fate. This is the reason why most consider family businesses as being

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[21] 'Manifest Elettorali - Partit Laburista 2013' Page 24, Point 28 (2013):
"We will introduce a Family Business Act, a law which will seek to facilitate and incentivise the transfer of businesses between family members. This law would include a clear definition of a family business in order to avoid the possibility of abuse."
[22] PricewaterhouseCoopers, 'Bridging The Strategy Gap In Maltese Family Business' Page 4 (2016).

different from "normal businesses": family ties could end up being beneficial on one hand, or totally catastrophic on the other.

1.3. Interpretation Section

Article 2 of the Family Business Act provides a beneficial insight and introduction to the definition of a family business provided in article 3 of the same act. The article starts off by defining an 'applicant' as a business wishing to register as a family business according to this Act and 'benefits', as being such incentives through which any assistance or relief is given to a registered family business according to the Duty on Documents and Transfers Act[23], Malta Enterprise Act[24], Business Promotion Act[25] and any other law which may be prescribed. This indicates the regulatory framework intended for the Family Business Act.

The next important definition is attributed to the notion of 'established in Malta'. The Family Business Act is meant to go beyond the local scenario of traditional Maltese family businesses and in fact, uses this definition to indicate that the definition attributed to family businesses by means of this act is to a certain extent, broad in this regard. 'Established in Malta' is defined as having:

"*the head office, agency, or branch or part of a business and shall include a permanent presence of that business carried out in Malta*[26]".

The fact that the business can also have an agency or branch in Malta and not necessarily the head office, means that the Family Business Act and its incentives derived through the creation of this definition can be a means to attract investment by way of foreign businesses being permanently present in Malta. This makes Malta an attractive jurisdiction for foreign businesses searching for unique opportunities to expand and benefit from engaging incentives.

[23] Duty on Documents and Transfers Act, Chapter 364 of the Laws of Malta.
[24] Malta Enterprise Act, Chapter 463 of the Laws of Malta.
[25] Business Promotion Act, Chapter 325 of the Laws of Malta.
[26] Family Business Act, Chapter 565 of the Laws of Malta, Article 2.

Another important interpretation found in article 2 is the reference made to the definition given to a 'family member', referred to as:

"*the family business owner's spouse, ascendants, descendants in the direct line and their relative spouses, brothers or spouses, brothers or sisters and their descendants or as the Minister may prescribe.*[27]"

The Final Report of the Expert Group on Family Business[28] made reference to the notion of 'family member' and outlined that the involvement of family members in the enterprise is a characteristic differentiating family businesses from non-family businesses. The report also notes that family members' involvement in the family enterprise ranges from 'employment' to 'involvement', or 'activity' by the member states being analysed. By contrast, the EU Citizens' Rights Directive defines a family member as being the spouse, the partner with whom the citizen has contracted a registered partnership, the direct descendants who are under the age of 21 or are dependents, and those of the spouse or partner, and the dependent direct relatives in the ascending line and those of the spouse or partner[29]. It is worth noting that prior to the enactment of the Family Business Act, the White Paper[30] preceding it excluded ascendants completely, with Azzopardi (2015)[31] noting that the reason for this omission was probably the idea of the spirit of the law to be one of continuity towards the next generation. However, this changed and ascendants were added to the promulgated act, with the probable motive being to incorporate more types of family businesses within the definition found in the Act. Also, the term 'spouse' is to be interpreted in light of both the Marriage Act[32] and the Civil Unions Act[33].

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[27] Ibid.

[28] European Commission, 'Final Report Of The Expert Group, Overview Of Family-Business-Relevant Issues' (2009).

[29] Directive 2004/38/EC of the European Parliament and of the Council of 29th April 2004 on the right of citizens of the Union and their family members to move and reside freely within the territory of the Member States amending Regulation (EEC) No 1612/68 and repealing Directives 64/221/EEC, 68/360/EEC, 72/194/EEC, 73/148/EEC, 75/34/EEC, 75/35/EEC, 90/364/EEC, 90/365/EEC and 93/96/EEC (2004) OJ L158/77.

[30] Ministry for the Economy, Investment and Small Business, 'The Family Business Act White Paper' (2015).

[31] Cheryl Azzopardi, 'Family Businesses In Malta, A Legal Perspective'' (LL.D, Faculty of Laws, University of Malta 2015).

[32] Marraige Act, Chapter 255 of the Laws of Malta.

[33] Civil Unions Act, Chapter 530 of the Laws of Malta.

The term ‘owner’ is referred to as:

“*the ultimate beneficiary, natural person who, directly or indirectly, has a shareholding or other interest in a family business.*[34]”

We can thus conclude that the owner is primarily the person deriving the benefits, profits and other derivatives from the family business. The law does not provide us with a precise definition in this regard. From this outset it is also evident that the ultimate beneficiary cannot be a juridical person, and must be a ‘natural person’, who has a shareholding or other interest, in a direct or indirect manner. This leads us to the definition in article 3 which separates direct and indirect modes of acquisition.

[34] Family Business Act, Chapter 565 of the Laws of Malta, Article 2

2. The Definition in the Family Business Act

From the outset, article 3 of the Family Business Act primarily sets out the conditions for registration as a family business. This article, being the focus of this paper, sets out the legal basis for a family business in the Maltese framework. For the purpose of the role of the regulator and his functions as set out in article 20 of the same act, the definition in article 3 is used as a requisite necessary for eligibility for registration and the benefits which come along with such an advantageous position.

Article 3 introduces the fundamental requirement that a family business should first and foremost have to be a business established in Malta[35], as already referred to earlier. On an international landscape, Malta is renowned as being an ideal environment for businesses wishing to work using family-friendly measures; and has a reputable legal framework for the management of trusts and companies[36]. The enactment of the Family Business Act is another pillar which can prove beneficial as an opportunity to attract international families with the prospect of establishing an agency or branch in Malta.

At face value, article 3 leads us to understand how the legislator considered that the ideal method to define a family business should be by individualizing direct and indirect methods of acquisition of a family business. This gives us a clear indication that the Maltese definition focuses on the elements of ownership and managerial control. Other factors such as the question of inter-generational control, size and class have not been included in the requisites. The Maltese definition can be said to be in line with most trends as very few recognised definitions around the EU do not involve an aspect of ownership and managerial control.

The following are forms of businesses recognised as being direct methods of acquisition of a family business:

a) Listed companies;

[35] Family Business Act, Chapter 565 of the Laws of Malta, Article 2
[36] Jean-Philippe Chetcuti, 'Kin Win' (2014) December 2013/January 2014 STEP Journal.

b) Limited liability companies;

c) Registered partnerships;

d) Businesses set up as trusts;

e) Unregistered partnerships and;

f) Those that the Minster may prescribe.

Apart from direct methods, article 3 also makes reference to indirect methods of acquisition of a family business, being:

a) Holding companies;

b) Those held in a trust and;

c) Private foundations.

2.1.Listed Companies

The first form of a business referred to in article 3 refers to a public limited liability company, whose shares are listed on a regulated market or traded on a multilateral trading facility, with the minority of the shares including the rights held, whether directly or indirectly, by at least two owners who are family members within the same family.[37]

Public limited companies are duly formed and registered under the Maltese Companies Act, which defines a public company as a company which is not a private company.[38]A company formed in Malta may either be a public company or a private company, with a public company's name ending with the words "public limited company" or its abbreviation, "p.l.c. ." A defining difference between private and public companies set

[37] Family Business Act, Chapter 565 of the Laws of Malta, Article 3 (1) (a)
[38] Companies Act, Chapter 386 of the Laws of Malta, Article 2

out in the Company Act relates to the minimum share capital; with the minimum share capital of a public company being not less than forty-six thousand five hundred and eighty-seven euro and forty-seven euro cents (€46,587.47), while that of private companies shall be not less than one thousand one hundred and sixty-four euro and sixty-nine euro cents (€1,164.69).[39]

From this description of listed companies provided in article 3, it becomes clearer why the definition focuses on having two owners who are family members from the same family. The spirit of the legislation in this regard sees a family business as a close-knit environment enterprise where at least two family members are involved, and the necessary importance is drawn to what constitutes a family member as explained above.

2.2.Limited Liability Companies

The next form of business is that of a limited liability company; a company which is also duly formed and registered under Part V of the Companies Act. Contrary to a public limited company, a private limited liability company restricts the right to transfer its shares and prohibits any invitation to the public to subscribe for any shares of the company.[40]

Contrary to the case of listed companies, article 3 sets out that for limited liability companies, all the shares of the company are to be held directly or indirectly, by at least two owners who are family members within the same family.[41] We are not speaking of the majority of shares to be held by at least two family members from the same family, but all shares are to be held accordingly. Apart from this difference, the legislator also adds another criterion with regards to managerial control; by requiring that at least one family member is formally involved in the general governance, the proper administration and management of the company.[42] It is presumed that one of the family member, who is also an owner, is also formally responsible for the day-to-day running of the family business. This ensures that family members not only control the ownership of the

[39] Id. Article 72
[40] Id. Artile 209
[41] Family Business Act, Chapter 565 of the Laws of Malta, Article 3 (1) (b)
[42] Ibid.

company, but are also actively involved through their employment in key positions such as directorship of the company.

The first proviso of this section provides the exception that all shares should be held by at least two owners who are family members within the same family. Shares held directly or indirectly by individuals who are not family members shall be disregarded for the purposes of this section provided that their aggregate issued value does not exceed five percent (5%) of the issued share capital.[43] The author believes that here, the legislator wanted to allow for the possibility of outside investment, although this percentage might not be attractive enough for outside investors. Since most families do not quote on a stock exchange, as in the case of a listed company, difficulties may arise with regard to financing. Nonetheless, this is not necessarily a disadvantage: Baskin (2001) outlined that an advantage for family business is the ability to take long-term decisions and the ability to invest in the long-run, something which he refers to as the 'patient capital'; as it allows these enterprises' management to see beyond what other business structures can expect[44]. In a recent study assessing family businesses in Malta, twenty-four percent (24%) of respondents agreed that family businesses tend to find it harder to access capital, thus relying on family funds and bank loans[45].

To put things into perspective, for a limited liability company to fit into the definition found in article 3, it must have two persons who are family members within the same family and that do not have an aggregate share issued value of more than ninety-five percent (95%), whilst other persons who are not family members can only have an aggregate share issued value of not more than five percent (5%) of the issued share capital of the company.

This section's second proviso provides that in the case of shares held directly or indirectly by employees who have been in continuous, full-time employment within the family business for over three years and who are not family members shall be disregarded for

[43] Ibid.
[44] Otis Baskin, 'Why Family Firms Have An Edge In The Global Marketplace' (2001) 4 Graziadio Business Review.
[45] PricewaterhouseCoopers, 'Bridging The Strategy Gap In Maltese Family Business' (2016).

the purposes of this paragraph if their aggregate issued value does not extend ten percent (10%) of the issued share capital of the company[46]. This is another safeguard which builds on the previous proviso and was introduced following the publication of the White Paper[47] in 2015. A higher proportion of employees in family firms, as opposed to non-family firms, feel a larger sense of loyalty to the family enterprise.[48] This comes as no surprise since generally speaking, family-run businesses tend to value loyalty more amongst their staff – employees are not regarded as just a number[49]. The legislator took all of this into consideration when adding this proviso. Nevertheless, having an 'outsider' involved in the structure of a family business can prove to be quite beneficial, since such a person is more likely to be objective and to bring forward some fresh insight.

Restrictions on the apportionment of ownership shall be extensively dealt with at a later stage upon analysing the contents of article 5.

The final proviso states that where any business assets are held on lease, the family members are the majority of the lessees in the lease agreement.

2.3. Registered Partnerships

Registered partnerships are defined in Part III and Part IV of the Companies Act, as either duly registered partnerships *en nom collectif* or partnerships *en commendite*. The partnership *en nom collectif* is characterised by the unlimited liability of all its members or partners. On the contrary, in the partnership *en commandite*, at least one member of the partnership has limited liability and at least one member has unlimited liability.

Article 3 states that for partnerships *en nom collectif* and partnerships *en commandite,* full capital contribution to the partnership shall have been made, directly or indirectly, by at least two owners who are family members within the same family having, directly or

[46] Family Business Act, Chapter 565 of the Laws of Malta, Article 3 (1) (b)
[47] Ministry for the Economy, Investment and Small Business, 'The Family Business Act White Paper' (2015).
[48] Mario Duca, 'Family Businesses And The Economy' (*Times of Malta*, 2012) <http://www.timesofmalta.com/articles/view/20121011/business-comment/Family-businesses-and-the-economy.440621> accessed 5 April 2017.
[49] PricewaterhouseCoopers, 'Sustaining Malta's Family Businesses' (2012).

indirectly, the right to receive the majority of distributable profits, and at least one of whom holds the majority of the decision making rights.[50]

These provisions are similar to those relating to limited liability companies in that they oblige at least two owners, who are family members from the same family, to take up full capital contribution and not only states that one of these persons should have the majority of decision making rights, but also that these two persons have the right to receive the majority of distributable profits. This clearly aims at the consolidation of ownership within the family structure and even though these types of partnerships have, through the years, declined in popularity, the definition still refers to such formations in accordance with the previsions in the Companies Act.

Similar to the case of limited liability companies, this section is also equipped with provisos detailing the exception of capital contributions made, directly or indirectly, by persons not being family members. This applies in the case where the aggregate contribution does not exceed five percent (5%) of the total contribution, with the exception where capital contributions are made by full-time employees who have been employed for over three years and are not family members. Here, the employees' aggregate contribution does not exceed ten percent (10%) of the total contribution. A similar exception also exists on business assets held on lease[51].

2.4. Businesses set up as trusts

Maltese law defines a trust in article 3 of the Trust and Trustees Act[52]. A trust exists where a person, being a trustee, holds as an a owner, or has vested in him property under an obligation to deal with that property for the benefit of persons, called beneficiaries, whether or not yet ascertained or in existence, which is not for the sole benefit of the trustee, or for a charitable purpose, or for both such benefit and purpose aforesaid. In 2014, an Act of Parliament entitled the Trusts and Trustees (Amendment) Act,[53] amended this piece of legislation and amongst other changes, introduced the idea of establishing

[50] Family Business Act, Chapter 565 of the Laws of Malta, Article 3 (1) (c)
[51] Ibid.
[52] Trust and Trustees Act, Chapter 331 of the Laws of Malta
[53] Trust and Trustees (Amendment) Act, XI of 2014

family trusts and the framework necessary for the regulation of such corporate vehicles. Article 43B of the Trust and Trustees Act now holds that a family trust is one whose object and activities are limited to acting as a trustee in relation to a specific settlor or settlors. It also provides administrative services in respect of a specific family trust or trusts. Furthermore, a family trust does not hold itself as a trustee to the public and does not act habitually as a trustee in relation to more than five settlors at a time[54]. Thus, this type of trust is one which is created for the purpose of holding property settled by the settlor or settlors for the present and future needs of family members or family dependants.[55]

While the notion of family trust does not seem to be expressly connected to the definition of family businesses in the Family Business Act, businesses set up as trusts do qualify under article 3 of this same Act, provided they fulfil a number of conditions. Article 3 provides that a trust qualifies as a family business where its shares or interests are being held by a trustee under a trust for the benefit of members of a family as beneficiaries; which has been established by a written instrument; and all the beneficiaries are owners and family members within the same family.[56] It is important to note that the legislator expressly mentions 'established by written instrument', since the Trust and Trustees Act provides that the terms of a trust mean both the written *and* oral terms of a trust[57], and since the spirit of the law is one in favour of legal certainty[58], the legislator is advocating in favour of a written instrument.

All the beneficiaries must be owners and family members within the same family. This section also includes similar safeguards in relation to beneficiaries who are not family members within the same family business trust where they do not benefit from more than an aggregate five percent (5%), or if they are only residual beneficiaries who will benefit from the trust upon the termination of said trust. The case of three years' continuous full time-employment is repeated in this section.

[54] Trust and Trustees Act, Chapter 331 of the Laws of Malta, Article 43B
[55] Ibid.
[56] Family Business Act, Chapter 565 of the Laws of Malta, Article 3 (1) (d)
[57] Id. Article 2
[58] This is due to the extensive and detailed definition in article 3

A trust allows the founders of the business to plan its direction after its transfer to the next generation by tailoring the trust to the to the unique issues of each particular family. A trust also serves to implement effective family corporate governance, conflict management and asset planning and facilitates the creation of a clear distinction between family life and business life, two areas which can very easily be blurred. When setting up a trust, founders of a family business are in reality, entrusting the ownership of their business to an independent professional third party, who is obliged to make sure that the family business with all its assets will not be unnecessarily divided and consequently reduced in value due to any potential disagreements between subsequent generations. The underlying aim would be that of protecting the business for the benefit of the beneficiaries of the trust which are in turn, appointed by the settlors.

2.5. Unregistered Partnerships

Article 3 also mentions unregistered partnerships under the name of '*other registered forms of a family business*'. These types of family businesses are recognised where the form of business is carried out by family members in the form of a partnership other than that found in the case of the previously-mentioned registered partnerships (partnerships *en nom collectif* and *en commandite*). Here, the business and its assets should be owned and controlled, directly or indirectly by at least two owners who are family members within the same family.[59] In contrast with limited liability companies and registered partnerships, here the legislator is requiring that both owners control both the business and the ownership of assets, thus making it more difficult to register as a family business in the case of unregistered partnerships.

Sub-article (e) regulating unregistered partnerships also includes four provisos; namely that other assets held by individuals not being family members should be disregarded if they do not exceed five percent (5%) of the net assets; that other assets in the case of employees in continuous full-time employment for a period of more than three years who are not family members are also to be ignored if they do not exceed ten percent (10%) of the net assets; and a similar condition in relation to business assets held on lease as contemplated above.[60] The final proviso specifically defines other registered forms of

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[59] Family Business Act, Chapter 565 of the Laws of Malta, Article 3 (1) (e)
[60] Ibid.

family businesses as unregistered organisations according to the provisions the Civil Code. Sub-Title V of Title II in the Second Schedule of the Civil Code defines unregistered organisations as organisations having a form recognised by law; constituted by an instrument in writing and which, being registerable in terms of that schedule or any other special law, is not so registered.[61] Thus, the most important requirement in this instance is the written instrument needed to register such partnership according to the law. In accordance with the Civil Code, such organisations are not defined as legal persons but enjoy limited recognition and legal powers for the specific purpose for which they are constituted.[62]

One might question the need for such recognition of seemingly disordered types of businesses. In the author's opinion, such an addition is beneficial since in encourages these businesses to get get their affairs in order. This is not only beneficial for the business itself, but also leads to a better understanding of business forms in the economy and more accurate studies on family businesses.

2.6.Those that the Minister may prescribe

The last mentioned method of direct acquisition of a business in this section refers to that as the Minster may prescribe. This provision is believed to allow a degree of flexibility in the legislation, empowering the Minister to make provision for other forms if the need arises.

2.7.Holding Companies

When the Family Business Act speaks of indirect acquisition of a family business, it is referring to cases where shares, interests and other assets are held indirectly by family members in the business, or contributions made to the business indirectly by family members[63]. The first form of this type of family business recognised in Article 3(2)(a) refers to holding companies where at least eighty-five percent (85%) of shares, interests, contributions or other assets, are held indirectly by family members in the business; in

[61] Civil Code, Chapter 16 of the Laws of Malta, Second Schedule, Title II, Article 13(1)
[62] Id. Article 14(1)
[63] Family Business Act, Chapter 565 of the Laws of Malta, Article 3 (2)

such companies beneficially owned by family members, as the case may be[64]. One notes that the ninety-five percent (95%) figure found in the White Paper has been reduced to eighty-five percent (85%)[65], probably to ease the requirements, making it easier to fall within the definition.

2.8. Those held in a trust

The second form of indirect acquisition of a family business is that where trustees set up a trust for the benefit of family members within the same family. This, provided that other beneficiaries who are not family members within the same family shall be disregarded for the purposes of this formation if they do not in aggregate, benefit more than five percent (5%) of the family business. Residual beneficiaries shall also be disregarded if they only benefit from the trust when it is terminated by reason of the fact that there are no existing beneficiaries capable of benefitting from the trust at any relevant point in time[66]. This section also includes the condition employees being in continuous full-time employment with the family business trust for over three years and not being family members within the same family when they do not in aggregate benefit from more than ten percent (10%) of the family business[67].

2.9. Private Foundations

The Family Business Act defines private foundations in Article 2 as foundations established for a private interest and registered as a legal person in terms of the Civil Code. Thus, a requirement in this regard is the registration of the private foundation in light of the provisions of the Civil Code. A private foundation is defined in Article 33 of the Second Schedule of the Civil Code as a foundation established for the private benefit of one or more persons or of a class of persons, and such beneficiaries shall enjoy such benefits and shall have legally enforceable rights against the foundation[68]. This type of

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[64] Id. Article 3 (2) (a)
[65] Ministry for the Economy, Investment and Small Business, 'The Family Business Act White Paper' (2015).
[66] Family Business Act, Chapter 565 of the Laws of Malta, Article 3 (2) (b)
[67] Ibid.
[68] Civil Code, Chapter 16 of the Laws of Malta, Second Schedule, Title III, Sub-title II, Article 33 (1)

foundation differs from a 'purpose foundation' which is established for the achievement of a defined purpose, generally a social one. Article 3 provides that private foundations may be recognised as family businesses where they are set up for the benefit of family members within the same family, provided that beneficiaries who are not family members within the same family are disregarded if they do not in aggregate benefit from more than five percent (5%) of the business, or if they are residual beneficiaries, or in the case where other beneficiaries are employees who are continuous full-time employees for over three years, are not family members within the same family and do not in aggregate benefit from more than ten percent (10%) of the foundation.[69]

[69] Family Business Act, Chapter 565 of the Laws of Malta, Article 3 (2) (c)

3. Factors affecting the Definition of a Family Business in the Family Business Act

The Act continues by making specific provisions defining ownership of a family business, apportionment of such ownership and also elements of registration of a family business. All these factors should be examined prior to comparing the Maltese definitions to other definitions and its usefulness within a Maltese scenario.

3.1. The element of ownership

Article 4 of the Family Business Act defines shares or share capital of a company as either issued share capital, the shares allowing for rights to dividends, shares being voting shares, and shares allowing for the rights to assets and profits upon winding up of the said company.[70]

To better understand the notion of a family business presented in this article, an analysis of the differences amongst shares, shareholders and share capital is necessary. Companies are formed as a result of subscribers who agree to form a company and contribute to the company's memorandum of association as shareholders. A shareholder is thus a proportionate owner of the company in line with the company's share capital, being the funds contributed to the company's resources by its shareholders. According to the Companies Act, Maltese companies are bound to include an amount of share capital with which the company proposes to be registered, being authorised capital; the division of such shares of fixed amount; the number of shares taken up; and the amount paid up in respect of each share, in the memorandum of the company.[71] Reference should be made to the difference between two types of share capital being issued: share capital and authorised share capital. While the authorised share capital is the total nominal value of the shares which a company may issue, as found in the memorandum of the company; the issued share capital is the total nominal value of the shares which have in fact, been taken up by the shareholders of the company.[72]

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[70] Family Business Act, Chapter 565 of the Laws of Malta, Article 4
[71] Companies Act, Chapter 386 of the Laws of Malta, Article 69
[72] Andrew Muscat, *Principles Of Maltese Company Law* (1st edn, Gutenberg Press 2007) 605.

This difference is important as article 4 refers to issued share capital of the company, and disregards authorised share capital. What is important for a company to qualify as a family business is an examination of the issued share capital of the company. This article emphasises the fact that when qualifying the structure of the shares and share capital of the company, all four elements are essential: looking at the issued share capital, shareholders having the right to dividend, shares having the right to vote, and the share having the right to assets and profits upon winding up.[73] Azzopardi (2015) comments that the presence of this article is necessary in order to avoid having businesses seeking to register as 'sham family businesses', where between two family members, only one has a right to dividends.[74]

The article highlights that for the purpose of a definition and qualification of a family business under this Act, all other shares shall be disregarded. For example, the right to vote is not generally regarded as an essential feature of shares, but it is seen as being a dominant feature when determining how strong the share actually is. If a shareholder wants to have a say on the running of the company, voting shares would be vital. In the case where a company's memorandum provides for different classes of shares, there may be shareholders who do not have the right to vote. According to the Companies Act, ordinary shares of a company shall not be redeemable, and every company shall, at all times, have ordinary shares.[75] The law does not state that voting shares are linked to ordinary shares, as there may be preference shares with voting rights and ordinary shares without voting rights, however this is not the practice.

3.2. Apportionment of ownership

The portions to be allotted between owners of the family business are determined by article 5 of the Family Business Act. This article divides apportionment into five types of formation, namely, companies, partnerships *en nom collectif* and *en commandite*, trusts, other forms of partnerships and cases of indirect ownership. In each of these types, the legislation provides that an owner who is also a family member shall not have, in

[73] Family Business Act, Chapter 565 of the Laws of Malta, Article 4
[74] Cheryl Azzopardi, 'Family Businesses In Malta, A Legal Perspective'' (LL.D, Faculty of Laws, University of Malta 2015).
[75] Companies Act, Chapter 386 of the Laws of Malta, Article 72 (5)

ownership or beneficial interest, ownership of more than eighty percent (80%) of issued share capital in the case of companies; the partnership's assets in the case of recognised partnerships; the trust's property in the case of trusts; the business assets in the case of other partnerships; and shares, interests, other assets or contributions in the case of indirect ownership.[76] This restriction is somewhat diminished by virtue of sub-article (2) of the same article, which provides that the percentage of eighty percent (80%) shall be that remaining after one deducts the figure of five percent (5%) from contributions not made by family members, and that of ten percent (10%) from contributions made by full time employees in continuous employment for at least three years, according to article 3.[77]

In the author's view, article 5 is pivotal as it conditions most of the provisions found in article 3 by limiting the control held by one of the family members. The law encourages family businesses to, not only have more than one family member from the same family owning the business, but also having both family members exercising effective control on the family business by limiting one of these persons from having more than eighty percent (80%) of the ownership of such business.

3.3. Family business registration

One should note that the direct effect of the definition listed in article 3 is the registration of Maltese family businesses with the office of the family business regulator defined in the Family Business Act. The act clearly states that a business shall be registered as a family business after it has been accepted as such by the regulator,[78] defined as the person who is appointed to manage, supervise and administer the Register of Family Businesses.[79] The regulator shall assess all applications registering their business as a family business, and after registration, ensures that registered businesses are fully-compliant with legislation and requirements as established in the Act.[80]

[76] Family Business Act, Chapter 565 of the Laws of Malta, Article 5
[77] Ibid.
[78] Id. Article 7
[79] Id. Article 2
[80] Id. Article 20

Part III of the Act wholly relates to the office of the regulator, his or her appointment, disqualification from appointment, removal from office and functions. The regulator is appointed by the Minister for Economy for a period of three years and may be duly re-appointed after the expiration of such period.[81] The office of the regulator is a novel concept as it is probably the first time that an EU member state is specifically legislating in this area, and appointing a permanent office ensuring that the legislation is not merely promulgated, but implemented effectively. Some of the regulator's notable functions include that of accepting applications from businesses for registration, keeping a family business register, ensuring family businesses comply with the legislation, help family businesses by providing them with information regarding benefits and responsibilities, and also giving the Minister for Economy any recommendations on the legislation in this area.

The regulator also has the function of encouraging family businesses to enter into written agreements concerning governance of the business, but does not oblige such business to do so as a prerequisite to registration.[82] In the author's view, this may pose a problem when considering family businesses' tendency to be susceptible to a number of conflicts due to their familiar nature. This can be addressed with an obligation to register a family constitution to regulate these matters.

The benefits of being registered have been briefly discussed in Section 1.3. The main focus of the legislation is the facilitation of the transfer of family businesses from the owners to other family members within the same family.

Since the enactment of this piece of legislation, the benefits announced have been two-fold: governance benefits and fiscal initiatives.[83] Governance benefits include tax credits, legal and accountancy advisory services, arbitration facilities, education and training incentives, positive consideration of lease renewals occupying government premises and loan guarantees. Fiscal benefits have been introduced through amendments in the Duty

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[81] Family Business Act, Chapter 565 of the Laws of Malta, Article 17
[82] Id. Article 20
[83] 'Introduction And Information' (*Economy.gov.mt*, 2017) <http://economy.gov.mt/en/familybusinessact/Family%20Business/Pages/Introduction-and-Information.aspx> accessed 5 April 2017.

on Documents and Transfers Act,[84] making it easier for *intervivos* transfers through advantageous rates on transfer of property, and a one-time tax reduction incentive, reduced from five percent (5%) to one point five percent (1.5%) in 2017 for family businesses transferring their business to the descendants.

[84] Act No. XLVIII of 2016

4. A Comparative Analysis of the Definition of a Family Business in the Family Business Act

In an article published by the Family Firm Institute, Allouche (2014) claimed that to date, no clear consensus has been reached on the definition of what constitutes a family business. However, he also noted that:

"a consensus definition may not represent a pertinent research goal because, by nature, family businesses are contingent to the institutional legal context, which differs from country to country."[85]

This helps us understand the importance of the local scenario's role in constructing the right definition for Maltese family businesses. The context of the location matters as local legislation, unlike for example, EU-wide policies, are directed towards specific scenarios. Prior to concluding whether or not the definition is relevant to Maltese family businesses, a comparative analysis with regards to the EU definition already referred to in Section 1.2 shall be carried out in order to identify the differences in substance.

The above-mentioned Final Report of the Expert Group's Overview of Family-Busines-Relevant Issues (2015) noted in its suggestions that there are more than ninety different definitions of family businesses across the EU. It called for more efforts to establish an official EU definition, taking into account member states' differences in a number of sectors, whilst stressing that a 'simple, clear definition which is easily applicable and comparable between countries' would help for a better understanding of such a phenomenon. This would eventually allow for measures to be introduced to target this 'new' sector.[86]

Thus, Malta's move to legislate in the area of family businesses was also a reaction to this report's call to tackle this sector. It underlines the need to adapt the proposed EU-

[85] Jose Allouche, 'The Impact Of Family Control On The Performance And Financial Characteristics Of Family Versus Nonfamily Businesses In Japan: A Matched-Pair Investigation' (2008) 21 Family Business Review 315-330.
[86] European Parliament, 'EU Report On Family Businesses In Europe' (2015).

wide definition[87] to the local scenario, whilst also keeping in mind the incentives in favour of these specific enterprises.

4.1.Similarities with the EU definition of family business

A prominent similarity between the two definitions relates to the fact that neither specify a minimum or maximum capping on the size of the business to be taken into consideration when evaluating if it should be defined as a family business or not. Whilst the EU definition specifically states 'any size[88]' relating to the business, the Maltese definition does not explicitly mention or relate to a form of size and so, it is taken for granted that size is not a factor one should consider when qualifying a business form.

Another similarity relates to the dimension of involvement of family members within the family business. Both definitions speak of involvement in ownership and governance of the business. The Maltese definition classifies different forms of family businesses and in most forms (notably limited liability companies, registered partnerships and other forms of registered businesses) require additional control by family members on administration, management and decision-making. On the other hand, the EU definition provides the specific requisite that a minimum of one representative of the family is formally involved in the governance of the firm. The EU definition is generic in this regard as it does not elaborate on different forms of business, such as trusts, which have the inherent ability to enable another party to manage the owner's business. The Maltese definition specifically caters for such scenarios and hence, does not speak of a minimum requirement for governance control by family members as in the case of trusts.

Both definitions also expressly mention listed companies and both make it possible for such formations to qualify as family businesses. While the Maltese definition requires the majority of shares to be held by two family members from the same family, the EU definition stipulates that the person establishing or acquiring the firm or his/her family or descendants holds twenty-five percent (25%) of decision making rights. This is a perfect

[87] European Commission, 'Final Report Of The Expert Group, Overview Of Family-Business-Relevant Issues' (2009).
[88] Ibid.

example of how the Maltese definition is much stricter in requiring greater family control of ownership and governance in comparison with the proposed EU definition.

In Section 1.4 it was established that the Maltese definition speaks only of natural persons being direct or indirect ultimate beneficial owners in the family business formation. In the same way, the EU definition also speaks of natural persons and does not provide the choice of having a juridical person as the ultimate beneficiary.

4.2. Notable differences between the two definitions

The study conducted by KMU Forschung Austria (2008) concluded that in almost one-third of the countries studied, one-person enterprises or self-employed persons are considered family businesses, whilst on the other hand, one-third, do not consider this type of business to be such. From the author's point of view, the most notable difference between the EU definition and the Maltese definition is the fact that the EU definition includes one sole proprietor firm, companies owned by a single person, and self-employed persons who work without having any officially employed staff members.[89] In this light, the EU definition includes family firms which have not yet gone through the first generational transfer.[90] Prior to further comparisons, it is necessary to point out that even though the EU definition includes sole-proprietors and self-employed persons, it still necessitates that the family business is a legal entity which can be transferred in the future. In contrast, the Maltese definition generally sets the bar at a minimum of two family members from the same family, being owners of the family business and, one member from the same family being in possession of decision-making rights. The Maltese definition does not allow for sole-proprietors or self-employed to be registered as family businesses. This must be analysed in light of the spirit of the legislation. The scope of this piece of legislation is to assist and facilitate the transfer and ownership of a family business from a generation to the next[91] and in the author's opinion, it would not have been fruitful had the legislator opted for allowing single owners to register their business

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[89] M Azucena Vicente Mollina and Janette Rutterford, 'Towards A Theory Of The Family Firm: Approach To An Operational Definition And A Framework For Family Business Research' [2010] European Academic Publishers.

[90] Paloma Fernández Pérez and Andrea Colli, *The Endurance Of Family Businesses: A Global Overview* (1st edn, Cambridge University Press 2013) 85.

[91] Nadine Lia, 'The Value In Legislating For Family Business' (2015) XXV Id-Dritt.

as a family business. In order to promote a culture whereby family businesses are increasingly transferred *intervivos*, it is necessary to encourage family business to plan ahead and add other family members into their structure.

While the EU definition does not expressly define who a family member can be, in sub-article 1 of the definition it refers to 'other persons' being 'natural persons', who established the family firm as "their spouses, parents, child or children's direct heirs.[92]" In this area, the Maltese definition includes more persons as the interpretation clause refers to family members as "spouses, ascendants, descendants in the direct line and their relative spouses, brothers or sisters and their descendants or as the Minister may prescribe."[93]

Generally speaking, the EU definition is *prima facie* not as detailed as the Maltese one and this is certainly understandable since the EU definition has been recommended for the use of all member states, with the scope of producing quantitative research on this specific sector across the European Union. Thus, it is presumed that it will be a task for the member state to adapt the general definition to their own scenario by qualifying different requirements. The Maltese definition gives a multitude of forms of acquisition of a family business, registration and both direct and indirect forms of ownership.

Another difference is seen in determining the percentage of involvement of ownership of family members in the family business. The Maltese definition is more demanding and, for example, in the case of limited liability companies, requires that all the shares of the company are to be held directly or indirectly, by at least two owners who are family members within the same family, save the minimal exceptions related to ownership of non-family members and full-time employees. Thus, the requisites in the Maltese definition are more demanding when comparing this with the EU definition which only requires a majority of decision-making rights in the possession of natural persons establishing the firm, or acquiring share capital, or their mentioned family members. The Maltese definition also goes into the details of the apportionment of ownership of the

[92] European Commission, 'Final Report Of The Expert Group, Overview Of Family-Business-Relevant Issues' (2009).
[93] Family Business Act, Chapter 565 of the Laws of Malta, Article 2.

family business by capping the ownership of one family member at eighty percent (80%) of the issued share capital.

5. Conclusion

Throughout this study, it has been noted that the prevalent focus of the definition of a family business introduced in the Family Business Act has, as its basis, the drive to regulate succession of such businesses by encouraging them to transfer their business during the owners' lifetime. This is perhaps one of the reasons why the Maltese definition of family business is somewhat different to the proposed EU definition. This definition seeks to encourage this method of transmission of ownership through responsible governance by way of a new registration process. It is now the role of the regulator to administer such a task and ensure firstly, that there is increased awareness about such an initiative amongst Maltese family businesses and that the legislation lives up to its intended potential.

One of the distinguishing features of the new definition is the way it describes different forms of businesses and caters for them separately through different requirements. All other definitions studied from all over the EU do not delve into such detail to define family businesses and this shows that a study of local business forms has been undertaken in order to detail not only how most Maltese family businesses are currently formed, but to try, as much as possible, to cater for all local cases in the field. Another concluding factor is that the legislation clearly does not encourage sole-proprietors or self-employed persons to register as family businesses since this is contrary to the spirit of the legislation. The idea of having more than one family member involved in the structure is necessary to reduce the cases of costly *causa mortis* business transfers or the eventual dissolution of the business. Statistics provided through the Family Business Act White Paper show that nearly half of family-run businesses employed two family members, with the remaining employing more than two family members. This runs contrary to the misnomer that family businesses represent a father-sibling trade.

The definition introduced in this Act is definitely the way forward, not only for Maltese family businesses, but also for the rest of the EU member states. It has resulted in Malta being one of the few member states receiving funds on the basis of the legal definition being adopted. Malta is the first country to answer the EU's call for an adoption of a legal basis for family businesses and one of the leaders in offering fiscal incentives in this area.[94] One also cannot forget to mention the international opportunities created through this legal basis which is seeking to attract foreign family businesses to establish themselves in Malta.

In the author's opinion, it would be correct to state that the definition of family business encapsulates ownership and management control; two fundamental elements which separate family businesses from non-family businesses. When comparing the Maltese definition with the EU definition, the Maltese one is not only much more specific, but also clearly explains requirements needed concerning both ownership and management of the business.

At this stage, it would be futile to propose recommendations or changes to this definition since this law has only been promulgated five months ago, and its effects on the local field are yet to be analysed. Nonetheless, it is necessary to point out that the relevant authorities should keep up consultation efforts with family businesses and relevant stakeholders to make sure that the legislation answers its recipients' needs. In Section 4.3 it has been noted that the legislator opted to exclude the setting up of a family constitution as a requirement for registration. A family constitution would not prevent any conflicts from arising in the future, but it would aim at solving such conflicts in an orderly and efficient manner. In the near future, research should be directed towards the expected effects and benefits, if any, of the introduction of a requirement for a family business to have a family constitution prior to its registration according to the Family Business Act.

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[94] Nadine Lia, 'Family Business Regulator, Malta And The Work It Had Undertaken, Speech At The Business Transfer Conference, Valletta, 17th March 2017' (2017) <http://economy.gov.mt/en/BTC/Documents/Presentations/Presentation%20-%20Malta%20and%20Transfers%20in%20Family%20Business_Nadine%20Lia%20-%20BTC%20Malta2017.pdf> accessed 19 April 2017.

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