The Wealth Management of Family Businesses and the Family Business Act by Ms Maria Farrugia and Dr Nadine Lia

The Family Business Act (FBA) is an enabling law which is intended to support the growth of the Maltese family business sector: a first of its kind. This article analyses the initial comments of potential users and professional advisors in order to better understand the impact this advance will have on the Maltese family business sector. Furthermore, this article highlights the ways in which the proposed legislation is expected to support family businesses in managing their wealth effectively and in sustaining it over generations. In the wake of higher competition amongst jurisdictions and the increasing population of high net worth individuals (HNWIs), particularly in Europe, the study also delves into the extent to which Malta can be considered to be an ideal jurisdiction for family businesses and family offices.

Family Businesses

> *"Family businesses are the single best source of employment in the private sector. Therefore, what is beneficial to [the] family businesses sector is beneficial to the European economy and this must be recognised accordingly."*[1]

Family businesses account for 90% of businesses in North America[2], two thirds of businesses in Australia[3] and 85% of businesses in Europe[2], constituting 40-50% of European employment[4]. Locally, 70% of total Maltese businesses are family owned[4], accounting for more than 90% of the Maltese labour market[5]. These figures are a testament to the important role that family businesses occupy within the global and Maltese economy. Whilst contributing greatly towards employment and the economy as a whole, they also bring long-term stability and show great commitment and responsibility towards the community[6].

Many family businesses lack the proper governance structures, leading to difficulties and potential failure in transferring the business to the next generation[7]. The demise of family businesses as they are being transferred from one generation to the other may be linked to a number of factors, including the lack of early succession and financial planning. This is considered

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[1] European Family Businesses (EFB), *EFB Position Paper: European Parliament own-initiative draft report on 'Family Businesses in Europe'* (2015) p. 1

[2] Ernst and Young (EY), *EY Family Business Yearbook 2014*

[3] KPMG and Family Business Australia, *Family Business Survey 2015*

[4] European Family Businesses (EFB), *'Facts and Figures'* <http://www.europeanfamilybusinesses.eu/family-businesses/facts-figures> Accessed 7 February 2016

[5] PwC Malta, *All in the family? The future of the Maltese Family Business – Family Business Survey 2014*

[6] Malta Association of Family Enterprises (MAFE), *'Family Businesses are important motors to the economy'* (2014) <http://www.mafe.org.mt/publications/family-businesses-are-important-motors-to-the-econ> Accessed 17 October 2015

[7] European Family Businesses (EFB) and KPMG, 'European Family Business Barometer – Determined to succeed' (4 edn., 2015)

to be a "*critical area*" for most local family businesses as they fail to address this issue, with only 16% having a formal succession plan in place[8].

Whilst 49% of businesses are transferred to the second generation, a staggering 21% and 12% succeed in transferring the business to the third and fourth generation, respectively[8]. Hence, the significance of the drafted Family Business Act (FBA) which is intended to promote family businesses and facilitate business transfers to safeguard their continuity[9].

Malta as a Jurisdiction for Wealth Management

The World Wealth Report 2015 shows an increase in HNWIs, both in number and in wealth when compared to 2014. Whilst European HNWI wealth and population grew by a staggering 4%, due to the poor economic performance and the drop in stock markets in most countries, Europe is expected to attract further HNWI wealth, with a predicted annual growth rate of 8.4%[10]. This positive outlook places Malta in a better position to attract investment of HNWIs and families, leading to an increase in demand for wealth management services.

During her address at the official launch of the FBA (White Paper), Dr Nadine Lia, legal advisor for the Ministry for the Economy, Investment and Small Business (MEIB) and Chair of the FBA Committee, explained that as jurisdictions have become very legally and aggressively competitive, it is essential that Malta's regulatory framework continues to be competitive by offering opportunities to such investors, including wealthy families. This is in light of the move towards greater transparency and increased disclosures with no room for secrecy[11]. With the implementation of the Fourth Anti-Money Laundering (AML) Directive, offshore accounts can no longer be kept in the dark. Offshore finance centres such as Jersey, Guernsey and the British Virgin Islands have been blacklisted, leading affluent investors to look for an alternative optimal jurisdiction to invest their wealth[12].

The FBA (White Paper)

Based on the contribution of family businesses to the European economy, the European Commission has urged Member States to tackle the issues that such businesses are faced with to

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[8] PwC Malta, *All in the family? The future of the Maltese Family Business – Family Business Survey 2014, p.5*

[9] Ministry for the Economy, Investment and Small Business (MEIB), 'Minister Cardona discusses the drafting of the innovative Family Business Act during a conference on business transfers in Brussels' (2014) <https://economy.gov.mt/en/press-release/Pages/PR141372.aspx> Accessed 8 October 2015

[10] Capgemini and RBC Wealth Management, 'Global Population of High Net Worth Individuals and their Wealth Hit New Highs' <https://www.capgemini.com/news/global-population-of-high-net-worth-individuals-and-their-wealth-hit-new-highs> Accessed 17 October 2015

[11] A. Cremona, *'The draft 4th AML Directive and the proposed public register of trust beneficiaries – using the proverbial sledgehammer?'* (The 4th Annual Malta Wealth Management Forum: Malta Family Law and Family Wealth - Servicing & Protecting Family and Business Interests and Wealth through Malta, ESAFON, 2014); M. Ganado, *'What is on the agenda of the global family lawyer when advising asset holding solutions?'* (The 4th Annual Malta Wealth Management Forum: Malta Family Law and Family Wealth - Servicing & Protecting Family and Business Interests and Wealth through Malta, ESAFON, 2014)

[12] M. Mizzi Buontempo, 2014. *'The legal and Regulatory considerations relating to the Introduction of Family Offices in the Trusts and Trustees Act'* (The 4th Annual Malta Wealth Management Forum: Malta Family Law and Family Wealth - Servicing & Protecting Family and Business Interests and Wealth through Malta, ESAFON, 2014)

help them to prosper and to continue to succeed when passed from one generation to the next. Malta is the first country worldwide to adopt a legislation which is specifically addressed towards "*ensuring the governance and continuity of sustainable family businesses*"[13].

The FBA (White Paper) was officially launched on 21st October 2015 at the MEIB by the Hon. Christian Cardona. This is the result of a two year process involving thorough research on local family businesses to enable the lawmakers to address their needs. At this event, Mr Paolo Morosetti[14] praised Malta for being the first European country to be acting upon the discussions that have taken place at European level with respect to the importance of supporting sustainable family businesses.

At this event, Dr Nadine Lia explained that businesses must have good governance in the first place, if they wish to succeed. The Act is not a "*fiscal advantage*" for registered family businesses, rather it encourages family businesses to have sound governance structures in place, whilst offering guidance to business owners as to how they should plan for succession. In doing so, the Act is also expected to support family businesses in preserving family wealth as it is being transferred from one generation to the next.

Defining Family Businesses

Despite the sizeable presence of family businesses worldwide, to this day no universal definition exists. Nonetheless, there have been several attempts over the years. A family business can be considered to be one whose equity belongs to the founding family or where some of the members of the board of directors are family members[15], a business which is operated and owned by the founding family[16], or whose founder or co-founder occupies the role of Chief Executive Officer[17].

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[13] Ministry for the Economy, Investment and Small Business (MEIB), '*The Family Business Act: White Paper*' (2015) p. 4

[14] Mr Paolo Morosetti is the Director of the Strategic and Entrepreneurial Management Department at the SDA Bocconi School of Management in Milan, Italy.

[15] J. L. Miralles-Marcelo, M. Miralles-Quirós and I. Lisboa, *'The impact of family control on firm performance: Evidence from Portugal and Spain'* (2014) 5, Journal of Family Business Strategy, p. 156

[16] L. R. Gómez-Mejía, K. T. Haynes, M. Núñez-Nickel, K. J. L. Jacobson and J. Moyano-Fuentes, 'Socioemotional Wealth and Business Risks in Family-controlled Firms: Evidence from Spanish Olive Oil Mills' (2007) 52 (1), Administrative Science Quarterly, p. 106

[17] R. Fahlenbrach, *'Founder-CEOs, investment decisions and stock market performance'* (2009) 44, The Journal of Financial and Quantitative Analysis, p. 439

Duca[18] defines a family business as a business which is majority owned or controlled by a family, and which includes the involvement of at least two family members. He further explains that a family business is founded on a three-tier system as depicted in Figure 1. This interpretation is based on the Tagiuri and Davis Three-Circle Model, whereby each circle represents a segment which is independent yet overlapping: Family, Ownership and Business. The priorities and objectives of each element differ, and as these structures overlap, conflicts arise. Duca adds that the issues which family businesses are normally faced with, relate to these three areas.

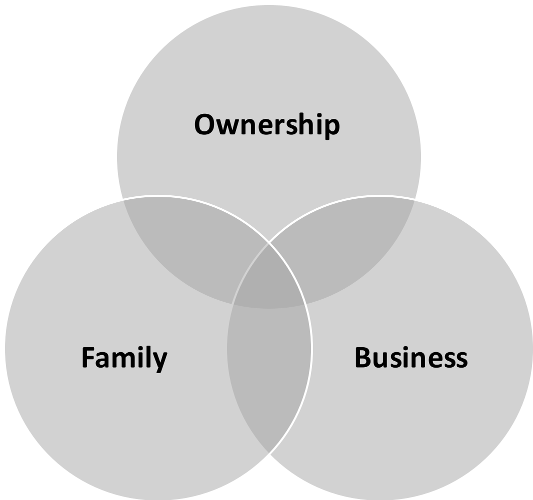

Figure 2.2: The Three Circle Model[19]

A European Definition

Due to the significance of family businesses within the European Union (EU), the European Commission took on a project together with experts in the area to get a good overview of the sector, including the characteristics and the environment which family businesses operate in. This led to the publication of the Final Report of the Expert Group in 2009. After analysing over 90 identified definitions, the following definition was proposed:

"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.

[18] M. Duca, 'A Guide to a Family Business Constitution' in: M. Duca (ed), *The Maltese Family Business: Getting Organised* (APS Bank Business Publications, 2015) p. 101
[19] M. Duca, 'Understanding Family Businesses' in: M. Duca (ed), *The Maltese Family Business: Getting Organised.* (APS Bank Business Publications, 2015) p. 15

(3) At least one representative of the family or kin is formally involved in the governance of the firm.

(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 per cent of the decision-making rights mandated by their share capital."[21]

This definition was developed with the intention of it being "*simple, clear and easily applicable*"[20]. It is based on the definition adopted by the Finnish Working Group on Family Entrepreneurship as it is believed to have been widely accepted whilst being comprehensive and workable. This definition is not legally binding but it is only recommended for use within Member States.

A Maltese Definition

Most Europeans have tended to focus on Small and Medium-Sized Enterprises (SMEs) when referring to family businesses, failing to recognise that a number of family businesses are large multinational organisations. Family businesses can be of any size and can be both, listed or unlisted[21].

A local study which was carried out in 2015[22] revealed that professional advisers and family business owners were concerned that the FBA might not address business models such as trusts and foundations. However, the Maltese legislator recognised that family businesses are heterogeneous and that they are based on different business models. This latter point was particularly applauded by Mr Paolo Morosetti at the official launch of the FBA (White Paper), who considered this definition to be easier to apply and work with than that proposed by the EU in 2009. Furthermore, although the FBA is developed with the characteristics of the Maltese sector in mind, the definition still caters for foreign family businesses wishing to establish part or all of their business in Malta.

The definition, laid out in Article 3 of the proposed FBA as represented in the White Paper, specifies the conditions that must be satisfied by businesses wishing to register under this Act. It distinguishes between various business models as shown in Table 1.

Listed Companies	The majority of shares, including rights, are held (directly/indirectly) by two or more owners who are family members[23] within the same family.

[20] European Commission, 2009. 'Final Report of the Expert Group - Overview of Family-Business-Relevant issues: Research, Networks, Policy Measures and Existing Studies' (Enterprise and Industry Directorate-General) COM (2009) p. 9

[21] European Family Businesses (EFB), 'Definition' <http://www.europeanfamilybusinesses.eu/family-businesses/definition> Accessed 17 October 2015; Ministry for the Economy, Investment and Small Business (MEIB), '*The Family Business Act: White Paper*' (2015)

[22] I. Casha, 'Succession Planning Process in Maltese Family Businesses: An Analysis' (M.Acc. thesis, University of Malta 2015)

[23] For the purposes of the FBA, a 'family member' is defined as the FB owner's spouse, descendants in the direct line (and their relative spouses), brothers or sisters (and their descendants), or as the Minister may prescribe.

<table>
<tr><td>Limited Liability Companies</td><td>All the shares of the company are held (directly/indirectly) by two or more owners who are family members within the same family, and

one or more family members are involved in the management of the company.

➢ Where non-family members hold shares (directly/indirectly) in the company, these are to be disregarded if their aggregate issued value is not more than 5% of the issued share capital of the company.
➢ Where business assets are held on lease, the majorityof the lessees in the lease agreement are family members.</td></tr>
<tr><td>Registered Partnerships en nom collectif and Partnerships en commandite</td><td>The full capital contribution to the partnership was made (directly/indirectly) by two or more owners who are family members within the same family, having (directly/indirectly) the right to receive the majority of distributable profits, and

at least one of these two family members holds the majority of the decision-making rights.

➢ Where non-family members make (directly/indirectly) capital contributions, these are to be disregarded if their aggregate contribution is not more than 5% of the total contribution made by all partners in the partnership.
➢ Where business assets are held on lease, the majority of the lessees in the lease agreement are family members.</td></tr>
<tr><td>Trusts</td><td>All the beneficiaries are owners and family members within the same family.

➢ Where non-family members are beneficiaries, these shall be disregarded:
(a) if their benefits from the family business do not exceed 5% of the business, or
(b) if they are only residual beneficiaries who will benefit from the trust only upon its termination because there are no family members within the same family capable of benefitting from the trust.
➢ Where business assets are held on lease, the majority of the lessees in the lease agreement are family members.</td></tr>
<tr><td>Other Registered Forms</td><td>The business and its assets are owned and controlled (directly/indirectly) by two or more owners who are family members within the same family.

➢ Where non-family members hold other assets, these are disregarded if their aggregate value is not more than 5% of the net assets of the family business.</td></tr>
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	➢ Such business shall abide by the provisions relating to Unregistered Organisations in the Civil Code and the relative Schedule. ➢ Where business assets are held on lease, the majority of the lessees in the lease agreement are family members.

Table 1: Conditions for registration as a family business under the Act[24]

The Act also defines what is meant by shares, interests, other assets held or contributions made indirectly by family members. This refers to shares, interests, other assets or contributions held or made by (i) holding companies which are at least 95% beneficially owned by family members, (ii) trustees of a trust which is set up for the benefit of family members within the same family, or (iii) private foundations which are set up for the benefit of family members within the same family. Additionally, Article 3 to the Act also caters for any other business which may be provided for by the Minister.

Challenges Faced by Family Businesses

As part of its research project, the Expert Group[25] identified the challenges which are specific or are of particular concern to family businesses. These are presented in Figure 2.

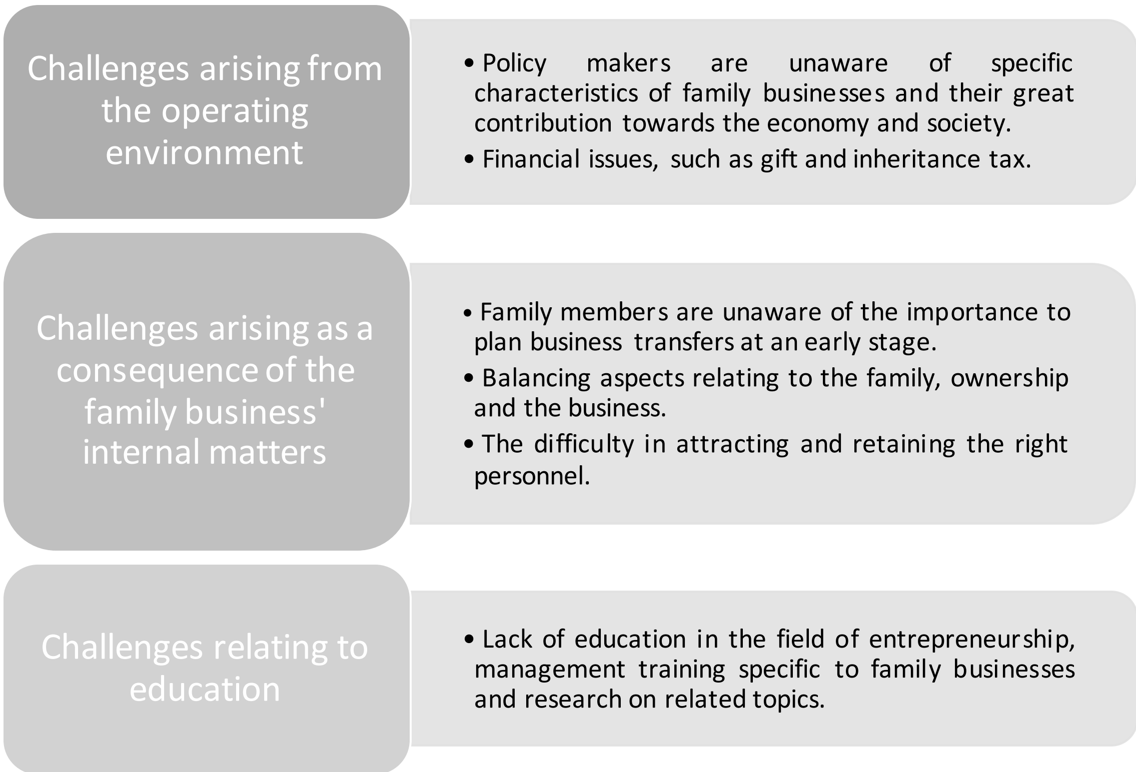

Figure 2: The challenges faced by family businesses, as identified by the Expert Group[25]

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[24] Ministry for the Economy, Investment and Small Business (MEIB), '*The Family Business Act: White Paper*' (2015)

[25] European Commission, 2009. 'Final Report of the Expert Group - Overview of Family-Business-Relevant issues: Research, Networks, Policy Measures and Existing Studies' (Enterprise and Industry Directorate-General) COM (2009)

In 2015, the key challenges identified by European family businesses were increased competition (37%), difficulty in attracting and retaining skilled employees (33%) and declining profitability (32%)[26]. Staff recruitment was also considered to be a major internal issue for 46% of local family businesses in 2014, followed by company re-organisation (40%), business or product development (27%) and succession planning (27%). Meanwhile, with respect to external issues, most Maltese family businesses were concerned with market conditions and Euro uncertainty (68%), followed by competition (41%) and government regulation (27%)[27].

Succession Planning

> "*A good steward in a family firm is a decision maker who is a caretaker of a family's assets, who desires to pass a healthier and stronger business to future generations.*"[28]

Transfer of business ownership and management was identified as the biggest challenge which family businesses are faced with in the European Commission's report of 1 July 2015 on family businesses in Europe. In a local study carried out in 2014[29], succession was not identified as one of the primary factors that are considered to impact the growth prospects for family businesses. These were found to be the size of the local market, local economic conditions and local competition. Nonetheless, Borg Cardona suggests that the low importance given to succession issues might be due to the lack of awareness of their importance, increasing the need for the proposed legislation.

The succession process does not refer to the mere transfer of the business as an asset from an owner to a successor, rather it involves the transfer of "*the skills and the desire to be in business*"[30]. As family businesses advance from one generation to the next, they are faced with increasing demands on their financial capacity[31]. Hence, the importance of looking at succession as a process which safeguards family wealth and ensures that it is compounded[27]. Failure to prepare proactive strategies for the future of the business, will lead to loss of wealth and business competitiveness.

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[26] European Family Businesses (EFB) and KPMG, 'European Family Business Barometer – Determined to succeed' (4 edn., 2015)

[27] PwC Malta, *All in the family? The future of the Maltese Family Business – Family Business Survey 2014*

[28] J. H. Davis, M. R. Allen, & H. D. Hayes 'Is blood thicker than water? A study of stewardship perceptions in family business' (2010) Entrepreneurship Theory and Practice, 34 (6), 1093

[29] E. Borg Cardona, '*Family businesses: a case for special treatment at law?*' (MSc thesis, University of Malta 2014)

[30] R. Shrapnel, '*Succession Reset - Family Business Succession in the 21st Century*' (Baker Tilly International, 2014) p. 7

[31] R. Shrapnel, '*Succession Reset - Family Business Succession in the 21st Century*' (Baker Tilly International, 2014); I. Casha, 'Succession Planning Process in Maltese Family Businesses: An Analysis' (M.Acc. thesis, University of Malta 2015)

Family Wealth Management

The wealth management of family businesses involves the preservation of capital for future generations, having a longer planning horizon than that for traditional investors[32] and giving equal attention to issues related to the family and wealth[33]. In the words of Haynes Daniell and McCullough[33], family wealth management involves the preservation of a "*family's hard-earned wealth and compound(ing) it successfully over time.*" Investment decisions made by family business owners should be in line with the family's core values, with the aim of generating sustainable returns for current and future generations.

The Family Office

Family offices are generally established by wealthy families (typically having a net worth exceeding €100 million) to manage their wealth, help in the family's plans for the future and to offer consultancy services[34]. These can be of two types: a single-family office (SFO) which provides its services to only one family, and a multi-family office (MFO) providing services to a number of families[35]. Most SFOs are built by the family's most trusted advisor who would typically be the family accountant or lawyer[36]. Additionally, Gray[37] refers to a "*virtual office structure*" whereby the family office services are outsourced.

The use of family office services is still not widespread locally. This could be due to the poor consideration given to formal governance mechanisms and wealth management in family businesses. In fact, more than a third of local family businesses are unaware of the family office structure[38]. Furthermore, most Maltese family businesses are still entering their third generation[39] and first and second generation family businesses are more concerned with building wealth[38]. Meanwhile, family members from the third and fourth generation are more likely to make use of wealth management services and to use a SFO or MFO.

Trusts as a Tool to Preserve Family Wealth

A trust is defined as:

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32 G. Aquilina 'Family offices develop a taste for private equity' (2015) 135 *Professional Wealth Management,* 14

33 M. Haynes Daniell and T. McCullough, *Family Wealth Management: Seven Imperatives for Successful Investing in The New World Order,* John Wiley & Sons, 2013, xvii

34 D.M. Beers, 'The Family Office: Recent Developments' (2011) *Tax Management Memorandum* 52(24) 483

35 Family Office Services Switzerland (FOSS), 'What is a Family Office?' <http://www.switzerland-family-office.com/what-is-a-family-office.html> accessed 16 September 2016

36 C. Lowenhaupt, 'What wealthy families really want: a trusted advisor' (2008) 22(13) *Accounting Today*, 18

37 L. Gray 'The Three Forms of Governance: A New Approach to Family Wealth Transfer and Asset Protection, Part III' (2011) 14(1) *The Journal of Wealth Management*, 53

38 N. Sant, 'The Value in Legislation for Family Businesses' in M. Duca (ed), *The Maltese Family Business: Getting Organised* (APS Bank Business Publications, 2015)

39 E. Borg Cardona, '*Family businesses: a case for special treatment at law?'* (MSc thesis, University of Malta 2014)

"…where a person (called a trustee) holds, as owner or has vested in him property under an obligation to deal with that property for the benefit of persons (called the beneficiaries), whether or not yet ascertained or in existence, which is not for the benefit only of the trustee, or for a charitable purpose, or for both such benefit and purpose aforesaid." [40]

Trusts are often used as a legal vehicle to preserve family wealth as it is transferred from one generation to the other by centralising control and management of assets and by protecting family assets from potential claims from creditors. In 2014, the Trusts and Trustees Act, Act XXXV of 1988, Chapter 331 of the Laws of Malta, was amended to include the concept of 'Family Trusts'. Such a trust can only act as trustee to a specific settlor(s) and provide administrative services to a family trust(s). Furthermore, the trustee shall not act as a trustee to the public and cannot act as a trustee to more than five family trusts at once[41].

Mifsud Parker[42] believes that this notion was introduced to protect family wealth, due to the crucial role that family businesses have within the Maltese economy. A family trust achieves this objective by appointing a trustee who is entrusted with the responsibility to preserve and invest the settlor's assets and to ensure that family members' decisions are in the best interest of the family trust. The trustee should also seek advice from the right professionals to ensure the continuity of the family business from one generation to the next. Hence, a family trust allows family members to be involved in the family's investment decisions whilst safeguarding the long term interests of the family through the overseeing of the trustee.

The Need for the FBA

The first generation founds the business and creates a wealth base. The second generation, influenced by the prior generation's values and vision, strengthens the family wealth and improves the business. Very often, the third generation lacks motivation to take the business forward and family wealth is exhausted by this stage[43]. This phenomenon, known as 'the third generation curse', is very common[44] but this does not mean that all families lose their wealth in this manner. Very often, the reason why family wealth is lost is the founder's lack of instructions as to how to administer the wealth once he/she steps down[45].

Organised business in Malta was generally established post World War II, that is, around seventy years ago. Thus, since many Maltese family businesses are currently entering their third

[40] Trusts and Trustees Act 1988, Art. 3

[41] Malta Financial Services Authority (MFSA), 'Consultation Document: Proposed Rules for Trustees of Family Trusts' (2014)

[42] P. Mifsud Parker, 'The Use of Trusts for Family Businesses' in M. Duca (ed), *The Maltese Family Business: Getting Organised* (APS Bank Business Publications, 2015)

[43] G. Robinson, 'Fulfilling legacies' (2006) 139(4) *CA Magazine,* 45

[44] Robinson, 'Fulfilling legacies' (2006) 139(4) *CA Magazine,* 45; M. Haynes Daniell and T. McCullough, *Family Wealth Management: Seven Imperatives for Successful Investing in The New World Order,* John Wiley & Sons, 2013

[45] Hargreaves, 'Squandering the Family Fortune: Why rich families are losing money' (CNN Money, 2014) < http://money.cnn.com/2014/06/25/luxury/family-wealth/> accessed 26 February 2016

generation[46], this is opportune timing for a legislation which addresses the issues which family businesses are faced with, particularly during the process of business transfer which is threatened by the 'third generation curse'. Furthermore, a readily established business is more likely to survive increasing competition and an ever-changing environment[47]. Hence,

> "*it is far less costly in economic, financial and social terms in the long run to invest to preserve and develop existing businesses, than to sit back and allow them to fail, or invest in start-ups that could potentially move in to take their place.*"[48]

Objectives of the Bill

> "*The scope of the legislation is to encourage and assist family businesses to enhance their internal organisation and structure with the aim that they effectively operate the business and work towards an effective succession of the family business.*"[49]

The proposed legislation intends to encourage family businesses to improve their governance structures and to regulate themselves, whilst raising awareness of the need to transfer family businesses inter vivos (during the lifetime of the family members). This is being encouraged because there is a greater chance of success when transferring a business inter vivos, rather than after the founder has passed away (causa mortis), especially when the latter is as a result of the unexpected loss of a family member. Clearly, transfers inter vivos are more transparent and smooth, consequently maintaining the confidence of all stakeholders[49].

The incentives being proposed have been developed with the intention of ensuring continuity of the business from one generation to the next, in line with the recommendations put forward in the European Commission's report of 1 July 2015 on family businesses in Europe, to:

(i) develop a legal framework which facilitates transfer of family businesses and ensures their survival, and

(ii) promote education, governance structures and business strategies which are specific to family businesses to enable their long term success[50].

The White Paper provisions comprise of governance benefits and fiscal benefits for businesses which register as a family business in terms of Article 28 of the FBA[51]. The governance benefits

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[46] E. Borg Cardona, '*Family businesses: a case for special treatment at law?*' (MSc thesis, University of Malta 2014)

[47] I. Casha, 'Succession Planning Process in Maltese Family Businesses: An Analysis' (M.Acc. thesis, University of Malta 2015)

[48] E. Borg Cardona, '*Family businesses: a case for special treatment at law?*' (MSc thesis, University of Malta 2014) p.8

[49] Ministry for the Economy, Investment and Small Business (MEIB), '*The Family Business Act: White Paper*' (2015) p.8

[50] Commission, 'Report on Family Businesses in Europe' COM (2015) 2014/2210(INI)

[51] Registration requires submission of the Application Form for Registration as a Family Business in the First Schedule of the FBA, together with the other documents listed in this Schedule. These include an Organisation Chart certified by an accountant or lawyer and a bank reference letter of the business. Applicants are also required to pay an administration fee upon applying for registration. Furthermore, the Regulator has the authority to accept or refuse applications subject to further conditions as outlined in Article 28(5) of the FBA.

will be enacted through Malta Enterprise and are displayed in Table 2. The latter incentives, which aim to support a smoother transfer of the business or its retention within the family, are to be included in the Duty on Documents and Transfers Act, Act XVII of 1993, Chapter 364 of the Laws of Malta.

(i)	Micro investment of a maximum tax credit €50,000 over a three-year period.
(ii)	Legal and accountancy advisory services related to business succession up to €2,500 per annum over a five-year period.
(iii)	Arbitration of up to five sittings for assistance with the valuation of assets and/or shares being transferred.
(iv)	Education and training for owners and their employees of up to €1,000 per annum per family business.
(v)	The positive consideration of lease renewals occupying government premises. The Regulator shall recommend to the Malta Enterprise and/or Malta Industrial Parks the renewal of the tenancy of industrial government premises or land on lease or emphyteusis, when such premises are being occupied by a registered family business and business continuity is confirmed.
(vi)	Loan guarantees of up to €500,000 per business for the purpose of acquiring the business or parts thereof.
(vii)	The waiver of the condition that assets be bought from third parties for the purposes of benefitting from the Investment Aid 2014-2020.

Table 2: The Initial Governance Incentives proposed by the FBA[52]

The Income Tax Act (ITA), Act LIV of 1948, Chapter 123 of the Laws of Malta legislates that upon transfer of immovable property (Art. 5A) the transferor is charged property tax on such transfer, or income tax on capital gains (Art. 5) as applicable, whereas upon a transfer of shares (Art. 5), the transferor is charged Income Tax on capital gains. Both the abovementioned transfers are subject to an exemption where the asset is transferred by way of donation to a relative[53]. This remains unchanged under the proposed FBA.

The transferee is currently charged duty on documents and transfers of €5 for every €100 or part thereof of the higher of the amount of the consideration or the value of the property being transferred, in accordance with Article 32 of The Duty on Documents and Transfers Act 1993. Meanwhile, according to Article 39 of the proposed FBA, duty on documents and transfers shall be charged at 3.5% for the first €500,000 of the value of the property being transferred.

With respect to the transfer of shares, Article 32 of The Duty on Documents and Transfers Act 1993 legislates that transferees are subject to duty on documents and transfers of €2 or €5 for

[52] MEIB, '*The Family Business Act: White Paper*' (2015)

[53] Here, the term 'relative' refers to a person's spouse or his/her descendent or ascendant in the direct line, including the spouse of such descendant or ascendant. The exemption also applies to donations made to the person's brother or sister or to a descendant of his/her brother or sister (where the individual has no descendants in the direct line), or to a philanthropic institution which is approved for the purposes of Article 12(1)(e) of the ITA 1992.

every €100 or part thereof[54] of the higher of the amount of the consideration or the value of the shares being transferred. However, the first €150,000 of the value of the shares or interests in a partnership, trust or foundation, which is registered as a family business under the FBA, being transferred are to be ignored under Article 39 of the proposed Bill.

A concern which emerged in Borg Cardona's[55] research in 2014 was that exempting family businesses from such taxes would cost around €10 million per annum and could lead to such firms having an unfair advantage. Hence, the proposed incentives are intended to level the playing field for the benefit of the economy and society.

The Regulator

The proposed legislation states that a Regulator of family businesses shall be appointed to assess the applicants for registration as a family business under the FBA and ensure their compliance with the relevant regulations. The functions of the Regulator, as laid out in Article 19 (2) of the FBA (White Paper), also include maintaining a Register of family businesses, promoting the family business sector, encouraging cooperation between Government and the sector, and encouraging family businesses to prepare written agreements which regulate the governing principles of the business.

In order to assess the implications of the proposed FBA on Maltese family businesses, a total of twenty-one interviews were held with professionals and family business owners, followed by the distribution of questionnaires to local family business owners. The qualitative and quantitative data collected relates to the respondents' views on the proposed legislation, with specific reference to the ways in which it intends on supporting family businesses in safeguarding their continuity and preserving family wealth.

How the Proposed Bill Addresses and Helps Family Businesses

A FBA Committee member highlighted that the FBA intends on helping family businesses in two particular ways: encouraging family businesses to improve their management and governance structure and helping families organise themselves better, internally. Other interviewees also highlighted that the FBA addresses the needs of family businesses when they transfer, with particular reference to inter vivos transfers. Hence, family businesses are being encouraged to plan their succession process as early as possible to address any issues which may arise at transmission stage. As suggested by Shrapnel[56], proper succession planning can enable the protection of family wealth. Thus, although interviewees suggested that the Act does not address

[54] Subject to the conditions laid out in Article 42 of the Duty on Documents and Transfers Act 1993.

[55] E. Borg Cardona, '*Family businesses: a case for special treatment at law?*' (MSc thesis, University of Malta 2014)

[56] R. Shrapnel, 'Succession Reset - Family Business Succession in the 21st Century' (Baker Tilly International, 2014)

this issue, by fulfilling its objectives, the FBA will also be encouraging the preservation of family wealth.

The aid that the proposed Bill is offering to family businesses was considered to be the "*first building blocks*" towards building a framework which addresses the complexities and issues that are unique to family businesses. One must bear in mind, however, that at this point in time it might still be premature to assess how successful the Act will be in meeting its objectives, as this highly depends on the take-up rate once it is enacted. Meanwhile, although family business owners interviewed had heard about the proposed FBA, most were unfamiliar with its contents, suggesting that more effort should be made to market the legislation with all potential users.

Registration with the FBA

Family business owners showed substantial interest in the proposed legislation, some even delaying the transfer process in order to benefit from the proposed incentives. In line with the professionals' expectations, many family business owners are willing to restructure in order to benefit from the proposed legislation. Nonetheless, as suggested by interviewees, restructuring might not be the optimal option for all family businesses, based on the circumstances of each business. Hence, family businesses should seek professional advice in selecting the best approach towards safeguarding their continuity.

Increased Stakeholder Confidence

The proposed legislation should result in increased confidence of shareholders, investors and employees of registered family businesses in the long run, once the legislation has been implemented and developed further. Increasing stakeholder confidence would address one of the issues faced by family businesses relating to the employment and retention of the right personnel[57]. Furthermore, registration with the FBA should also increase the confidence of family members by knowing their place within the family business and safeguarding it for future generations.

Defining the Roles within the Family Business

Although the members' roles of most family businesses appear to be defined, meaning that an organisational chart can be prepared in line with the FBA's registration requirements, most respondents claimed that formal structures like family constitutions and shareholders agreements are not used at all. These findings are similar to those obtained by Muscat[58] who identified a significant absence of governance structures amongst small local family businesses.

57 Commission, 'Final Report of the Expert Group - Overview of Family-Business-Relevant issues: Research, Networks, Policy Measures and Existing Studies' (European Commission Enterprise and Industry Directorate-General)
58 B. Muscat, '*The Family/Business Balance in Selected Maltese SMEs and the Role of the Financial Advisor*', (B. Acc. thesis, University of Malta, 2012)

Lack of governance bodies can have far reaching consequences, affecting the wealth management of family businesses by discouraging the diversification and successful transfer of wealth[59]. The Chair of the FBA Committee also highlighted the importance of having sound governance structures during the launch of the FBA, where it was explained that good governance is a prerequisite for family businesses which want to succeed.

Their minimal use can be partially explained by the lack of awareness of such documentation and structures which was identified in this study. Thus, education in this regard must be increased. One can say that this issue will be addressed through the training incentive being proposed. Meanwhile, it is still unclear as to how the regulator will be supporting family businesses to prepare such formal structures and organise themselves better in order to meet the objectives of the FBA, as stated in the White Paper.

The Initial Incentives

A maximum of €2,500 per annum for legal and advisory services to support succession and the transfer of the business from the current owner to either family members or third parties.

Succession has long been recognised as a tremendous challenge which can threaten business continuity[60]. Planning for succession enables family members to anticipate and address issues which are expected to arise upon transfer[61].

One way in which the regulator intends on assisting registered family businesses throughout this process is by providing an incentive of a maximum of €2,500 per annum for legal and advisory services relating to business succession and valuation of assets and/or shares being transferred. Consistent with Borg Cardona's[62] findings, the professionals and family business owners interviewed agreed that business reorganisation is highly dependent on positive will.

Most family business owners consider this incentive to be useful. However, one can only determine whether it will succeed in encouraging family business owners to approach a professional advisor and prepare a formal plan for business transfer once the law has been enacted. Nonetheless, if business owners would have not yet considered the long-term survival of their business, this incentive may at least bring to their attention the necessity of discussing such issues initially amongst family members and then with professional advisors, knowing that a fraction of the expenses involved will be reimbursed.

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[59] R. Zafft, 'Large, Family-Run Firms: the OECD Experience', (The Fourth Asian Roundtable on Corporate Governance: Shareholder Rights and the Equitable Treatment of Shareholders, OECD, 11-12 November 2002)

[60] L. Songini, L. Gnan, and T. Malmi, 'The role and impact of accounting in family business' (2013) 4 (2) Journal of Family Business Strategy, 71; K. E. Gersick et al. 'Stages and Transitions: Managing Change in the Family Business' (1999) 12 Family Business Review, 287; W Gibb Dyer, 'Succeeding Generations: Realizing the Dream of Families in Business' (2000) 45(2) Administrative Science Quarterly, 401; Commission, 'Report on Family Businesses in Europe' COM (2015) 2014/2210(INI).

[61] I. Casha, 'Succession Planning Process in Maltese Family Businesses: An Analysis' (M.Acc. thesis, University of Malta 2015)

[62] E. Borg Cardona, '*Family businesses: a case for special treatment at law?*' (MSc thesis, University of Malta 2014)

Loan guarantee of up to €500,000 for acquiring the business or part thereof.

The proposed Bill also states that registered family businesses may be eligible for a loan guarantee of up to €500,000 for the purpose of acquiring the business or part thereof. Although the major factors which limit family businesses' growth, as identified by Borg Cardona[63], did not include access to investment finance, this could still affect a firm's ability to remain competitive. Most family businesses do not appear to have any difficulty in accessing finance, however, as indicated by a business owner, bank financing, the preferred financing method of family businesses, requires substantial assets to be tied up as collateral. Hence, this incentive will help lessen this burden. In fact, both professionals, and family business owners considered it to be a useful incentive.

A level playing field can be achieved if the FBA addresses issues which are at the core of family businesses, such as the management of family members' relationships and the separation of family from business matters[63]. The professional interviewees participating in this study highlighted the importance of these issues which bring out the difference between a family business and a non-family run business. Although the core problems relating to business management are similar, family businesses are also affected by the challenges relating to the running of the family and thus, the management of the relationships between family members. Such issues should be tackled by the proposed incentive relating to management, business and family governance training, which is the materialisation of one of the recommendations put forward by Borg Cardona[63].

More Applicable to Smaller Businesses?

A point which emanated from the feedback received from interviewees was that the initial incentives appear to be more attractive to smaller businesses. However, in light of the wide definition of family businesses contained in the White Paper, there is still the possibility for larger businesses to register. When asked about this paradox, a FBA Committee member explained that it is imperative that the definition gauges the population of family businesses in order to identify and address their needs accordingly. Furthermore, excluding businesses of a certain size would have discouraged small businesses to grow if that would have meant that they would no longer be recognised in terms of the Act.

Meanwhile, it can be argued that large businesses tend to be better organised and have already succeeded in growing, requiring less help than those businesses which lack the knowledge and resources to seek professional advice and to invest in the development of their business. Nonetheless, the quantitative findings of this study showed no significant association between the perceived usefulness of the proposed incentives and the respondents' company size.

Borg Cardona conveyed that a very wide definition would cover most businesses in Malta whilst a very narrow one which only caters for very small family businesses could be considered to be discriminatory[63]. It can be concluded that the FBA has succeeded in striking the right balance

[63] E. Borg Cardona, '*Family businesses: a case for special treatment at law?*' (MSc thesis, University of Malta 2014)

between the two extremes, since although the proposed definition caters for various business models, these are subject to the registration conditions laid out in the Act. However, this can only be confirmed once the legislation is implemented and the number of registered family businesses is determined. Moreover, once these have been identified, further incentives can be developed to address other emergent issues.

Settling a Family Business through a Family Trust

The setting up of a family trust can help preserve family wealth[64]. However, the use of trusts appears to be still quite alien locally. As is common in other civil law jurisdictions, the Maltese find this concept difficult to grasp. In fact, Malta may be considered to be unique as a civil law jurisdiction which also caters for trusts; a result of the British influence on the Maltese islands. Nonetheless, since family trusts are recognised in terms of the FBA, the implementation of the proposed legislation is expected to increase awareness of the benefits of this structure, possibly encouraging its use as a means of ensuring the continuity of family businesses and preserving family wealth.

Preservation of family wealth, tax planning and efficient decision making are some of the advantages of using family trusts. Moreover, a family trust can create consolidation, whereby upon death, family wealth is managed as one fund which can continue to accumulate, rather than divided amongst several heirs. Additionally, transferring the family business' shares to a trust during the settlor's lifetime, protects the family from the financial strain which can arise when the company is liquidated[65].

Other benefits of this structure include the prevention of having one dominating individual influence business decisions and the protection of vulnerable family members. The assigned trustee could ensure that wealth is rendering optimal returns in the interest of all family members. Due to the binding terms set out in the trust deed, a family trust can act as a safeguard against certain unprecedented issues which may arise, facilitating the continuation of the family business, based on the parameters established by the founder or settlor. As a result, this can increase the confidence of family members and shareholders.

Meanwhile, interviewees who were sceptical about the use of family trusts argued that the terms in the trust deed might be too binding, such that they may not be applicable to the future circumstances of the business, consequently limiting the opportunities available to future generations. However, Maltese trust legislation provides significant protection in this regard by allowing the settlor to reserve certain powers and the appointment of a protector.

Attracting Foreign Family Businesses to Malta

The FBA intends to contribute towards Malta's development as the financial centre of choice for international businesses, particularly those within the EU and Commonwealth by allowing foreign

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[64] I. Casha, 'Succession Planning Process in Maltese Family Businesses: An Analysis' (M.Acc. thesis, University of Malta 2015)
[65] J. Chetcuti, 'A Legal Toolkit for Family Businesses' in: M. Duca (ed), *The Maltese Family Business: Getting Organised* (APS Bank Business Publications, 2015) p. 65

family businesses to benefit from the legislation[66]. Whilst some professional interviewees believed that this can indeed compliment other attributes which already make Malta a competitive jurisdiction for businesses, provided that the benefits of this legislation are marketed properly, others were not convinced. However, this is not one of the primary objectives of the legislation. Thus, any interest which the Act generates amongst foreign entities can be perceived as a by-product of a framework whose main aim is to contribute towards the growth of the local economy by enhancing the sustainability of local family businesses.

The Use of Family Offices

The feedback obtained from family business owners confirmed that the use of family offices in Malta is not widespread, the majority being unfamiliar with the term. Since first and second generation businesses are more concerned with creating wealth, rather than administering it, wealth management services are more likely to be sought by family businesses at later generational stages[67]. In fact, the two respondents which claimed to be making use of a SFO and MFO were in their third and fifth generation, respectively. This can be explained by the increased need for formal governance structures to be formed at later generational stages due to the greater risk of conflicts as additional family branches emerge and more family members form part of the family business[68].

In light of the costs involved in running a SFO[69], professionals recognised that this option is not for everyone. Nonetheless, a MFO representative suggested that MFOs or virtual family offices can serve as a cheaper alternative for less complex or affluent families.

Advantages of Using a Family Office

Qualitative findings revealed the following ways in which a FO can help a family business:

(i) Centralisation of specialised and tailor-made services.

Managing family wealth, where it is substantial, requires a dedicated team of professionals with different expertise to administer the wealth in line with the family's objectives. Rather than having several dispersed advisors working for the family business, a family office centralises all the services related to investment and advisory, facilitating consolidation. Furthermore, specialised services ensure that advice is given on the basis of previous experience with other businesses of

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[66] MEIB, '*The Family Business Act: White Paper*' (2015)

[67] N. Sant, 'The Value in Legislation for Family Businesses' in M. Duca (ed), *The Maltese Family Business: Getting Organised* (APS Bank Business Publications, 2015)

[68] S. Sciascia, P. Mazzola, and F. W. Kellermanns, 'Family management and profitability in private family-owned firms: Introducing generational stage and the socioemotional wealth perspective' (2014) 5(2) Journal of Family Business Strategy, p. 131

[69] C. Lowenhaupt, 'What wealthy families really want: a trusted advisor' (2008) 22(13) *Accounting Today*, 18; L. Gray 'The Three Forms of Governance: A New Approach to Family Wealth Transfer and Asset Protection, Part III' (2011) 14(1) *The Journal of Wealth Management*, 53

a similar nature, consequently addressing issues which are particular to family businesses more effectively. As a result, family wealth is safeguarded and enhanced.

(ii) Increased transparency.

Since a family office is a formal structure for wealth administration, separate from family members, the use of such structures increases transparency[70].

(iii) Family members are left with more time to focus on more currently prevailing issues.

In light of the challenge that family business owners are faced with in devising a sound plan of how their wealth is to be transferred to the following generations, the professional role of wealth managers and family offices becomes increasingly important. Such service providers can provide a neutral view to family affairs. At the same time, this leaves family members with more time to focus on prevailing issues such as those relating to the day-to-day running of the business.

(iv) Enhanced communication and improved management of family members' expectations.

Professional interviewees highlighted the importance of managing the relationships amongst all family members, including those who do not work within the family business. A family office can enhance communication within the family, ensuring that everyone's interests and expectations are aligned. This avoids conflict, consequently facilitating preservation of family wealth.

(v) Educating family members.

Aquilina[71] considered education to be an important element of the services offered by family offices, particularly SFOs.

Family Businesses' Preferred Trusted Advisor for Wealth Management

When asked about their preferred trusted advisor for family wealth management, family business owners revealed that this role is assigned to someone with whom they have built a sound relationship. Very often, this trusted role is occupied by the family lawyer or accountant. Furthermore, whilst the accountant or auditor is deemed to be the trusted advisor for the management of wealth generated from business activities, whilst lawyers and notaries are consulted for matters relating to succession and for the preparation of legal documents.

It is expected that the proposed legislation will bring increased awareness of the family business sector and the challenges with which it is faced. Furthermore, the knowledge acquired from registered family businesses will facilitate identification of other issues which need to be addressed by the FBA. Meanwhile, the feedback from family business owners suggests that there is a lack of awareness about the FBA and its contents. In light of this, a far reaching education campaign should be organised to ensure that all potential users and professional advisors are informed about the proposed legislation. Once professionals are familiar with the regulations and incentives being proposed, these will be in a better position to advise their clients about the

[70] P. Mifsud Parker, 'The Use of Trusts for Family Businesses' in M. Duca (ed), *The Maltese Family Business: Getting Organised* (APS Bank Business Publications, 2015)

[71] G. Aquilina 'Family offices develop a taste for private equity' (2015) 135 *Professional Wealth Management,* 14

registration process involved and the benefits of registration. Accordingly, professionals who advise or work within family businesses are encouraged to educate potential users and promote registration with the FBA. They should contact their clientele to inform them of the ways in which they could benefit from the proposed legislation and recommend registration accordingly. Moreover, professionals should ensure that they are kept informed about the sector's needs so as to offer a more valuable service to their clients.