The role of the State in the promotion of family businesses.

Tax exemptions and family businesses in Spain in a long-run perspective.

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1. INTRODUCTION

In the last two decades Spanish integration in the world economy has been fast and spectacular, and family firms have been leading actors in this process. However, little is known about the role the State has had in promoting these national champions in the international markets. This article studies the changing relationship the State has had with family firms during almost two centuries through the changes in legislation regarding taxes closely related to the creation and above all transmission of family firms. The article offers for the first time an innovative long-term approach to this subject, and also presents a comparative international framework to place the Spanish case. The main sources used are legal compilations and specialized fiscal publications since the eighteenth century until 2005, national and regional statistics about fiscal revenues from selected taxes directly related to creation and transmission of family firms, national and regional directories of firms, and information from private archives, corporations and associations of large family firms in Spain. The paper synthesizes huge and scattered information to provide a clear framework about two main issues.

First of all, what we consider a key historical change regarding family firm transmission and taxation that has taken place in Spain and has affected family firms in a distinctive way when compared to other European countries. Historically, the laws regarding wealth transmission and taxation always pursued the increase of revenues in times of economic need, usually either after big territorial losses or after a military conflict –as in other European countries. In Spain until the last third of the 20th century these laws

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taxed all kinds of goods and wealth to be transmitted (personal and entrepreneurial). However, in the last three decades the laws about wealth transmission in Spain have increasingly created a relatively new separation between what we could call “personal” wealth (regardless composition and origin) and “productive” entrepreneurial wealth. The goal has been to maintain tax pressure on the wealthiest individuals, while reducing tax pressure on the “productive wealth” of individuals who reinvest in their businesses, officially in order to help entrepreneurial survival of private firms in times of rapid openness and integration in world markets. This was done without controls to check whether this kind of wealth was invested within or outside the country, and above all to control whether this “productive wealth” was really invested in productive activities or in financial speculation.[2] Entrepreneurs in Spain seem to have been affected in different ways by the change: old and large family firms have probably gathered resources and contacts to take advantage of the new philosophy of taxation, whereas younger and smaller family firms may have found very difficult to obtain information and resources to benefit from the change. The conceptual separation held by the State in practice has meant that the difficulties to use the new laws may negatively affect the competitiveness of many micro and small family firms (more than 2/3 of total firms in the country, a % which is higher than the average found in other developed European countries), and may have positively affected competitiveness and internationalization of larger family firms –more able to fulfil complex legal requirements to demonstrate the “productive” side of the transmitted goods whose exemption of taxes is sought after. Thus, our paper suggests that current debates about the role of transmission taxes (either as reducing wealth inequalities in a positive way, or as unfair mechanisms that multiply the taxation of wealth through generations) miss the importance that these taxes may have had and have in promoting different long-term conditions of competitiveness for firms of different sizes. Our paper suggests that the case of Spain reveals that laws regarding transmission of wealth are not neutral, and have a bias in its application considering size and its cumulative effects on growth and competitiveness. Our data also suggest that recent laws on succession transmission may be unfair for microfirms and small firms –which represent more than half of employment and wealth in Spain (according to works by Obesso and Saiz 1999, and Galve Salas 2003).

[2] An opinion shared by Alfredo Pastor, former secretary of State of Economy in the last socialist government (interview held with Paloma Fernández in Barcelona, January 17th 2008).

Secondly, the paper provides evidences to demonstrate that the tax policies that more directly affect family firms are not peculiar in Spain, but similar to those of other western European countries. There are however two main differences in this comparative analysis. 1) The chronology of these tax policies and its entrepreneurial effects: whereas the most developed Western European countries started creating strong taxation on wealth transmission after the I World War and above all after the II World War, Spain created tough taxes on this only after 1977, taxes that started to reduce its pressure on wealth transmission in the late 1990s. This chronology is important: Western European countries like France and the UK suffered big death rates among old family firms before the golden age of growth, whereas in Spain this troublemaking period came much later, and was very intensely suffered though during a shorter period of time than in other countries (Colli, Fernández and Rose, 2003). And 2) an appropriate understanding of this chronology should consider the spectacular capacity shown by the largest Spanish family firms to lobby and positively change regional and national tax policies in the last 15 years, which is something unparalleled in Europe, and which has greatly supported the internationalization of Spanish family firms (Fernández and Puig, 2007) This second differential aspect of the institutional factors surrounding family firms in Spain in international comparison has already been studied by Fernández and Puig (unpublished paper presented at this Bergen conference). However, much less is known about the evolution of tax legislation on wealth transmission in a long-run perspective, and with an international perspective. Our paper provides a comparative study about this less well-known aspect, the major fiscal policies regarding family firm transmission, and offers some hypothesis about its consequences for firms of different size and age.

1.1. <u>Getting laws back into the historical study of businesses</u>

Laws do not determine, but do highly condition rules of the game for businesses. The advance of capitalism has meant, among many other things, the increase in the number and complexity of laws that firms of all sizes need to know in order to do their activities, and also to reduce increasing operation costs. Particularly after the II World War, as national States have accepted the influence of international institutions in the design of their economic policies, the costs involved in crossing borders have meant a great obstacle for many micro and small firms. The consequence of this development has often been that only large firms or well-coordinated networks of SMEs can have enough financial resources to sustain stable strategies of growth, or internationalization, and reduce high information costs involved in managing an increasing volume of laws affecting individual, family, and entrepreneurial wealth.

It is in this context that it is important to acknowledge the role of institutions in creating favourable, or unfavourable, conditions for the competitiveness of firms of different sizes and financial requirements. This paper wants to be a contribution in this sense, and explores how legal rules of the game have strongly influenced the strategies and competitiveness of family businesses, but with quite different results and considerations depending on the size of the business. Our paper argues that policies regarding family firms should not use universal definitions, because they are not "neutral" in their effects, and should consider the different requirements large on the one hand, and SMEs on the other hand, have in terms not only of financial costs but also of information costs. As laws increase in numbers and complexity within regions, national States, big regional continental blocks, and the world, the expenses a micro or small firm has to access information grow so much that often the firm does not really know what the firm can do for its own benefit, while larger firms can hire good and big legal consultant firms that make the work of digesting laws easier and more profitable with less costs.

The situation of firms has been more complex in Spain since 1977. Before this year, it was relatively easy to evade and reduce the payment of taxes by big and medium firms. However, after that year, and with the beginning of democracy in Spain, the legal complexities grew and the legislation did not allow the tax evasion or tax reduction so easily. Micro and small firms had a more difficult time to reduce this cost in their accountancy books and many in succession periods disappeared (as it had happened in the UK in the 1950s with the high rise in death duties of the time), whereas medium and large firms sought better legal services to gather disperse and complex information to reduce the burden of paying taxes. Big firms have had more possibilities to evade and reduce payment of taxes due to their greater access to good consultants and foreign financial institutions. This situation has affected all kinds of firms, but the impact of a changing legislation on wealth transmission has been particularly tough on what we call "family firms", being known as those in which members of a family or groups of families have the power to control the strategic management of the firm and try to keep such control from one generation to another.[3] Rising death duties (Impuesto de Sucesión) and the creation of a wealth tax on real estate (Impuesto de Patrimonio) after 1978 hardly hit family owned firms in comparison with other kinds of firms, and larger firms joined forces to create a lobby to reduce this pressure in 1992 (the Instituto de la Empresa Familiar), which they obtained with great success in the following decade.

It is extremely difficult to know all the legal ways used by some large firms to avoid or reduce the payment of taxes. This paper does not provide an exhaustive analysis of this, but considers as a hypothesis that there are four frequent areas of law in Spain through which large family firms have found useful ways to reduce tax payment, ways that have been extremely more difficult to know and use by small and medium family firms. From more recent to more historical, these four legal mechanisms have been: 1) through innovation legislation (this happened more often since the 1990s); 2) through labour legislation regarding flexibility in hiring and dismissal operations since the 1990s; 3) through internationalization of firms (by the use of rules regarding intangible assets deductions until a maximum of 20 years since 1973); and 4) through legal exemptions on Inheritance and Wealth Tax legislation.

Our paper cannot deal here with all these four great areas of tax avoidance. We will basically study the big changes in what big lobbies of large family firm have considered as the cornerstone of their problems, which is inheritance and wealth tax legislation (*impuestos de sucesión* y *patrimonio* in Spanish). We will see some evidences that lead us to question whether the big legal changes that have taken place in Spain in the last two centuries have really been a problem for "family firms" in general, or just the opportunity for big lobbies to ask for more legal advantages needed by large family firms to keep growing and get global. We will also see how in the last three decades the legislation in Spain has helped this globalization of large family firms, with commercial laws that are extremely difficult to be used by small and medium family firms. Our paper suggests that further research should be done to confirm this hypothesis, which

[3] Definitions vary in detail but not in these two basic concepts regarding family control and generational transmission. See Colli, 2003. Also websites of the main international lobbies of large family firms: *Family Firm Institute*, *Group of European Family Firms*, *Instituto de la Empresa Familiar*, and *Associazione Italiana delle Aziende Familiari*.

could have important consequences to understand some of the institutional factors behind the lack of competitiveness of many family SMEs in this country. The paper approaches these problems by focusing above all on the significance of taxes and their exemptions for family firm strategies. The paper indicates that since the 18th century until the last three decades of the 20th century succession taxes and wealth taxes were really kept to a minimum in Spain, compared to other European countries and the US, which experienced an important rise after the I and above all II World Wars. The State needed resources for economic reconstruction and the wealthy families were seen as a primary focus of tax revenue. Progressive tax policies were designed to put less pressure on salaried families and microfirms. However, at least in Spain, exemptions to existing laws (to reduce payment of taxes, or avoid its payment) started to appear to modify the toughest side of tax pressure. Often exemptions appeared after a long activity of lobby of particular groups like retired soldiers of war, landowners, industrialists, or financiers. Francoist rules maintained old philosophies of making entrepreneurs associate in sectorial associations and groups that were required to organize a shared task of tax collection. However, as tax pressure increased in the last decades, particularly in Spain after the 1970s, more "across sectors" organized pressure appeared in order to obtain reductions and avoid payments. The creation of a lobby of big family firms in Spain, one of the most powerful lobbies of this kind of firms in Europe, studied by Paloma Fernández and Nuria Puig in a paper presented to this conference, needs to be understood in this historical context. This lobby, which appeared in 1992, took as its central target the reduction of inheritance and wealth taxes in Spain. This paper wants to take a long-term perspective on this issue and study when, how, and why the State in Spain started to design legal rules of the game that affected the operations and activities of family firms. In this way our paper argues that laws did not determine but highly influenced opportunities that not all firms were able to use, thus conditioning their ability to adapt to changing economic environments.

1.2 Back to political history to understand economics and business

Economics and politics are extremely intertwined in Spain, as in other countries with a long history of personal capitalism. Cabrera and Del Rey (2003, 278) relate the importance of such link during the post-war era in Spain, between 1939 and 1975.

According to Sánchez Recio (2003, 18) the institutions of the Francoist regime created the adequate framework for the formation of networks of interest. According to Barciela (2003, 120) lobbies resided also in the ministries during this military dictatorship. Personal relationships with the Administration were important. However, such relationships had also been important in the 19th century, and remain as a key factor affecting the strategies of firms even today at the regional level, in the capital of the country, in Brussels, or in Shanghai. In this issue Spain seems to be not too different to other European countries. We should not forget that this year the European Commission has started a voluntary register of lobbies, which aims to include the more than 15.000 groups of interest and 2,500 organizations that the Commission estimates that frequently try to influence the design of European laws affecting business life.[4] Lobbies are everywhere in Europe, indeed, though, as studied by Fernández and Puig in the paper they deliver in this conference, Spanish lobbies of family firms have been particularly strong and more successful than other European lobbies of family firms.

What follows in the next sections is a very synthetic overview of the evolution of the fiscal legislation more closely related to family firm wealth transmission in Spain. We highlight particularly changes affecting the inheritance tax, as it has become a target in the battle for tax exemptions in the last 3 decades. As it is known, the main feature of a family firm is the convergence of members of the same family in the management office. The Inheritance Tax affects very much the course of the firm. We also pay attention to the Local Industry Taxes (nowadays *Impuesto de Actividades Económicas*), the Corporate Income Tax (*Impuesto de Sociedades*) and Wealth Tax (*Impuesto sobre el Patrimonio*).

2. The evolution of taxes on inheritance and wealth

<u>2.1 A comparative and historical overview</u>

Family firms have different rights in the legislation of different European countries, and we can easily observe this by looking at the general situation of legislation about the Inheritance Tax at the beginning of the 21rst century. Firstly, we have to take into

[4] *La Vanguardia*, June 24th 2008, p. 62.

account the existence of “forced heirs” that appear in Spanish law but not in US law (and other countries). According to this legal requirement of Spanish law, if the patrimony of a deceased person consists only of his/her family firm, there is no alternative but to divide the family firm to distribute its wealth among all heirs; one (two) third(s) must go to the heirs (if any). Under American law, which differs by state, and in other countries, there is no part of the estate that cannot be disposed of by the testator by the terms of his will. This is different in Spain: we could speak about the inalienable succession of one or two thirds of the value of the deceased's estate. Secondly, there are uncountable differences in tax rates, tax quotas or periods of application. In general there are three typologies of countries. We present a synthesis in the following table.

Table 1. Inheritance taxes in the U.S. and several European countries at the beginning of the 21rst century

Countries	*Succession Tax abolished (year)*	*A fixed succession tax*		*Progressive tax rate on inherited wealth**		*Max. % tax rate on inherited wealth**	*Tax exemptions for family business properties***
			Less 15%	*15-35%*	*+35 %*		
USA					x	60	
U.K.		x				40	x
France					x	40	x
Spain				x		34	x
Belgium				x		30	x
Netherlands				x		27	x
Greece				x		25	x
Ireland		x				20	x
Norway				x		20	
Poland				x		20	x
Finland				x		16	x
Denmark				x		15	x
Italy	x (2001)						
Portugal	x (2004)						
Sweden	x (2005)						

Source: Own elaboration from Albi (1993), De Pablos (1985), De Pablos (2001), IEF (19994), IEF (2005).

Notes:

*The tax is progressive because it varies according to kinship degree (spouse and children the cheapest the tax, more distant family degree the most expensive the tax).The table has only considered taxes for wealth inherited by wives/husband and offspring. As kinship degree is more distant the percentage of tax imposed on inherited wealth increases and extremely varies in each country and among countries.

** The exemptions are above all for small and medium family properties, often of the primary sector. Usually they require a number of years during which heirs will demonstrate their continuity in the management of the inherited business property. Most countries specify size and sector required to obtain exemptions. Spain is one of the few countries where size and sectoral specialization is not indicated to obtain tax exemptions.

The table above shows that there are very few countries where the succession taxes, usually created either after the I and II World Wars, have disappeared. Interestingly enough, this category of countries with no succession taxes burdening family firm succession include on the one side Mediterranean countries with long history of fraud and corruption like Italy, and countries with a long history of transparency and high tax pressure like Sweden. Both, for different reasons, help the survival of family SMEs with this exemption of taxes. A second type of countries are those where there has been a tendency to concentrate the taxation on the transmission of wealth through fixed taxes (UK and Ireland). Most of the countries of the table fall in a third category, which is one in which a progressive concept on the taxation of wealth transmission is applied. Progression meaning that it takes into account levels of wealth ownership and also degrees of kinship (closer kin paying less than more distant kin). It is interesting to observe that it is the U.S. where the maximum tax rate is applied in the sample, something which is even supported by the wealthy in that country (a letter addressed to President Bush in 2002 by members of the Rockefeller and Gates families, among others, available in internet, pleaded for avoiding the repeal of the estate tax, to avoid the creation of an "aristocracy of business" where blood and not merit would be the sticking glue). [5]

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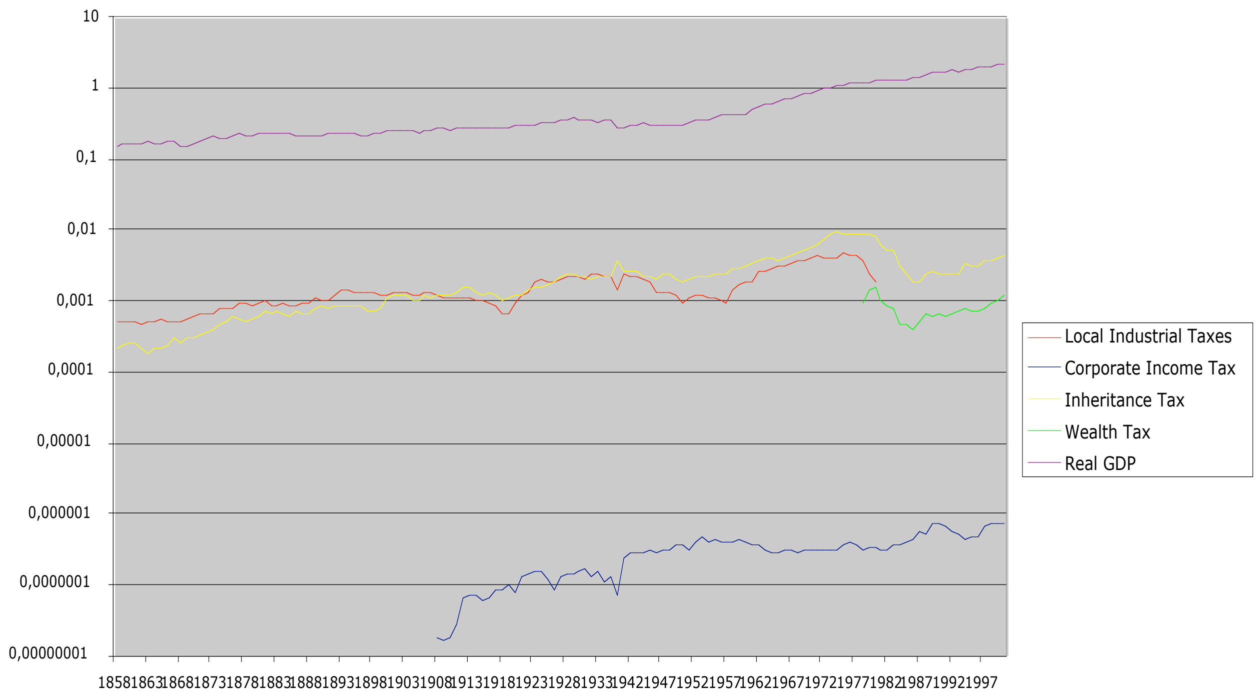
[5] BBC News, Wd. 14 Feb. 2001 "Rich Americans back inheritance tax". William Gates Sr, father of Bill Gates, organized the petition. Around 120 rich Americans, including billionaire investors George Soros and Warren Buffett, supported the petition that a repeal of the estate taxes (assessed on the net worth of an individual at death) would damage government essential governmental programmes or hurt families on

Spain falls in an average situation within this sample of countries. With a progressive system of taxation, the maximum rate paid by close kin inheriting wealth and estate is far from France, UK or the US, closer to Belgium and the Netherlands, and certainly very distant from the tax exemptions of Italy or Portugal –its Mediterranean neighbours. A historical overview on the evolution of taxes on inheritance and wealth in Spain that may more easily have affected family firms is provided below:

Evolution of several taxes and GDP (real series per cápita)
1858-2000



Source: Carreras, Prados and Roses (2005) chart 17.6, p1337, Comín and Díaz (2005), chart 12.10, p 918, and Barberán (2005), chart 1.
No available data for population before 1858 and no data for taxes between 1935-1940.
Notes: Inheritance Tax is Impuesto de Derechos Reales and Impuesto de Sucesiones
Local Industrial Taxes are Contribución Industrial y de Comercio, Impuesto Industrial and Impuesto de Actividades Económicas
Corporate Income Tax is Contribución de Utilidades and Impuesto de Sociedades

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low incomes. Buffett said that repealing the estate tax would be like “choosing the 2020 Olympic team by picking the eldest sons of the gold-medal winners in the 2000 Olympics” and that would lead to the creation of an “aristocracy of wealth” instead of a meritocracy.

The graph above, which is the result of a research still in progress, seems to show first of all two periods in Spain where there was a clear divergence between the evolution of GDP per capita on the one hand, and the per head evolution of four groups of taxes closely related to wealth and business transmission typically linked to a family firm (local industrial taxes, corporate income tax, inheritance tax and wealth or estate tax).[6] These two periods are Franco's dictatorship (1939-1975) and the years of transition to democracy and economic crisis of the 1970s and 1980s. If we confirm these observations with further research the graph would be showing probably two important periods of tax evasion and corruption. The historical contexts in which this would have taken place are quite different, however. Whereas during Franco's dictatorship the law was extremely flexible and exemptions blossomed to favour tax evasion (Hernández Moyés, 2006), during the democratic period extremely tough fiscal laws were designed to obtain revenues from private firms and groups to finance a declining public sector and rising social expenses derived from the economic crisis. In order to understand these gaps between the evolution of GDP per capita and the evolution of tax revenues per capita affecting family firm succession we will adopt an evolutionary and institutional perspective and will stop to observe the main legal changes that took place during the 19th and 20th centuries. This way we will better indicate the historical roots of current legal rules of the game affecting family wealth transmission, and the different effects these have on firms of different sizes and ages.

2.1.1. The laws on inheritance and wealth in Spain during the 19th century and first third of the 20th century

The definition of a "family firm" as a subject of study is a product of recent scholarly historiography still under debate, where there is no consensus. Nonetheless, family businesses are very old, and most scholars would agree that they are those businesses where relatives of the same family or different family groups are involved to control strategic decisions.

[6] Wealth tax included since 1978 until 2003 basically real estate properties, though an official report of 2003 indicated that around 35% of income related to this tax was made of shares of firms not operating in the stock market (a conservative and safe investment which has great fiscal advantages in Spain). El Nuevo Lunes, June 19th 2006.

The first taxes on wealth transmission appeared in Spain in the late 18th century and first decade of the 19th century, very linked to the loss of the American continental colonies and the need to obtain more revenues to finance more expenses linked to war situations at the time (Solé, 1967). During the nineteenth century taxes began to have a more clear shape, especially after the fiscal reform of 1845, in which a reorganization of taxes took place. So, by this year, all industrial activity was subject to an industrial tax (*Contribución Industrial*). This tax was based on a canon related to the number and kind of production machines or elements of production of different economic activities.

The Inheritance Tax (*Impuesto de Derechos Reales*, established in 1872) also affected small firms. Generally taxes were sensible to the transmission of the family firms, and so the law included exemptions for wealth transmitted to kinship in first degree (descendants). Small craft business could have benefited from these legal rules. Through the 19th century this tax appears and disappears according to legislation and the politics.[7] From 1867 onwards, movable property was also taxed. This is significant: when movable property is more heavily taxed than real property, it affects in a greater extent entrepreneurs without real properties and self-employed. Moreover it could benefit the rich and owners of real estate, who did not have to pay so much for this tax. This policy was maintained in the general fiscal reform of 1900.

The reform of 1900 created (after the loss of Cuba, Puerto Rico and the Philippines, which meant big spending and shrinking revenues for the Spanish State) another main tax, the future Corporate Income Tax (*Contribución sobre las Utilidades*). Soon, in 1906, all types of factories were required to pay for this tax. From 1921 it affected commercial firms. Since 1940 it affected all kinds of firms. Moreover, public limited companies were forced to pay for the already existing industrial tax, which was even more costly.

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[7] The first antecedent of the Inheritance Tax was the Manda Pía Forzosa, a fixed tax on the wills. After this, there was another tax development, in 1829, which consisted in a 0,5% on real estate transfers, plus a 4% on real estate sells plus a 2% on inheritances between spouses and a 12% when there was no will. In 1835 it was revoked because of its unpopularity. In 1845, along with the more important fiscal reform in Spain in XIX th century it was established again. (Barberán and Malo 2005).

In 1932[8] some changes were made in the inheritance tax, which had consequences on big business people. A legal measure increased a 20% the tax rate on transmitted wealth. Two years afterwards the project of the minister Chapaprieta appeared in 1934. He pretended that all the "reserves" of companies were taxed as if they were capital, and that the Inheritance Tax had to be applied without distinction to all inheritances, even to close relatives that had been previously enjoying exemptions and light tax pressure. This was too revolutionary, and the Inheritance Tax was rejected by the upper class.

2.1.2. The Francoist regime (1939-1975)

During the Francoist Regime a dictatorship was established.[9] As the Administration did not have the right means to check if all fiscal subjects satisfied their fiscal duties, it was implemented a system with origins back into the XIXth century. This fiscal system consisted in the payment of an amount of tax whose burden had to be distributed among the members of a profession. As many authors have pointed out, in the long term this system favoured the flexible negotiation of the fiscal burden and the creation of lobbies inside each profession and economic sector to reduce or avoid payment. Usually the bigger the firm the easier to be in the commissions that decided how to pay the amounts fixed by the state to be paid by each profession or sector, so the bigger the firm the easier to reduce the amounts to be paid, and the smaller the firm the more difficult to avoid unwanted fiscal pressure.

In the fiscal reform of 1957 it was made compulsory that any firm that wanted to begin an industrial activity, had to pay a license, besides the industrial tax (this linked to benefits).

During the 1960s Spain enjoyed the benefits of living near the European neighbours that were living the golden age of growth, and also the benefits of the new strategic situation in the cold war that made Spain interesting for US investments. Multinationals rushed to

[8] That is during the Republic period (1931-1936), in which more social measures were implemented.

[9] The dictatorship extended from 1939 to 1975. It was the result of the civil war between "republicanos" (supported by left wing parties) and "nacionales" (supported by right wing parties). Politic matters were dominated by the decisions of the Chief of State, Francisco Franco. In economic matters some kind of liberal economic philosophy was implemented, as we shall see.

invest in a potentially good market like Spain, and Spain's GDP per capita and industrial production rates performed extremely well. The time was potentially good to increase taxation on wealth creation. The big legal change in this period happened in 1964, with a fiscal reform that established the new legal frame. In respect to the Inheritance tax, it was finally separated from the Wealth Tax, beginning its own path.

In the same year it was created another important tax. Although it was an indirect tax it complicated things for enterprises: the Tax on the added value (*Impuesto sobre el tráfico de empresas*). This was a tax on all the added value generated by a firm. The problem was that it increased in excess the costs of productions through the increase of inputs, at a time of increased inflation. This rising burden was to be a problem for all firms that suffered the price crisis of the 1970s.

2.1.3. Democratic period (1975 onwards)

With the beginning of the democratic period in Spain, some things changed. First of all, the wealthy were the target of the new governments that had to control the 1970s oil crisis during the political transition to democracy, a time when rightist forces slowly allowed the participation of unions and socialist and communist parties in the political arena after 40 years of prohibition. Leftist forces agreed to perform a smooth role and tried to avoid big strikes or actions against the economic crisis due to the delicate political situation of transition to a new democratic order. In this context a new tax was born, the Wealth Tax or estate tax (*Impuesto sobre el Patrimonio*). It should be just a tax for the control of the Income Tax, in an eventual size-cross check of taxpayers. Since 1991 it has become compulsory. This was more than a new tax. It was a tax on individual wealth that had a progressive idea of burdening people according to wealth. It was no longer the old system of taxing professional groups who in an internal way far from the authorities decided how and who had to pay what. Rules of the game sharply changed, and affected in a serious way not only the wealthy entrepreneurs but also family firms in which individual and collective wealth was so closely intertwined. This was a tough moment for family-owned firms, in which personal wealth and productive wealth was mixed. In parallel with the new estate tax, the old inheritance taxes went up, and the maximum rate on inherited wealth now could go up to 40 per cent of the value of the total wealth (personal, and entrepreneurial) of a person. Succession after the death of a member of the management of a family firm could mean in fact the need to sell the firm to allow heirs to pay taxes. Old firms in second or third generation in management saw this as a real threat for the continuity of a family firm, after the rise of death duties in 1978 and particularly with the combination of this with the compulsory payment of the Impuesto de Patrimonio (created in 1978) in 1991.

Political rules of the game also changed in the last decades because the central government started to allow that the newly created regional governments legally collected inheritance and estate taxes. From 1980 onwards the regions of Spain (CCAA) have acquired competencies in the management of some taxes. In particular, the Inheritance Tax, the Tax on the Added Value, the Income tax, Transfer Tax and some other special called taxes. The competences of all regions regarding tax collection in Spain have been increasing. From the Inheritance Tax the regions collect all the revenues produced in their own territory (that is, all the collected revenues generated by the firm settled in it). Moreover, they also are allowed to regulate the rate and the creation of exemptions and deductions. As it is easily understandable, this situation generates today a competitive race among regions to capture the more number of firms as possible settled in its country. And this occurs just in a moment where the globalisation forces the struggle for the lowest costs of production, in order to try an internationalisation into the European markets. This is the reason why firms seek the best region to settle and the regions seek the best fiscal landscape for them. Looking at the different Spanish regions, we find a group of them which have preferred to establish fiscal deductions on quota about ninety or ninety five per cent of the burden for the lowest kinship degrees. With this formula, they pretend to reduce the total amount to almost nothing. It is the case of Murcia, and Castilla-La Mancha and Castilla- León, Baleares, Galicia and Valencia. In Cantabria and other regions as La Rioja and Asturias, they opted for setting a small coefficient. That is, to pay only a 0,01% on the quota. The effect is similar to the cases above mentioned. Madrid has exonerated the donations for close relatives. All regions are trying to compare to the favourable tax situation of two historic regions: País Vasco and Navarra. These regions have had a very kind legislation in this respect because of their historical privileges (fueros). In Madrid a mild legislation for firms has created a stimulating effect in the last years, according to IEF (2007). As a consequence, it brought more capitals to the region of Madrid.

In this section we have revised the fiscal evolution in Spain since XVIIIth century. We would like to continue in the next section with the legal components of tax elusion or tax exemption.

3. Section 2. Tax exemptions in Spain

3.1. Possibilities of tax exemptions, fiscal elusion and other advantages for firms

Although it is very common nowadays to speak of tax exemptions for firms or individuals, this concept has had an evolution through History. The reasons to create tax exemptions have increased in the last two centuries in relationship with the general evolution of the economy and its complexity.

From the moment in which a tax on inheritances was born, in the late 18th century and during the 19th century, we can already find the existence of a very early exemption to pay to benefit certain heirs. In these cases the exemptions were valid for first-degree relatives, those established "in favour of the State" [10] and those for charity.

In the very early time when the tax was established, it fell on death deeds. The amount was fixed for each deed. When the heir was the State or charity, the State renounced the collection of the tax. State, as it was common for this period, did not interfere nor hinder what individuals did. As time went by the law started to establish differences among potential heirs who could benefit. The tradition in Spain has usually preserved the following rules: a deceased person's wealth has to fall on first line of direct blood-related descendants, and the testator is forced to leave at least one third of the wealth to his or her descendants (considered "forced heirs"). There are regional traditions preserved by law that may help the deceased person concentrate the transmitted wealth into a few heirs as in Catalonia or Basque Country, and others of Castilian origin that preserve the right of all direct legal offspring to receive equal shares of parents´ properties.

[10] In 1881 a tax exemption was declared on those inheritances established for the State. In 1908 there was an exemption on the farm banks or non-profit institutions. In 1910 the minister Cobián eliminated the exemptions on descendants, back again exempted in 1932 in the republican period.

With the arrival of Francoist period, the laws added more cases for the application of exemptions as, for instance, those related with state-subsidised houses. Along the 1960s and 1970s the cases included to benefit from payment exemption increased even more. The literature that sums up these tax-exemptions are: Fuentes Quintana, (1990), Barciela (1994) for the 1940s and Díaz Fuentes (1994) for tax-exemptions between 1951 and 1954. Gunther (1980) said that some of these policies were adopted in order to reward supporters of the regime. However it is not clear yet how economic priorities were set. Possibly in the sixties the more relevant exemptions family firms could enjoy were the important reductions that life insurances had: there were 500.000 pts (3005 euros) off for close kinship. Anyway, the remaining had a reduction of 90%, which decreased for distant relatives. For the owners of small farms there also were exemptions on some titles or on the soil worked directly by the farmer.

The State settled the exemptions. Generally they were the result of several policies to promote industries in some underdeveloped areas. Nevertheless some lobbies appeared to get also some other particular benefits for their industries. Lobbies tried to get some fiscal benefits. This seems to be proved for the case of Vizcaya steel sector in the years of oil crisis (1973-1974).[11] But there were numerous attempts to obtain payment exemptions. The need for protection against competition was the main reason behind the attempts to get fiscal benefits in some industrial sectors like the steel sector above mentioned, but also in the fishing sector (Valdaliso, 2001) and agriculture Barciela (2003, 120). Aurelia Hernández has studied in her doctoral dissertation the *modus operandi* to pressure for tax exemption during Francoism: as law had to be approved in the Cortes (Spanish Francoist Parliament), some lobbyist working for those interested industrial sectors began a relationship with the Procuradores (members of Parliament) to amend laws in tax matters (Hernández Moyés, 2006).

These policies of granting tax exemptions to promote the economic activity of pressure groups continued in the democratic period, more specifically in the early 1980s. It was then when an industrial restructuring took place in Spain, to reduce an oversized public industrial sector and some inefficient private firms (Bel and Costas, 2001). The huge

[11] Archivo General de la Administración, (6) 51.00 box 34.

industrial sectors developed by the Francoist period benefited from this financial support of the State. Given that in the Francoist period the industrial trend to promote industrial development was defined by the creation of those huge industries, the bulk of subventions went to those industries (Simón, 1997). That means that small and medium enterprises (SME) with economic problems were in great measure discriminated in comparison with big firms. Simón (1997) has calculated that the fiscal exemptions in all those taxes related to firms (especially Corporate Income Tax) reduced State revenues a 30% of the budgeted amount during the years of the industrial reorganization of the 1980s and early 1990s.

In the early 1990s there were more fiscal sensibility regarding the family firm, in the sense that policy-makers declared in the media their awareness about the role they seemed to be playing in the economic growth of the nation. Since 1995 there is a 95% tax exemption of wealth transmission when the family firm ("the productive side" of the wealth of individuals working in a "family firm") is transmitted to close relatives.[12] According to De Pablos (2001) there has always been a general trend to elude taxes whenever it was possible. The Spanish Family Firm lobby (Instituto de la empresa familiar, IEF) had managed to make authorities understand that family firms played a big role in the Spanish industry. Since its creation in 1992 they have put several proposals on the table in order to reduce the fiscal burden of the transfer of family firms. To do this they even tried to amend the legislation with the help of a Parliament party (CIU) –the same pressure mechanism used in the 1960s and back during the late 1890s!!. [13]

So owners of family businesses have used their abilities in order to get tax exemptions. But they can also try to obtain these exemptions through other ways. There are also financial and commercial mechanisms available. Generally, as they involve knowing all the intricate of the legislation, these mechanisms are only within reach of firms that can pay for the best consulting services. In short, only big firms may do use of them.

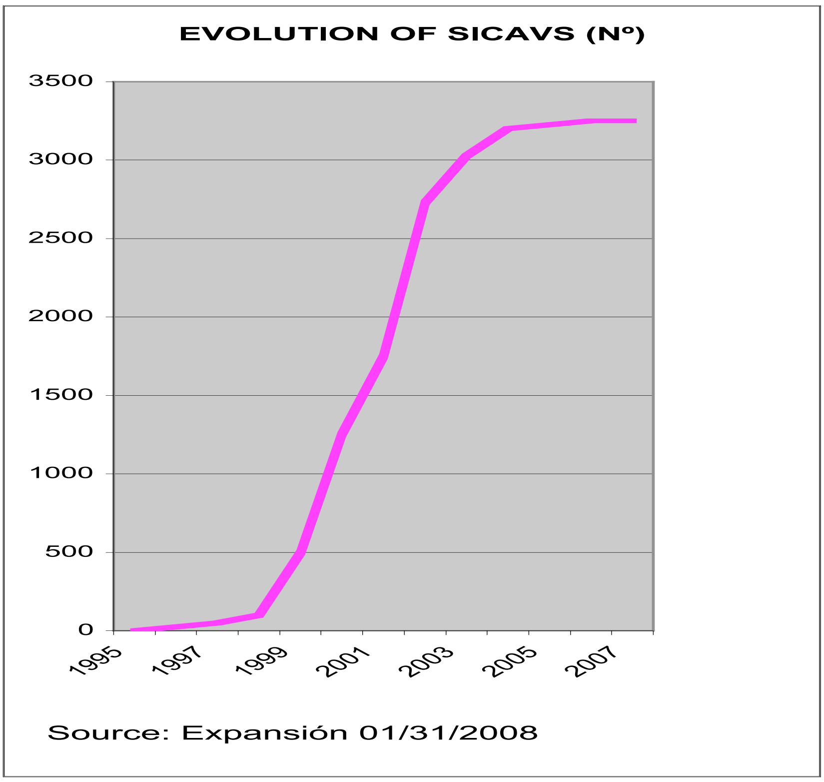
[12] It was so when some conditions appeared, as running with the business for at least ten years and some others.

[13] More on this issue appears in the paper to be presented by Fernández and Puig during this EBHA conference in Bergen August 2008.

Among these financial and commercial instruments we emphasize the creation of investment companies with variable capital (in Spanish called *Sociedades de inversión de capital variable*, SICAV), a common investment instrument in Western Europe. For Spain the main feature of these companies lie in its reduced tax rate in the Corporate Income Tax. In Spain corporate tax rate is 35 per cent, but for SICAV´s it is only 1 per cent. That means that these companies can become a company for the tenancy of patrimony. It is needed 2, 4 millions euros and 100 partners in order to create them. That means that it is only available for some fortunes.

In this chart, it is possible to observe the increasing evolution of the SICAV´s phenomenon in Spain in the last years, in which large family firm groups are playing an important role, taking advantage of recent favourable legislation that allows the protection of their patrimony and wealth –a legislation much more complicated to know and use by micro and small family businesses-.

Number of SICAVS constituted in Spain, 1995-2007



There is also another financial instrument to modify the financial capacity of the companies: The "amortization" of the so called "fondo de comercio" (accounting for intangible assets). This concept appeared for the first time in the Spanish Chart of Accounts of 1973 and still stands. It is based upon a 1933 law on business establishments. When they were about to be sold it was important to know if the price asked was fair. So in the official state gazette they had to advertise including not only the name but also the turnover, patents, trademarks, number of customers, and "every other sign to recognise the accurate value of the establishment" (Perales, 1974). In the 1970s it seems to have been not as used and useful as it is nowadays, when Spanish big firms are buying firms abroad and benefit from this fiscal reduction in buying foreign intangible assets, during at least 20 years! Recently Brussels kept an eye on this matter, as it constitutes an infraction of the Community legality. In particular it goes against the article 12.5 of Corporate Income Tax law.[14]

4. Final Remarks

- There were three periods during which succession taxes, or the burden on family wealth transmission, was not a big issue: a) the nineteenth century (when tax rates were an estimated low amount), b) in the Francoist period, and c) after the 1990s (when the Inheritance Tax was handed over the regions sovereignty, the Inheritance Tax lost its importance). On the other side, there were other historical periods during which the burden increased and was felt like a big constraint by the wealthy and the owners of medium and large family firms: in 1900, 1920, in 1932 (II Republic), and after 1977 (new democratic governments)

- In Spain there has always been a slack tax system, which taxed, above all, the personal and familiar wealth, especially with indirect taxes. As it is known, indirect taxes damage more low-class population. However, in general the tax system has been for many decades relatively benevolent with corporate wealth, and in short periods of time extremely damaging. One would say Spanish tax legislation on wealth transmission has had no middle situation during the last

[14] "Brussels against Spain". Cinco Días, October 22nd 2007.

two centuries: either it has smashed the wealthy and owners of medium and large historical family firms or it has left them alone doing their own will.

- There has always been a difference between tax rates in personal and corporate commodities along these two last centuries. As an exception we need to mention the gap between the seventies and nineties of the XXth century. The tax affecting corporate commodities was increased, damaging family business in Spain.

- Since the last years of the XVIIth century to the last years of the XXth century, Governments have only dared –in a very slightly manner– to tax the corporate wealth through taxes that were not always compulsory. Besides, the collection of taxes depended on the professions´ quota assigned to them. This opened a door for the negotiation. In the first third of the XXth century there was a trend, despite the resistances, to separate personal and corporate taxes. This trend becomes clearer after two events. One is the generalization of public limited companies in Spain. The second is the moment of the development of capital-intensive companies from the second technological revolution, when new national and foreign companies settled.

- The Republican period. Between 1923 and 1935 fiscality was at the rear. Politics were only worried about the balance deficit and how to solve it. This praxis was the only one admitted in a prekeynesian era. As a consequence, it impeded the evolution to a modern fiscality through the main idea of using state revenues and expenses to correct market failures.

- Nevertheless, statements made by ministries, let us think of other ways to solve economic and fiscal problems. Economic thought in Calvo Sotelo (economic ministry of the Republic period) demonstrated that he actually was disposed to use taxes to redistribute income, fighting against poverty and illiteracy through a well-planned policy. These plans finished abruptly with the civil war and the arrival of the Francoist dictatorship in 1936. Anyway, the historic dilemma of the Ministry of Treasure was an old though still very familiar dilemma: to pay attention to the balance budget or to face the severe economic problems of the nation. Obviously the problems in the real life were enough important as to devote the policy efforts to them.

- From 1997 to 1994 fiscal philosophies returned to traditional aspects. Firstly, because they allowed all those productive activities to have a better fiscality than that demanded to other non-productive activities (which are not the majority). Secondly, because Governments protected the family firms dully, as in the XVIIIth century. In those firms the personal and corporate wealth is mixed, especially in public limited companies. This could not have occurred if the incomes of other individuals more differentiated. When incomes are more differentiated, revenues are more easily under control. Nonetheless our hypothesis is the following one: the difference between now and the past is that Governments are now fiscally supporting family firms not only as a consequence of lobbies´ pressure (though lobbies take all the merit about tax exemptions), but as an effect of a deliberately pursued state policy: since Spanish integration in the European Community Governments of all political signs have diminished the public firms and are encouraging the creation of private "national champions" able to face the huge competency found after the integration in the European Union.[15]

- Inheritance Tax is a tax that has helped the redistribution of income, but it has also been criticized for taxing wealth for a second time (after other taxes like Wealth Tax or Income Tax). Originally in Spain, as in Europe, tax laws applied according to the type of commodity involved and its origin. Even more, Governments have maintained the philosophy of collecting revenues with this tax, but changed the aim: in the democratic period the aim was to tax personal commodities separately from the taxes that affected corporate activities. This separation was clearly unfair with employees and with those that had small companies.

[15] "Spanish President Zapatero ruled out the proposal of creating national champions in Energy". Cinco Días, June 5th 2008.

- Comparing to Europe, fiscal policy related to family firms was not so different in Spain. There were only two differences: the chronology of the policy and the effects for the industry. There has also been massive pressure from family firms' lobbies for the last 15 years. Fiscal pressure was increased historically and it affected to family firms in a very unpleasant way in economic slumps. In France, for instance, tax pressure increased after the Second World War and in the early eighties. Yet in Spain that happened after the dictatorship period, when democracy developed.

- Our paper suggests that current debates about the role of transmission taxes (either as reducing wealth inequalities in a positive way for leftist-wing politicians, or as unfair mechanisms that multiply the taxation of wealth through generations according to family-owned businesses) miss the importance that these taxes may have had from a macro-level perspective in promoting (or not) different long-term conditions of competitiveness for firms of different sizes. Our paper suggests that the case of Spain indicates that laws regarding transmission of wealth are not neutral, and have a bias in its application considering size and its cumulative effects on growth and competitiveness. Our data also suggest that recent laws on succession transmission may be unfair for microfirms and small firms –which represent more than half of employment and wealth in Spain.

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