

CHAPTER 2

Working out inheritance in the family business in Brazil

Viviane GIRARDI

Tortoro, Madureira & Ragazzi Advogados, Brazil

and

Cassio S. NAMUR

Tortoro, Madureira & Ragazzi Advogados, Brazil

I. A Brief Introduction to the Family Business Environment in Brazil

1. This chapter aims to address the legal approach to the suggested solutions for succession in the family business. However, it is essential to discuss some initial elements of the reality of succession in Brazilian family businesses.

2. The family business has an important meaning, not only in Brazil, but also in other developed countries. In the US, there are thousands of family businesses, both small and medium-sized. Among the 500 largest American companies, as published by Fortune Magazine, 35% are family-owned. Around 75% of the jobs created in the US economy between 2000 and 2020 were through family businesses. In Germany, small and medium-sized companies, all family-owned and controlled, are responsible for about two thirds of jobs in the country. Coincidentally, in Germany, and England and France around 30% of the top 500 companies are family-owned. Wherever there is democracy and freedom of initiative, the family business will exist. Data from the Brazilian Institute of Geography and Statistics (IBGE) indicate that 90% of companies in Brazil have a family profile. As a result, they represent around 65% of GDP and are responsible for employing 75% of the country's workforce. (See: Vidigal, Antonio Carlos, *Viva a empresa familiar*, Rio de Janeiro: Rocco, 1996, p.15).

3. Succession is the ultimate test of a family business. In this sense, succession does not just involve one plan, but several. It is not a one-time event that occurs when an old leader retires and passes the torch to a new leader, but a process driven by a "clock" of development – starting very early in the lives of some families and continuing through natural maturation and the aging of generations. Succession always takes time. Even in cases where a sudden illness, or dramatic change, leads to abrupt changes in people's titles or roles, there is a period of preparation and

anticipation – the “passing over of the keys”, and a period of adaptation. (See: Kaelin E. Gersik {et al.}, *De geração para geração, tradução de Nivaldo Montingelli Jr.* – Rio de Janeiro: Elsevier, 2006, p. 194).

4. A recent study carried out in 2021 by EY and the University of St. Gallen revealed that among the 500 largest family companies worldwide, nine of them are Brazilian companies, by ranking: Marfrig Global Foods S.A., *Metalúrgica Gerdau S.A.*, *Votorantim Participações S.A.*, *Companhia Siderúrgica Nacional*, *Magazine Luiza S.A.*, *Cosan Ltda.*, *Energisa S. A.*, *WEG S.A.* and *Porto Seguro S.A.* (See: <https://www.pwc.com.br/pt/sala-de-imprensa/artigos/empresas-familiares-e-plano-de-sucesso.html#:~:text=Dados%20do%20Instituto%20Brasileiro%20de,75%25%20dos%20trabalhadores%20no%20pa%C3%Ads>).

5. Despite the impact these companies have suffered over almost two years of the Covid pandemic, resilience has prevailed. Many managed to change the direction of their business, adapting and innovating to support communities, confirming their commitment to social responsibility.

6. Perceptions of environmental, social and governance (ESG) issues are becoming more relevant as employees, customers, investors and other stakeholders are demanding that companies play a more active role in meeting today’s challenges, with 53% of family businesses formally reporting their ESG metrics. This is a very interesting adherence level, because this is not yet a level that is observed worldwide outside the scope of family businesses. However, family businesses still need to adapt to this new reality to attract new talent, win consumers and keep growing.

7. In general, family businesses tend to focus not only on the founder’s full attention, but also on most of their financial resources. The entrepreneur’s desire is to see their business grow vigorously and steadily. For this, they end up reinvesting the company’s earnings almost entirely in the company itself. It is not common for the founder to be concerned with creating personal patrimony. The company is all equity. For this reason, it is recommended that the entrepreneur dedicate attention to estate and heritage planning. This planning will ensure that the founder, or the generation that is currently in charge of the business, through the change of role inherent to the succession and continuity process, has the certainty that their needs will continue to be observed.

8. Heirs may face difficulties in the succession of the family business if they are not prepared to succeed. It is therefore important to prepare the successors. Not all heirs need, want, or are able to stay ahead of the business. It is necessary to separate inheritance management, which involves processes, as the heir is usually unable to continue the business that has been successful due to lack of technical preparation or a knowledge of the business to which he is a successor.

9. Another benefit of prudent wealth planning is separating company risks from personal risks, into a two-way street. If the company does poorly, its partners must be able to rely on their own financial resources and equity backing which guarantees them independence and results. Likewise, any financial crises which the partners may experience during the period they oversee the business must not interfere

with the financial management of the company. Proper planning is an effective tool in preventing this from happening. This thinking must be continuous in terms of taking care of the financial future of the business, and adding value to the collective patrimony.

10. Succession planning is the organising of the division of patrimony between heirs, and the establishment of administrative mechanisms for this patrimony, in view of the limitations imposed by legislation. In Brazil in particular, this is the Civil Code regarding assets destined to necessary heirs and those guaranteed to the surviving spouse or partner of a stable union or [*de facto*] companion to avoid future challenges or discussions in court. This aims to ensure the continuity of the business activity and avoid the dilapidation of the heritage built by a family business. With this planning, it is possible to avoid disagreements between heirs and partners and transfer the capital stock, whilst enabling a tax reduction which falls on the income of the individual, carried out through the legal entity based on the presumed profit.

II. Some Aspects of Brazilian Law in Matters of Family Business Succession

11. Brazilian law makes no distinction between assets received by inheritance. Therefore, the legal treatment is the same for any types of assets which includes corporate rights and participation. Under Brazilian law, succession can be governed exclusively by so-called legal succession, or jointly by testamentary succession.

12. With legal succession, the assets of the inheritance are collected and transmitted to the heirs in the exact terms the law establishes. In other words, it is the law itself which governs the entire succession, without the participation of any act or manifestation of the author of the inheritance.

13. Once the succession is opened, the assets are collected and the heirs pre-established by law are called to succeed, respecting the principles of equality of shares between heirs of the same class. Initially, the necessary heirs are called to succeed, which includes descendants, ascendants and spouses and stable unions or a [*de facto* companion], and only in the absence of this class of heirs are the other blood relatives summoned to receive the inheritance.

14. The class of necessary heirs – which in Brazil, under the terms of Article 1.845 of the Brazilian Civil Code – includes descendants, ascendants and the spouse or cohabitants in a stable union, where legitimate inheritance is guaranteed. This right to legitimate inheritance corresponds to a fraction of 50% of a person's assets. Therefore, the law places a limitation on the autonomy of the author of the inheritance who, when wishing to prepare his succession or even carry out a division in life, must direct this portion of the legitimate – the fraction of 50% of all his assets to his necessary heirs. This is in compliance with the legal order of Article 1.845 and Article 1.829 of the Brazilian Civil Code. Likewise, in terms of donation of assets, the legitimate fraction must always be respected when there are necessary heirs.

15. Alongside legal succession, Brazilian law establishes the so-called testamentary succession, which where the owner of the patrimony expresses his will regarding the destination of goods and rights for after his death. When there are necessary heirs, the Will must obey the limits of the legitimate fraction, and the author of the inheritance may freely dispose of the other half of his assets.

16. The Will, according to Brazilian law, can be made by public instrument or by private instrument, always respecting the formal requirements of this legal act. The Will can include any person, whether heir or not of the testator and, therefore, it presents itself as an instrument widely used in the context of successions involving business interests. Often, one of the heirs assisted or contributed to the family business and the others did not. Following the legal succession, at the time of the succession of the business owners, the heirs, usually the sons, would receive in equal proportions, the shareholdings, regardless of whether or not they contributed or worked in the company. If the testator wishes to remove this injustice or even harmonise the rights of those involved, the Will can be the legal means for attributing greater equity interest to one heir or another, or even to a third party who has contributed to the family business.

17. In turn, when there is no class of necessary heirs, i.e. in the absence of any descendants, ascendants or a spouse or cohabitant of a stable union, the entire inheritance may be disciplined by means of a Will, in which case the autonomy is broad and unrestricted for the owner of the goods and rights.

18. The Will also serves for off-balance sheet purposes. For example, for the recognition of a child, which also has a strong interference in the scope of business life when there is a [*post-mortem*] paternity claim. The Will is an instrument that is normally used together with other legal acts and transactions which can previously structure and establish the transfer of assets from one generation to the next, always with the aim of avoiding legal proceedings and, above all, family disputes which can often be responsible for important property losses.

19. Alongside the observance of legitimate and strictness regarding the class of necessary heirs, the law also establishes that the property regime – an institute of family law – affects the way in which succession is processed in Brazil. This is because the Brazilian legislator in 2002, when establishing the Civil Code in force, innovated by including two important aspects related to marriage and a stable union (or [*de facto*] union). One of the elements introduced and addressed by our criticisms was the inclusion of the spouse as a necessary heir. Previously, the spouse was included in the list of heirs, but not among those who were reserved and guaranteed the right to the legitimate. Presently, therefore, as the holder of the married estate, he is required to reserve the legitimate portion, and this is a sensitive aspect in the context of the succession of business families. This is either because the spouse, depending on the property regime, will already have guaranteed the right of sharecropping and, even so, will limit the Will, or because it is quite common for people to have children from different marriages, making succession more complex, especially in business families.

20. Another innovation of Brazilian law was the introduction of the so-called succession competition, which is where two different classes of heirs are called to succeed simultaneously. Therefore, the spouse of the deceased and his descendants, or the spouse of the deceased person and his ancestors, can be called to succeed at the same time.

21. In the event of succession competition with descendants, the participation of the spouse as heir will depend on the property regime adopted in the marriage. Under Article 1.829, item I of the Brazilian Civil Code, in the partial community property regime, conventional separation of property and final participation of the [*aquestos*], the spouse will compete with the descendants of the author of the inheritance and will inherit the mass of so-called private assets. Therefore, he collects his right to share in the mass of common property, if any, and participates as an heir, in the mass of the deceased person's private property. This is another very complex aspect in the context of the succession of family businesses, because the spouse may join or be entitled to receive compensation equivalent to equity interests which belonged exclusively to the family of the deceased.

22. This element of Brazilian inheritance law needs to be duly considered in the course of business life as a possibility, whether from the perspective of the founders of the company, or from the perspective of the heirs, to the extent that there may be entry into the society of spouses, who would not necessarily be desired as partners.

23. Therefore, in addition to the contractual clauses establishing rules regarding the [*affectio societatis*], the agreement of partners, or even the agreements between heirs, can be very useful instruments for the preservation and continuity of business activities in face of the death of those who make up the corporate structure.

24. A Will, donation and usufruct can also be instruments for carrying out succession planning. Restrictive clauses of use, such as inalienability, unsuitability and incommunicability can be imposed by the testator or author of the donation or usufruct, according to the need that the situation requires.

25. In addition to these characteristics, Brazilian law allows a person to share his assets in life, if all the requirements that would apply in the *post-mortem* succession are observed. Therefore, in the presence of the necessary heirs, the legitimate must be observed as well as the effects arising from the regime of assets of those involved. In sharing, the heirs appear to agree with the act and this matters as the collation of previously received goods can be foreseen.

26. Noteworthy is the prohibition of the waiver of inheritance law when succession is not open as Brazilian law prohibits the inheritance of a living person from being the object of a legal transaction. This is another element criticised by the doctrine in Brazil because it limits the autonomy of those involved, even in the context of a broad transaction with capable agents and free expression of will, as are the pacts involving heirs.

27. In addition to the aspects inherent to civil law, Brazilian succession establishes its own taxes to be levied on so-called non-onerous acts, such as donation and

inheritance. This aspect is curious because each Brazilian state has its own competence to allocate these taxes, which can generate the incidence of several state tax laws in the same succession depending on the location of the inventoried assets.

28. In turn, as the inventory process, in the context of Brazil, can be carried out by judicial or extrajudicial means, and in this case before the public notary, it is possible, depending on the movable nature of the assets, that the inventory is carried out in a state of the federation where tax rates are lower.

29. By way of illustration and far from exhausting this subject, below is a list of the main mechanisms for the implementation of business succession planning:

a) Formation of a foundation with the shares or quotas of the company, and with the totality of the social patrimony for a philanthropic social purpose, with the exemption of taxes.

b) Constitution of a trust or a holding company, with the purpose of participating in the capital of other companies, to the extent that control over them is assured, enabling the reduction of the tax burden and the organisation of family assets.

c) Creation of a company, allocating movable or real estate assets for the formation of its share capital, later donating shares to future heirs with usufruct reserve for the donor.

d) Constitution of an exclusive investment fund for the management of the financial resources of the owner of the equity, as with such resources, the quotas of this fund will be paid in. These shares may be donated by the owner of the equity, reserving the usufruct for himself to continue managing those resources and earning the gains from the financial assets.

e) Transformation of a limited liability company into a joint stock company, donating common shares (50%), with usufruct reserve, to children who have experience as administrators, and preferred shares (50%) to others who do not have the vocation to manage a venture.

f) Drafting of a shareholders' agreement, establishing a qualified quorum to approve matters related to the company's functioning, such as, changes in the percentage of mandatory dividends; sale of assets, appointment of a representative on the board of directors, etc.

g) Use of alternative transactions capable of providing continuity and growth to the family company, such as, the sale of assets to obtain funds to restructure the enterprise; sale or exchange of minority interest to obtain resources or share know-how, and; joint venture, enabling companies to cooperate with each other.

III. Conclusion

30. These are just some of the aspects affecting the succession of companies in Brazil, which, in addition to knowledge of corporate and tax law, also requires the participation of specialised lawyers in the fields of family law and succession law.

31. Undoubtedly, when referring to business succession, the prevention and structuring of an adequate asset transfer plan is the path that should be followed

and encouraged to preserve the business activity and, above all, as the owner of the business participates in most cases, this helps drive this process.

32. For succession planning to be considered valid under Brazilian law, in addition to observing the corporate and tax aspects which involve the various business strategies for transferring assets from the owner of the patrimony to his heirs, it must also observe the institutes of succession law and family law.