LEGAL AND ECONOMIC CONTEXT OF THE CZECH CIVIL CODE RULES ON FAMILY ENTERPRISES

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Abstract


The family-run business model is in the Czech Republic not used in the scope, as it is the case of other EU Member States. Until recently one of the reasons was also the absence of a legislative framework that would give to the family business or its organization a comprehensive and systematic rules and a stable order. This has – from a part – changed since January 1st, 2014 with the entry into force of the new Czech Civil Code, Act No. 89/2012 Coll. The present paper aims at pointing out the ways, forms and the diversity of family business from business in general according to the legislation in the Civil Code introducing in its Sections 700 – 707 the institute of family enterprise. In the context of economic-legal analysis undertaken some aspects related to the family enterprise are highlighted, in particular the sharing of profit gains, employment of family members in the operation of the family enterprise and the continuing of operation of the family business after the death of the family member being in the legal position of the entrepreneur.

Keywords: family enterprise, business, ownership, gains from performance of family enterprise, family ties

INTRODUCTION

Family business can be considered a very important part of national economies. Family businesses are significantly involved in the formation of the national GDP. Koiranen (2007) characterizes the family businesses as “the backbone of the European economy”. By far we can’t say that the family business fits only within the category of small and medium business. Among family businesses we find those that fall into the category of large enterprises, that is, undertakings that employ more than 500 employees.

In the Czech Republic, the family-run business model is not used in the scope, as it is the case on other EU – Member countries, in particular in the countries of the former “EU-15”. Countries like Spain, Austria, Italy, Germany, or the United Kingdom are the typical ones of the European Union showing a high level of family business. As to the Czech business environment, however, we may say that its form of business stays often underestimated. The cause is partly the historical development of the discipline of business, which begun to flourish relatively recently – much later than in the former quoted. Among other reasons belonged – until recently – also the absence of a legislative framework that would give to the family business or its organization a comprehensive and systematic rules and a stable order. This changed from a part since 1st January 2014 by the entry into force of the new Czech Civil Code. Nevertheless, the family-run business represents by now only around 30% of all business entities in the Czech Republic, among them such important worldwide known firms as Koh-i-noor, Petrof, ZON or RAVAK. (Plhoňová, 2013) However, it is worth noting that the share of family-run business on the Czech annual GDP amounts to 40% and it grows both in size and importance (http://www.rsmfamilyoffice.eu).
MATERIALS AND METHODS

The paper aims at analyzing selected issues of the new legal regulation, focusing on significant aspects of the institute in the context of economies, commercial law and family law, as well as to highlight the potential weaknesses in the regulation itself. The research was made on the basis of use of general theoretical scientific methods. The use of analytic method is accompanied by the historical method when comparing the rules contained in the former Commercial Code. Comparative method is employed also in the highlighting of the origin of the new institute and its relatively recent formation.

Paper starts with characteristics of the features of family enterprise. After that it defines the family members who are legally entitled to be involved in the operation of a family enterprise. Leading role belongs logically to the owner of the family enterprise and thus the subsequent part characterizes its specific position among the family members including the ownership of the enterprise. After a brief characteristic of the formation of a family enterprise, the following part focuses on claims that belong to family members involved in the operation of the enterprise. Explanations on the transfer of participation in family enterprise are followed by the regulation of possibilities for termination of participation by family member and – finally highlights the advantages and prospects for this type of business in the future.

RESULTS

Family enterprise – a new legal institute

The regulation of a family enterprise has no tradition in the Czech law. In recent years the family-run business entities, where the family members work under the guidance of one family member, without being regulated by mutual contractual relationships, gained on importance. Typical examples are facilities founded and run in the agriculture, gastronomy or accommodation sectors. Before 2014, the specific features of the relations between the family members who were personally involved in the operation of business enterprises of family type have not been taken into account by the rules of ius privatorum.

The new Czech Civil Code (“CivC” thereafter), law No. 89/2012 Coll. brings new rules for an entity called as family enterprise, in the provisions of Section 700–707 CivC. The roots of this regulation we may find in the Italian Codice civile (Art. 230bis) – notwithstanding the fact that Czech civil law tends to incline traditionally rather to Austrian’s ABGB or German’s BGB. According to the explanation given by Explanatory Memorandum to the CivC, the rules are aimed at filling the gap in regulation where the family members are in fact working for a family enterprise without their rights and obligations would be governed by a special contract closed to that purpose. And to aim was the Italian regulation more suitable as it is of recent date (introduced by the 1975 revision of the Code) and quite complex (see more in Piccolo, 2008).

The provision of Section 700 CivC specifies: “The family enterprise is a kind of commercial enterprise in which spouses and persons within a defined family relationship work together with at least one of the spouses and which is in the ownership of one of these persons. Those members who permanently work for the family or for family enterprise are viewed as family members involved in the operation of the family enterprise.”

This legal definition respects the main features of the family business that are stressed by many authors as part of the definition of family business in general, i.e.:
- degree of ownership,
- intention to the succession, and
- involvement of the family members in the business (Vallone, 2013).

**Family enterprise is no legal person**

The establishing of family enterprise does not create a legal person, it is not recorded neither in the company or another public register. It is in essence a contractual cooperation of natural persons within a family. As participating may be even persons that consistently work for the family. Family enterprise is thus not characterized by the subject of business, but by persons, who are involved in its operation. The institute of a family enterprise is intended first of all to offer to family members who work on the permanent basis for a family business and whose legal position is not ruled by a sort of family-bound contract certain protection and legal title to demand their legal rights.

We may imagine the family enterprise as a set of business assets serving to commercial purposes, in the operation of which are involved – through permanent labor participation – the members of the wider family without being partners of the company or being employed on the basis of a labor contract.

We may characterize the family enterprise as a special type of the commercial enterprise under Section 502 CivC. The advantage of the family enterprise is that its members regulate their mutual rights and obligations, profit shares, etc. by a contract. In the case of a family enterprise there are not – and shall not be – any rights and obligations arising by establishment of commercial company or cooperatives on the basis of articles of association or statutes, contract of silent partnership or labor contracts concluded between the members of the family. Members of the family enterprise are not partners, employees, but necessarily even not entrepreneurs. A family enterprise may operate in the way that only one member of the family
enterprise shall own a trade license for running the family enterprise.

Membership in the family enterprise

Member of a family enterprise becomes everybody who is involved in its activities i.e. persons who perform work for the family enterprise or who works on a permanent basis for the family any by that facilitates the operation of the enterprise or makes it possible.

Participation in the family enterprise is attached only to persons that are family members, cannot be transferred to anybody else. This rule has one exception, and that is the transfer of family member rights in the enterprise to another family member (for example, the son may transfer the participation to his sister). However, the latter is possible only in the event that all family member who are involved in the operation of the enterprise shall agree. Should only one member disagree then the participation can't be transferred even if all other members agree. (Petlina, Koráb, 2015)

Participation in the family enterprise shall always cease to exist in the case of the sale of the enterprise. When selling the family enterprise the family members shall always possess the pre-emption right. Similarly, in the case when family enterprise becomes subject to heritage, member participating in the operation have the right of priority to inherit it.

Participation in the family enterprise shall cease for a family member also in the case he/she terminates to perform the work for the family or the family enterprise, for example if a daughter who has worked as an accountant in the family enterprise ceases to work and moves abroad. Similarly, the latter may cease to exist in the case that instead of the previous work as a member of the family enterprise a person continues to perform the work on the basis of a contract of employment or, for example, begins to work for family as independent entrepreneur with a trade license for accounting.

Entitlement to a share in the profit created

Family members who are in fact involved in the operation of the family enterprise itself, are entitled to “their share” in profits generated (also to a share in property acquired from the profit as well as in increments to the enterprise), this extent that corresponds to the amount and type of work done by them. We should be aware that individual members of the family may have different opinions on “the importance and the benefits” of the work done by them for the family enterprise.

Here it should be noted, in accordance with the “Explanatory Memorandum” regarding the standard of living of family members, that “even a child that does not participate in the operation of the family enterprise (e.g. for health reasons, duration of studies etc.) can’t be served worse than his/her sibling, who works for the family enterprise. Only a fully legally capable person may waive his/her share in the profit (or even a part thereof), this in the due form personal declaration. This declaration must be done as public deed, e.g. declaration pronounced before and recorded by the notary public. It must always be evident that the declaration was manifested freely by the person and without any coercion by somebody other.

Since the family enterprise is intended for subsistence of the family, all family members who are involved in the running of the enterprise, are entitled to decide on:
- utilization of the profits (and how to deal with increments),
- matters outside the usual operation,
- changes to the basic principles of the enterprise operation or its suspension.

Decisions shall be taken by the majority of votes of the family members. To this issue the Explanatory Memorandum to CivC notices that the decision-making on the above matters is entrusted to the entire “family community, or to all members of the family involved in the operation of the family enterprise without regard to ownership or co-ownership”.

Therefore, even if the family enterprise shall be, for example, in the joint property of the spouses, it will not be – in a situation where in its operation are involved their daughter with her husband, the husband and wife’s brother and/or grandparents – in the sole discretion of the spouses only to suspend the operation of the enterprise, even though they have it in their joint property. The decision shall belong to all parties involved by majority of votes – exactly because the enterprise represents a source of subsistence for all of them and the family as a whole.

Should a person who is incapacitated be among the family members, then:
- in the case of minors it shall be for the vote represented by his/her legal representative,
- in other events such person shall be represented than by the guardian.

In order to maintain the family enterprise in the hands of family members who are actively engaged in the business, the family member who was involved in the operation of the family enterprise, may take the advantage of:
- pre-emptive right when assigning the family enterprise (co-ownership share thereof) and/or property which, according to its nature and previous determination, served permanently for the operation of the family enterprise,
- priority rights when dividing the succession by the Court – according to the Explanatory Memorandum to CivC, especially situations where a division of the succession shall occur according to the last will of the deceased by the decision of a third person.
The participation in the operation of family enterprise terminates as follows:

- by a disposal of the enterprise, or
- member ceases to perform work for the family (even situations when a person who takes care for the family house where the whole family lives stops his activities due to illness, age etc.) or
- the legal grounds for the person's involvement in the operation of the family enterprise changes (e.g. the person enters into an employment relationship by closing the labor contract).

Upon termination of participation in the family enterprise, the family member shall be entitled to settlement of his/her share in the profits. If economically justifiable, the settlement can be arranged in instalments under the Section 706 CivC – in case this is agreed upon or decided by the Court. (Odehnalová, 2011) However, if there is no reasonable cause for the breaking down in instalments, the Court will not approve the instalment payment and/or shall decide on the invalidity of instalment arrangement.

**Advantages and disadvantages of the family enterprise**

There are several advantages and/or disadvantages brought by situation, when the mutual rights and obligations of the members of the family enterprise are not covered by a contract arrangement.

As disadvantage may be seen, for instance, that a family enterprise member may leave the enterprise at any time what may in the case of unexpected exit of the family member who participated on its operation in a significant way, cause considerable operational difficulties for the enterprise. As another disadvantage may be regarded the fact that family members who are involved in the operation of the family enterprise, are not eligible for regular monthly wages (reward), or to another protection of the family enterprise. As an advantage we may also classify the preferential right of family members involved in the operation of the family enterprise in the case when the enterprise is divided, in the procedure of dividing the enterprise by a Court and also the pre-emption right that have family members involved in the operation of the enterprise in the case of disposal (sale) with the enterprise. (Odehnalová, 2011)

**Gap in the CivC legislation – dependent work within the family enterprise**

No apparent rules on the procedure can be found in the legislation on family enterprise for situation when the participation of a family member in the operation of the family enterprise has already fulfilled characteristics of dependent work within the meaning of the Labor Code, i.e., it constitutes labor performed in person with a controlling link between him and another family member (usually a family member who owns the family enterprise).

From one point of view we can say that no provision of the CivC ruling on family enterprise contains a clear exception from the obligation to perform work exclusively in dependent employment relationship under Section 3 of the Labor Code. At the same time, there is also no reason for depriving the family members actually performing dependent work for the family enterprise of the protection granted to employees by the labor legislation, in particular as regards working hours, working conditions, remuneration, etc.

On the other side, the purpose of the rules on family enterprise is to accept the reality that, in the case of the ownership of the enterprise by one of the family members, other family members are to some extent involved in its operation without establishing any formal legal relationships among them, and the latter participate jointly, as a family, also in the benefits resulting for the family from such a business establishment. We may also argue that by participating in the operation of the family enterprise all characteristics of dependent work can't even be fulfilled, especially the existence of controlling link. This is due to the fact that participation in the operation of the family enterprise is of purely voluntary nature and, at the same time, there exists no controlling link between family members, (i.e. it is not compulsory to one member of the family to carry out the instructions of another member).

Both aforesaid conclusions may, however, lead to somehow absurd consequences. The application of the first conclusion would mean that in each case where a continuous and systematic work of a family member takes place when contributing to
the operation of the family enterprise (for example son and daughter help twice a week with cleaning of the family pension) and they will be given instructions by another member of the family (which is in practice common), there should be an employment relationship concluded. Such a conclusion would, however, be absurd from the practical point of view and the legal regulation of family enterprise would become essentially inapplicable.

The application of the second of the above conclusions would, on the contrary, allow to create situations where abuses of the work of family members take place while depriving them of the protection otherwise provided to employees. For example, in a situation where family members work on cultivation of agricultural land, and ordinary employees in a commercial enterprise would be limited by maximum length 12 hours per shift (and established mandatory breaks) according to the Labor Code, the work of family members involved in the operation of family enterprise could work, for instance, even 16 hours per day with no break, without thereby breaking the legal rules. (Janků, Marek, 2016) This can be hardly held for acceptable as well.

In deciding whether or not family members should enter into an employment relationship, we therefore recommend to consider their role in the activities of the family enterprise. In the case that the actual position of a family member will close to the employee's position, i.e. he/she will really perform systematic work in a subordinate position under the instructions of another person, we recommend rather the conclusion of the labor contract. On the contrary, if the character of the work will be closer to collective cooperation of family members in the operation of the business enterprise, the legal relationship can be left in the mode of family enterprise without any contractual arrangements.

What may be crucial for the solution of the problems also the view of regional Labor Inspectorates. Indeed, there is no clear position taken by these institutions yet, although it can be assumed that the appropriate assistance of a family member in the framework of the operation of the family enterprise will not be evaluated as illegal work, especially if the family enterprise will be owned by a member of the family as a natural person-entrepreneur. On the contrary, in the case where a family enterprise would be owned by a family member through a legal entity, and the status of family member would be in the position of the employee, the potential problems with the Labor Inspectorate can be considered for likely (especially in the control stage). We have to wait when a statement on this issue will be expressed by the courts, which may be, however, a question of several years. This uncertainty can therefore also be regarded as a disadvantage of family enterprise.

**Forms of continuity in operation of the family enterprise after the entrepreneur's death**

The issue of continuity of the activities of family enterprise operated by a natural person after its death is also not explicitly ruled by CivC provisions on the family enterprise. Here we may, however, apply the regulatory framework of the Trade License Act, No. 455/1991 Coll. as amended thereafter. Within the meaning of its Section 13, within the persons entitled to continue in running the family enterprise under statutory conditions until the end of proceedings on succession fall the estate administrator, executor of the will, if entrusted with the administration of the estate, heirs at law, if there is no last will, legatees, and the surviving spouse or partner, even if he/she is not the heir, if co-owner of the assets used to operate the business, the surviving spouse or partner, if the trade license is not continued by the heirs or a trustee, if the enterprise was inserted by the will into a trust fund (Testamentary Trust Fund). The option to continue under the trade license depends on the notification thereof to the Trade Office within limits set by the law. Trade License Act also governs the procedure for the continuation of the trade license until the end of the succession proceedings, or even continuing to run the trade license after the succession. It is therefore clear that statutory rules contain provisions the purpose of which is to prevent the functioning of family enterprise owned by the deceased family member during the time for which the property rights to the deceased entrepreneur's enterprise are not clarified.

**DISCUSSION**

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CONCLUSION

Family-run businesses and their economic contribution are not sufficiently well publicized, although they represent the driving force of national economies. Their position is quite complicated, but, as for the Czech Republic, we may assume that it will be strengthened in the years to come provided that they can deal with the competitive pressure and a necessary intergenerational transmission. The application of the effective legal rules on family enterprises for the involvement of family members into the operation of the enterprise can be very may be evaluated as very useful due to their informal character, respecting, at the same time, the family-centered nature of such an operation. However, we must realize the potential consequences following such arrangements and to take sufficient measures face them. At the same time, we must also consider whether under concrete circumstances, a different contractual arrangement would be more suitable, for example in the form of employment relationship or a business company running under articles of association. Reasons therefore may be the rights and obligations of the parties as well as the tax reasons.

Unfortunately, in the context of the CivC legislation on the family enterprise the amendments and modification of other legislation outside the CivC was not made that would address the questions related with this issue. In particular, this includes questions of the obligations of the persons involved in the operation of the family enterprise in relation to the mandatory payments on health and social insurance and the active employment policy, the legal regime of the claims of such persons in case of proven insolvency of the owner of the family enterprise.

The legal regulation of the family enterprise brings several new legal questions and many uncertainties, which will be dealt only in the following years by the practical development searching for answers. At the same time it is necessary to be aware of the partial nature of the institute for family enterprise in the context of the family-run business, as defined in the introduction of this contribution. The Institute of family enterprise is not applicable in particular to the form of so-called family business company, in which members of the family are involved in the business in the form of ownership of monetary or in-kind contributions to the registered capital of the company and at least one of the members of the family is a member of the statutory body or statutory body of the family trading company.

The way to increased support for the family-run business in the context of the Czech legislation and economy, therefore, must necessarily be started with the general definition of the family business, preferably in the context of an emerging European legislation.

REFERENCES


Contact information

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