

ASSESSING THE IMPACT OF SUCCESSION PLANNING ON THE LIFESPAN OF
FAMILY-OWNED BUSINESSES IN INDIA

Dr. Pranjal Nayar¹, Ms. Abhigna Valusa²

¹ Assistant Professor, Amity Law School, Amity University, Mumbai (ppnayar@mum.amity.edu)

¹ LLM Student, Amity Law School, Amity University, Mumbai, v.abhingna152@gmail.com

ABSTRACT

Family-Owned Businesses (FOBs) form the backbone of India's entrepreneurial and economic landscape. They account for the majority of privately held firms in India and contribute substantially to employment, regional development, and capital formation. However, these enterprises face a serious threat to long-term continuity, especially when transitioning from one generation to the next. The lack of structured succession planning, coupled with regulatory and tax ambiguities, results in fragmentation, loss of capital, and even business collapse.

This research critically evaluates how succession planning—or the absence thereof—affects the longevity of FOB in India. It draws on comparative legal frameworks adopted in Spain and Italy, where succession laws have been tailored to support generational continuity, both through legal recognition and fiscal incentives. These countries, by offering inheritance tax reliefs, recognizing intra-family transfers, and providing legal clarity, have demonstrated how policy interventions can stabilize family enterprises across generations.

Through doctrinal and policy-based research, the paper identifies the gaps in India's current tax and corporate frameworks that hinder effective succession. It proposes a policy model that draws from successful European practices but adapts them to India's unique social and legal context. The research aims to demonstrate that the longevity of FOBs is not just a private or familial issue but one with significant macroeconomic implications, warranting urgent legislative attention.

Chapter 1: Introduction

FOBs have historically played an integral role in India's private sector economy. According to the Ministry of Corporate Affairs, they constitute nearly 79% of private companies registered in India, many of which have grown into national and multinational enterprises¹. What sets these enterprises apart is not just their structure, but their ethos—rooted in long-term commitment, intergenerational transfer of values and assets, and a unique balance of personal and professional relationships.

Despite their economic significance, a large number of FOBs in India fail to survive beyond the second generation. Research suggests that less than 30% of FOBs successfully transition to the second generation, and only about 13% make it to the third². This phenomenon is not unique to

¹ Ministry of Corporate Affairs, Annual Report 2019, Government of India.

² Astrachan, J.H. and Shanker, M.C., "Family Businesses' Contribution to the U.S. Economy: A Closer Look," *Family Business Review*, Vol. 16, No. 3 (2003).

India, but the failure rate is exacerbated by structural and legal gaps in the Indian system—particularly the absence of a formal succession planning framework.

In India, succession in FOBs is often governed by informal mechanisms: verbal commitments, religious customs, family consensus, or handwritten wills. Unlike public corporations, which are legally required to have succession procedures and compliance structures in place, Indian family firms function largely outside such mandates. The result is that when the founding member dies or retires, the transition of control becomes chaotic, leading to disputes, fragmentation, and, in many cases, the eventual dissolution of the business³.

This problem is further compounded by India's current tax regime, which does not differentiate between intra-family and commercial transfers of business assets. Under section 45 of the Income Tax Act, 1961, capital gains tax is imposed even on inherited business shares unless specifically exempted⁴. This creates a financial disincentive for younger generations to take over and continue the business. In contrast, European jurisdictions such as Spain and Italy have developed nuanced succession laws that not only recognize FOBs legally but also offer tax exemptions, deferrals, and governance support during generational transitions⁵.

Spain's tax code provides substantial inheritance tax reliefs if a family member inherits and continues to run the business for a defined period⁶. Italy offers similar protections through Article 230-bis of its Civil Code, which defines rights of family members actively engaged in the enterprise and links them with succession benefits⁷. These measures encourage formal succession planning, reduce disputes, and ensure that family firms continue to contribute to the national economy.

This paper aims to explore these international practices in depth and assess their adaptability to the Indian context. While socio-cultural differences cannot be ignored, the structural principles of succession planning—legal recognition, tax support, and intergenerational training—are universally relevant. India's failure to legally define FOBs or differentiate them in tax treatment is not only an administrative oversight but a missed opportunity for fostering stable, long-term economic growth.

The central thesis of this paper is that India must recognize succession planning as a critical factor in economic policy, not just a private family matter. By embedding succession rules into its legal and tax frameworks—modeled after proven European systems—India can protect its economic backbone: the FOBs.

³ Miller, D. et al., "Are Family Firms Really Superior Performers?" *Journal of Corporate Finance*, Vol. 13, Issue 5 (2007)

⁴ Income Tax Act, 1961, s. 45

⁵ European Commission, Final Report of the Expert Group on Family Business, 2009.

⁶ Instituto de la Empresa Familiar, Guidelines on Family Business Succession, 2015.

⁷ Italian Civil Code, Art. 230-bis.

Chapter 2: The Role of Succession Planning in Business Longevity and the Indian Gap

Succession planning is the strategic process of preparing the next generation to assume leadership and ownership in a family business. It is not simply the nomination of a successor, but a comprehensive approach involving tax structuring, legal documentation, knowledge transfer, role assignment, and long-term vision alignment. The survival and success of FOBs across generations are directly linked to how early and effectively such planning is undertaken.

International studies consistently show a strong correlation between formal succession planning and business longevity. According to an OECD policy paper, countries with tax provisions and legal frameworks supporting intra-family transfers show higher survival rates of FOBs post-transition⁸. The research indicates that succession readiness—not just business acumen—is a decisive factor for sustaining profitability and internal stability.

In India, the absence of a legal requirement for succession planning has left FOBs vulnerable. Most Indian family firms do not have a succession agreement or even a formal governance structure in place. A report by PwC India noted that only 15% of Indian FOBs have a documented succession plan, compared to over 60% in Europe⁹. The informal nature of Indian business culture often discourages discussions around succession, which are wrongly perceived as premature or disrespectful toward the incumbent leader.

In terms of legal framework, Indian corporate and tax law does not distinguish between family businesses and non-family enterprises. The Income Tax Act, 1961, does not provide for any preferential treatment for intra-family business transfers, nor does it offer exemptions on capital gains or inheritance tax for successors taking over business assets¹⁰. This results in increased tax burdens during generational transitions, often forcing families to sell parts of the business to meet tax obligations, thereby breaking up the business's asset structure.

Additionally, India lacks a unified definition of what constitutes a family business. In the absence of a formal classification, it becomes nearly impossible for tax or legal policy to be tailored for this sector. European nations such as Spain and Italy have addressed this gap by enacting legal definitions and supporting policies. Spain defines family businesses based on ownership thresholds, active family participation, and succession intent, thereby facilitating targeted tax policies¹¹. Italy's Civil Code further enhances this with Article 230-bis, which provides for the legal rights and tax treatment of family members involved in the business¹².

The lack of a similar framework in India creates ambiguity, especially in tax enforcement and inheritance cases. Disputes often arise when multiple heirs claim a right to management or ownership without a formal will or succession plan in place. In many cases, FOBs have been dragged into litigation that consumes financial and emotional resources and weakens the market

⁸ OECD, "Taxation of SMEs in OECD and G20 Countries," OECD Tax Policy Studies No. 23 (2015)

⁹ PwC India, Family Business Survey, 2021.

¹⁰ Income Tax Act, 1961, s. 45.

¹¹ Instituto de la Empresa Familiar, Guidelines on Family Business Succession, 2015.

¹² Italian Civil Code, Art. 230-bis.

position of the business. Such scenarios could be avoided through structured planning, legal recognition of the business as a family enterprise, and targeted incentives to formalize succession. In addition to legal and tax constraints, cultural and social factors play a role in delaying or neglecting succession planning in Indian FOBs. Patriarchal norms often discourage discussions on transition, especially when the incumbent leader believes in lifelong control. Younger generations may also be reluctant to join the family business due to differences in vision or lack of autonomy, which further complicates the planning process. Without legal compulsion or fiscal incentives, families have little motivation to initiate these crucial conversations.

Despite these challenges, there is growing awareness in policy circles about the importance of succession planning. The Indian Ministry of MSME has acknowledged the risks posed by leadership vacuums in family businesses and the urgent need to offer guidance and incentives for succession¹³. However, no concrete legal proposal has yet been introduced in Parliament, and existing laws like the Companies Act, 2013, and the Income Tax Act, 1961, remain silent on this critical aspect.

It is important to note that succession planning does not benefit only the business-owning family. The stability of family businesses contributes to broader economic resilience. They offer long-term employment, reinvestment of profits into regional economies, and preservation of traditional industries. When a business closes or fragments due to poor succession, the consequences are felt beyond the family—it disrupts supply chains, affects employees, and shrinks the regional economic base.

Therefore, the role of succession planning must be recognized not as an internal family affair, but as a public policy priority. Policymakers must understand that legislative inertia on this issue is equivalent to an economic risk. A formal legal framework recognizing FOBs, supported by tax incentives for succession planning, can convert what is currently a private vulnerability into a pillar of national economic strength.

¹³ Ministry of MSME, Annual Report 2020, Government of India.

Chapter 3: Comparative Succession Frameworks in Spain and Italy: Legal and Tax Perspectives

Comparative legal analysis is an effective method of policy reform, especially when jurisdictions face similar structural challenges. Spain and Italy, like India, have economies significantly influenced by FOBs. However, unlike India, these European nations have developed structured legal frameworks that actively support succession planning. This chapter examines how these countries address the issue and what lessons India can adopt.

3.1 Spain's Succession Framework

Spain has taken a proactive stance toward succession in FOBs through tax policy and institutional support. The Spanish Civil Code and national tax statutes provide inheritance and gift tax exemptions for family businesses, provided certain conditions are met. One key provision allows for up to 95% tax exemption on transferred shares if the heir maintains ownership and active involvement in the business for at least five years¹⁴. The remaining 5% is taxed at a preferential rate.

Moreover, Spanish law requires that at least one family member must continue to manage the company, ensuring business continuity. These policies are designed to facilitate generational transfer while minimizing financial disruption to the business. The Instituto de la Empresa Familiar (IEF), a national body promoting family business sustainability, plays a crucial role in training, awareness, and legal advocacy¹⁵.

The Spanish model is particularly notable for integrating legal clarity with fiscal relief. By linking tax incentives to governance commitments, Spain ensures that only genuinely family-run businesses benefit from the exemptions. This reduces misuse while promoting formalization of succession through legal agreements and strategic planning.

3.2 Italy's Legal Model and Article 230-bis

Italy, too, has embedded FOB succession into its civil and tax law. Article 230-bis of the Italian Civil Code provides legal recognition to family members who contribute to the family business, even if informally. It ensures that such members are entitled to remuneration, succession rights, and protection against unfair exclusion¹⁶.

Italy's tax system complements this civil provision with favorable inheritance laws. Business transfers made to children or spouses are exempt from inheritance tax, provided the business is continued for at least five years. If the heirs do not continue the business or sell the shares prematurely, the exemption is withdrawn, creating a natural incentive for long-term management continuity¹⁷.

Another unique feature of Italy's succession planning model is the "family pact" (*patto di famiglia*), which allows living founders to formally designate successors and allocate shares during their lifetime. This avoids posthumous disputes and ensures a smoother transfer of both

¹⁴ Instituto de la Empresa Familiar, Guidelines on Family Business Succession, 2015.

¹⁵ Instituto de la Empresa Familiar, Guidelines on Family Business Succession, 2015.

¹⁶ Italian Civil Code, Art. 230-bis.

¹⁷ Italian Civil Code, Art. 230-bis.

management and ownership. The pact must be notarized and registered, thus formalizing succession planning as a legal instrument.

3.3 Cultural and Institutional Context

Both Spain and Italy share cultural similarities with India: family-centric decision-making, generational ownership, and emotional attachment to business legacy. This makes their models particularly relevant for Indian policymakers. Importantly, these countries have not abandoned traditional family structures but have complemented them with modern legal frameworks to stabilize economic outcomes.

By contrast, India has not yet adopted any policy or law that defines FOBs or facilitates generational transfers in a structured way. The Income Tax Act, 1961 does not exempt intra-family transfers of business assets from capital gains tax unless the transaction is structured as a gift or part of a will¹⁸. However, such transfers still carry risks of scrutiny under anti-abuse provisions, discouraging formal succession planning.

Moreover, India lacks an institutional counterpart to Spain's IEF. While organizations such as the Confederation of Indian Industry (CII) and FICCI have family business forums, there is no dedicated statutory or quasi-governmental body focused on FOB longevity. This is a gap that needs urgent attention if India is to replicate the success of European models.

3.4 Lessons for India

Several actionable lessons emerge from this comparison:

1. Legal Definition of FOBs

Spain and Italy both define family businesses in legal and tax statutes. India must develop a statutory definition, perhaps by amending the Income Tax Act or introducing a standalone Family Business Code.

2. Tax Relief Linked to Continuity

Tax exemptions should be conditional upon continued family ownership and management for a specified period (e.g., five years). This aligns with the Spanish model and prevents abuse of the policy.

3. Recognition of Informal Participation

Italy's Article 230-bis acknowledges unpaid contributions by family members—an issue common in Indian FOBs as well. Indian law must evolve to protect such contributors legally.

4. Encouraging Written Succession Plans

Like the “family pact” in Italy, India can legalize and encourage formal succession agreements, thereby reducing inheritance disputes and enhancing transition stability.

5. Institutional Support

India should consider establishing a national family business authority or council, modeled after the IEF, to guide, train, and monitor succession practices.

¹⁸ Income Tax Act, 1961, s. 45

Chapter 4: Policy Recommendations and Conclusion

Succession planning for FOBs is not merely an internal matter for families—it is a matter of national economic policy. India’s lack of a formal definition or succession framework places its most vital business entities at risk. Drawing from comparative practices and domestic needs, this chapter presents a set of policy recommendations aimed at institutionalizing succession planning in Indian law and tax policy.

4.1 Policy Recommendations**1. Statutory Definition of FOBs in Indian Law**

The absence of a legal definition for FOBs in India creates ambiguity in taxation, compliance, and succession planning. India should adopt a statutory definition through either a separate legislation or amendment to the Income Tax Act, Companies Act, or the MSME Development Act. The definition should include parameters such as:

- Minimum 50% family ownership
- Active involvement of family members in management
- A demonstrable intent for intergenerational continuity¹⁹

This would form the legal basis for any fiscal or governance benefits.

2. Tax Exemptions for Intra-Family Transfers

India’s current tax law treats family succession as a taxable event, applying capital gains tax unless narrowly exempted under will or gift provisions²⁰. This should be changed to allow:

- Full or partial capital gains exemption for intra-family business transfers
- GST concessions for business asset transfers within the family
- Estate tax relief if the successor continues the business for at least five years²¹

Such tax incentives must be tied to compliance conditions like management continuity and documentation.

3. Legalization of Succession Agreements

Inspired by Italy’s “family pact” (patto di famiglia), India should encourage notarized, binding succession agreements. These would:

- Formalize leadership transition before death/incapacity of the founder
- Prevent intra-family disputes
- Provide clarity to regulators and banks²²

Such a framework would also reduce court litigation around inheritance of business interests.

4. Protection for Informal Contributors

In Indian FOBs, it is common for female family members and junior relatives to contribute informally without formal contracts. Drawing from Italy’s Article 230-bis, Indian law must

¹⁹ European Commission, Final Report of the Expert Group on Family Business, 2009.

²⁰ Income Tax Act, 1961, s. 45.

²¹ Instituto de la Empresa Familiar, Guidelines on Family Business Succession, 2015.

²² Italian Civil Code, Art. 230-bis.

recognize and protect the rights of family members who work in the business without formal employment agreements²³. This can be done through amendments to labour or commercial law, ensuring fairness and succession eligibility.

5. Establishing a National Family Business Authority

Like Spain's Instituto de la Empresa Familiar, India needs an institutional body—under the Ministry of Corporate Affairs or MSME Ministry—that would:

- Certify FOBs based on defined criteria
- Offer training, legal aid, and succession planning tools
- Serve as a platform for policy advocacy and awareness²⁴

This authority would act as both a regulatory support system and knowledge hub for India's vast family business community.

4.2 Conclusion

FOBs in India have been the foundation of private enterprise for decades, fostering employment, innovation, and economic growth. However, their greatest vulnerability lies in succession—a phase often mishandled due to cultural hesitations, legal vacuum, and tax disincentives.

This paper has demonstrated that structured succession planning is not merely a business practice but a national economic imperative. By examining successful models in Spain and Italy, it is evident that legal definitions, tax reliefs, and institutional support can significantly improve generational continuity. India must move beyond informal practices and recognize succession as a policy concern that intersects law, tax, and economic planning.

The recommended reforms—statutory definitions, fiscal incentives, succession pacts, contributor protections, and institutional support—can help India unlock the true potential of its FOBs. These businesses are more than profit-making entities—they are bearers of tradition, community anchors, and engines of sustainable growth. With the right legal and policy tools, they can continue to serve India for generations to come.

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²³ Italian Civil Code, Art. 230-bis.

²⁴ Ministry of MSME, Annual Report 2020, Government of India.

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