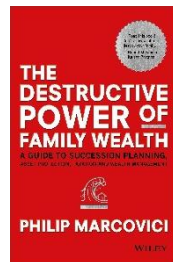


Thoughts on Family Constitutions

Philip Marcovici*

This article is an excerpt from *The Destructive Power of Family Wealth - A Guide to Succession Planning, Asset Protection, Taxation and Wealth Management* Published in 2016 by John Wiley & Sons Limited, UK



<https://www.amazon.co.uk/Destructive-Power-Family-Wealth-Succession/dp/1119327520>

Family constitutions are increasingly used by families, particularly those with a family business, to set out a framework for the more detailed planning that will subsequently take place. One of the biggest benefits of a family constitution is not the constitution itself, but the process of family engagement and discussion that implementing a family constitution results in. What a family constitution covers can vary significantly, but can include many items that are important for business owning families to consider. And family constitutions, and the areas they cover, are very relevant to families who may only own passive assets, and not actually be in businesses that are to pass from one generation to the next.

In most cases, while family members sign the relevant family constitution, it is not a legally binding document. Rather, the constitution is then used as the basis for creating binding documents that can include partnership and shareholder agreements, trust or foundation structures and other arrangements that do provide legal rights and responsibilities.

A few of the many items a well-thought out family constitution might contain:

- ***Background on the Family and Family Business:*** While the family may know its history well, thinking about how the family business started, the values of the founder of the business and the family origins, can be a useful starting point for the constitution and for the family discussions that putting the constitution in place will require.
- ***Mission and Vision:*** Drawing on the history of the family business, the objectives of the family can be laid out, covering what the family hopes to achieve for the benefit of the family, the family business, employees and the communities in which the family lives and operates.
- ***Family Governance:*** While related to the governance of businesses and assets, apart from the structures used to own assets, families can consider how the family itself will be involved in its own governance. Typically, a family council or similar body will be established, and procedures set out for who in the family will populate the council, how decisions will be made and how family council members can be appointed and replaced.
- ***Who are Family Members?*** Apart from spouses, up-front consideration of how the family views step-children, adopted children, and others is important, and ideally the issues are discussed before specific questions arise about specific family members, a potentially emotional and divisive issue.
- ***Family Assets and Who Really Owns Them?*** A critical issue for families to consider is the extent to which members of the younger generation are meant to be owners of assets or custodians of assets for further generations.
- ***Family Values:*** While family values are something that has to be part of the upbringing of children, setting out the values of the family in writing is often a good way of cementing the approach to business and wealth that the family is committed to.
- ***Family Education:*** There are many elements of education that are important for wealth owning families to consider, including the background that might be needed for those family members who want to join the family business. In a number of families (and also in the education programs offered by many

universities to business owning families) there is not enough emphasis on training not only those who will be involved in managing a family business, but also those who will become *owners* of a family business. How to read a balance sheet, be an effective board member, ask the right questions of executives running a business, are all some of the many skills that need to be learned by those who will be effective owners of a family business.

- *Employment Policies:* Should every member of the family (and maybe their spouses) have a right to work in the family business? Addressing the employment policies associated with family members working in the family business is a key area for a family to address, recognizing that the question of who is right to work in a family business will give rise to much in the way of potential unhappiness.
- *Expenses and Use of Family Assets:* The constitution should also consider the extent to which some expenses of the family may be communalized, and related to this, is the extent to which communally owned assets, such as a family house, boat or otherwise, will be used and paid for.
- *Social Responsibility and Philanthropy:* The family constitution is a good place to set out the family's views on responsible investing and philanthropy, and family values in relation to the family business, and its importance to non-family stakeholders, such as employees and the communities in which they live and work.
- *Entrepreneurial Children, Competition, and the Role of a Family "Bank":* Where there is a family business, families often focus on the many issues they need to consider in ensuring that the younger generation are well prepared to be involved in the business. What many families are less well prepared for are the challenges that having a particularly entrepreneurial child can raise, and how to encourage and develop the entrepreneurial objectives of the younger generation.
- *Compensating Family Members Involved in the Family Business:* A thorny issue that business owning families face, and which the family constitution should discuss, is how family members will be rewarded for the work they do in a family business.

- *Family Mentors:* Through the family constitution or otherwise, considering formally appointing mentors to the younger generation can be most useful whether a family business is involved or not.
- *Expectations Regarding Pre-Nuptial Agreements and Trust Arrangements:* Divorces in the younger generation can have a dramatically negative impact on a family business and family assets generally. Among the planning approaches wealth owning families can take are well-structured discretionary trusts and, where they are respected under the relevant law, pre-nuptial and post-nuptial agreements. Having the family constitution lay out expectations regarding such arrangements and their being a condition to inheritance is important.
- *Pruning the Family Tree:* Families that manage to keep their businesses intact over the generations tend to be families that are flexible in their understanding that it is inevitable that not everyone in the younger generation will see things the same way.
- *Harvesting the Family Business:* I have run across business owners, usually the founders, who sometimes say that they want the business to stay in the family “forever”. Well, forever is a very long time, and it is clear that a business that is valuable today, may not be particularly valuable in the future.
- *Family Retreats:* Connected to the family constitution are usually arrangements for regular, perhaps annual or more frequent, family meetings, involving the “family assembly” or other body, or a more informal get-together of the family to allow the family to review not only its business and wealth, but to work on connecting the family and keeping it connected.
- *The Family Legacy and Individual Legacies:* The family constitution will often start out with a discussion of the family history, and combined with its focus on the family business and on the family’s thinking on philanthropy and social impact, will represent the family legacy. It is often useful to consider, in the preparation of a family constitution and in discussions with family

members, what “legacy” really means, and the need for all family members to have the ability to achieve their goals and to be proud of doing so.

Even where a family does not use a family constitution, just thinking about and discussing the issues a typical family constitution covers can be a useful thing.

**Philip Marcovici is retired from the practice of law and consults with governments, financial institutions and global families in relation to tax, wealth management and other matters.*

Philip was a partner of Baker & McKenzie, a firm he joined in 1982, and practiced in the area of international taxation throughout his legal career. Philip was based in the Hong Kong office of Baker & McKenzie for twelve years, relocating to the Zurich office of Baker & McKenzie in 1996. Philip has also practiced law in each of New York and Vancouver, British Columbia. Philip retired from Baker & McKenzie at the end of 2009.

In 2013, Philip received a Lifetime Achievement Award from the Society of Estate and Trust Practitioners.

www.marcoviciasia.com