Generation gap

KELLY PARSONS
editor

The end of an era is approaching for many of Europe's law firms, as their founders and leaders near retirement age.

Historically, the heads of such firms were well-known personalities with considerable gravitas, on a par with the top politicians and business leaders. Their leadership was easily and naturally assumed because they were instrumental in securing the firm's foundations. In younger or second-generation firms this position is less straightforward as their leaders are not necessarily established names. Of course, in the most successful modern practice, the firm itself not the top personality becomes the star; but there remains an inherent need for a lawyer-leader to be endorsed as a symbolic figurehead, by not only their partners but also the wider market.

So the question on the minds of many observers is, can a more institutionalised, democratic culture evolve to take the place of the traditional patriarchal style of firm leadership? Have the current leading figures done all they can to ensure this transition transpires efficiently? After all, one of the most important functions of leadership is to produce more leaders.

The history of the profession is peppered with examples of firms that failed to recognise the need for a leadership transition early enough and paid a high price. And as our cover story this month ('Long live the King', page 20) outlines, there are more recent instances too. The plight of two leading players in the French and German legal markets illustrates well the dangers.

Several firms are making efforts to address this pressing problem and to an outsider the solutions can appear harsh. Sometimes the only way that successors can blossom is if senior figureheads step down in advance of their wishes or abilities. It is frequently remarked that good leaders come to the fore only when a vacuum is created for them to fill – founders must step back so that new talent will rise up.

The problem of leadership for lawyers is exacerbated by the fact that the legal environment can tend to undermine the natural instincts of good leaders. Partners are often too tied up in internal matters and performance to devote their time and energy to a vision of the future. In addition, most law firm leaders were, or continue to be, practising lawyers. Having been successful in their legal work it is often assumed they will be similarly effective in a management role. But lawyers are rarely recruited on the basis of their skills in leadership or management. In fact, according to research by the author of the second part of our cover story – 'Making lawyers into leaders' on page 25 – compared to the general public, the kinds of people who are attracted to the profession tend to be less sociable, and more sceptical, urgent, analytical, autonomous, defensive and thin-skinned. Yet the opposite traits are associated with strong leadership ability.

Furthermore, lawyers are rarely trained in such skills. For all the books and seminars devoted to the subject of running a firm, the only real training for leadership is the task itself. Yet many partners are neither willing nor able to take on these roles and are focused instead on income generation. This may be explained, in part, by the criticism that some firms don't know how to compensate or acknowledge the value of leaders: management is often not taken seriously, or is viewed as a secondary activity and the impact good leadership can have on the bottom line is ignored. To give leadership the priority it deserves, partners must recognise that running a firm or department is just as important and difficult as working on client matters, and that the firm's future depends on the quality of people willing to assume management positions.

It is also essential that the new generation of leaders possesses not only a vision of the future for the practice but also one of its past. Driving the organisation's goals is important, but maintaining the traditional values and principles that have ensured success to date is equally vital. ■

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Tactical target

A state aid challenge which looks set to usher a venerable tax break scheme to its grave may well be a strategic move by the Commission explains GEORGE METAXAS

A Luxembourg tax law of 1929 sounds like an unlikely target for the European Commission in 2006, but its time-honoured 77 years have not been enough to spare it the humiliation of an EU state aid investigation: just such an enquiry into legislation that exempts certain holdings from corporate taxes was opened on 8 February 2006.

A '1929 holding company' is exempt from business taxes on earnings (dividends, interests and royalties) and payments (dividends and royalty fees). The Commission's investigation is targeting the principal 1929 holding companies regime, as well as two more recent variants. The first concerns the so-called 'billionaire holdings', introduced in 1937 as an ancillary exempt status and requiring an initial paid-up capital contribution of at least one billion Luxembourg francs. The second relates to certain types of exempt financial holdings.

The 1929 company was created to attract financial institutions and holdings of multinationals, with considerable success. The financial services sector reportedly employs roughly 10 per cent of Luxembourg's working population and the country still has around 12,000 holding companies, even though their number has been declining in recent years.

It is a well established principle, confirmed by the ECJ, that national legislation providing corporate tax breaks may fall under the scope of the EC Treaty's state aid rules, if certain conditions are met. This can have far-reaching implications: approximately 25 per cent of all state aid in the EU is granted through tax schemes. Not every form of tax relief qualifies as state aid and those which do can often benefit from one of the existing derogations to the general EU prohibition of state aid. Nevertheless, this still leaves a substantial number of tax relief schemes exposed to an EU state aid challenge.

Direct taxation in the EU is generally a matter of national law and policy. Several member states have consistently opposed any substantive EU harmonisation in this field and have insisted on maintaining their power to determine their fiscal policy independently. Partly in reaction to this situation, some of the Commission's decisions in the area of direct corporate

taxation seem to be based on a broad interpretation of the concept of state aid, thus effectively limiting member states' powers in this area.

The Commission's investigation of Luxembourg's 1929 tax regime has prompted concerns that its goal may be some form of retroactive taxation, back-fines or other penalties. The Commission can order the suspension and recovery of illegal new state aid. However, 'existing aid', which also includes state aid implemented by a member state before its EU accession, is subject to suspension but not to retroactive recovery. Nevertheless, the legal basis, if any, for such an outcome is certainly not obvious in the case of an 'existing aid' such as the one involved here.

This conflict came surprisingly late, but not out of the blue. The Commission sent its first related preliminary inquiries to Luxembourg in 1999. After a few years of exchanges, Luxembourg adopted a law that came into force on 1 July 2005 and amended the 1929 regime, but the Commission considered this measure insufficient and proposed certain adjustments, which were rejected by Luxembourg. The Commission claims that it therefore had no choice but to initiate a formal investigation, on the grounds that the tax exemption under Luxembourg's 1929 scheme "may constitute a disguised subsidy in favour of multinational companies based in Luxembourg and may distort the European financial market".

The Commission's official announcement obscures the fact that, in recent times, Luxembourg's 1929 holding companies have lost their appeal, especially as they do not benefit from bilateral tax treaties. Nowadays other more recently created investment vehicles in Luxembourg – such as the 'Soparfi' (*sociétés de participations financières*) – which are not covered by the Commission's investigation, are better adjusted to international tax planning requirements.

More importantly, however, the changes Luxembourg introduced in 2005 have already heralded the end for 1929 holding companies. As of 1 July 2005, the 1929 regime's tax benefits have been cancelled or at least limited for newcomers, although existing 1929 holdings benefit from a grandfathering clause until the end of 2010.

It is therefore somewhat surprising that the Commission decided to escalate its investigation after the original 1929 tax regime was seriously restricted and has lost most of its practical importance. One possible explanation may be that it is easier for the Commission to challenge a national tax measure that is already on its way out, thus helping it to send a confident public message, create a relatively easy legal precedent and move the goalposts in a disputed jurisdictional area. ■