

# Obligations of a trustee of a private trust in Israel

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## Abstract

This article describes the various types of trusts under Israeli Law, and outlines the main obligations imposed on a trustee under Israeli Law, namely, the Israeli Trust Law.<sup>1</sup>

## Introduction

Section 1 surveys the various types of trusts under Israeli Law, and of the Trust Law provides that:

A trust is a relationship to property by virtue of which a trustee is bound to hold the same or to act in respect thereof, in the interest of a beneficiary of for some other purpose.

Section 2 of the Trust Law further provides that ‘a trust is created by Law, by contract with a trustee or by an instrument of Hekdesh’.

*A trust is created by Law, by contract with a trustee or by an instrument of Hekdesh*

It can be concluded from Sections 1 and 2 above that a variety of relationships are considered to be trusts under the Trust Law, not only private trusts, but other fiduciary arrangements as well. Therefore, and for the purpose of this article, the relationships set forth below will be excluded from the term

‘private trust’, and the obligations specified under Section ‘Obligation of the trustee of a Private Trust under section 17 of the Trust Law’ below will refer to trustees of a private trust.

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## The types of trusts subjected to the Trust Law

### A trust created by a contract

Trust relationships created by a contract<sup>2</sup> usually last for a relatively limited amount of time, such as an escrow bank account opened to facilitate a real property transaction.

Often, such relationships can be considered agency relationships as well,<sup>3</sup> and they are commonly known as ‘nominee arrangements’. In these cases, a legal entity is registered as the owner of a certain right, and undertakes in a contract to hold said right for the benefit of a beneficiary. The purpose of this arrangement is usually to provide the legal owner with confidentiality. In addition, the registered owner usually has limited discretion, and may even undertake to transfer the right back

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1. Trust Law, 5739-1979, 33 LSI 41 (1966–67) (Isr).

2. *ibid*, s 2.

3. Agency Law, 5725-1965, 19 LSI 231 (1964–65) (Isr).

to the name of its legal owner upon his first request. The legal owner can, therefore, be considered the principal, and the registered owner the agent. Such arrangements may apply to holding real estate<sup>4</sup> and to holding of shares of a company in a nominee capacity.<sup>5</sup>

### **A trust created under law**

Trust relationships that are created under law can be divided into several categories based on the manner in which the trustee is appointed: (i) trustees appointed by a judicial authority; (ii) trustees appointed under the supervision of an administrative authority; and (iii) trustees appointed with the consent of a governmental regulatory body.

#### ***Trustees appointed by a judicial authority***

The main characteristics of a trustee appointed by a judicial authority are set forth below<sup>6</sup>:

- i. The scope of the trustee's powers to act is determined by the legislation. The trustee receives control over the property by way of law, and he does not need any other legal means in order to execute his duties, such as a license, ownership, or any other right in the property.
- ii. A special law sets out the *modus operandi* of the appointing body and the powers, duties, and obligations conferred on the trustee.

- iii. The trustee's demise terminates the powers of the acting trustee.
- iv. The appointing authority may replace the trustee without needing to transfer any right of ownership.

Among these trustees, the following can be found: a company liquidator,<sup>7</sup> a Trustee in Bankruptcy,<sup>8</sup> a Guardian,<sup>9</sup> and an Estate Administrator.<sup>10</sup> For example, the court may instruct the Estate Administrator at any time,<sup>11</sup> and the Estate Administrator must file with the Administrator General a detailed report with respect to the estate under its management.<sup>12</sup>

#### ***Trustees appointed under the supervision of an administrative authority***

The Public Trustee can be listed as such a trustee. It is appointed by the Minister of Justice,<sup>13</sup> and its activity is supervised by the court.<sup>14</sup> Other such trustees are the Administrator of Abandoned Assets and of Enemy Alien Assets,<sup>15</sup> the Administrator of Absentees' Assets,<sup>16</sup> and the debenture trustee.<sup>17</sup>

#### ***Trustees appointed with the consent of a governmental regulatory body***

A trustee for an employee stock option incentive program<sup>18</sup> is included in this group. In such case, the consent of the relevant Tax Assessment Officer is required for the appointment,<sup>19</sup> who also supervises the trustee's activity.<sup>20</sup>

4. Application of this arrangement to real property is commonly known as a 'real property trust'; Real Property Taxation Law (Capital Gains and Purchase) 5723-1963, 17 LSI 193, s 69 (1963) (Isr).

5. eg OM (TA) 548/06 *Arnon v Pieutrekovsky* (1 March 2009), Nevo Legal Database (by subscription) (Isr).

6. Shlomo Kerem, Trust, 144 (4th ed., 2004).

7. Companies Ordinance [New Version] 5743-1983, 37 LSI 761, ss 300, 325 (1983) (Isr).

8. Bankruptcy Ordinance [New Version] 5740-1980, 34 LSI 639, s 46 (1980) (Isr).

9. Capacity and Guardianship Law, 5722-1962, 16 LSI 106, ss 28, 29, 33 (1961-62) (Isr).

10. Succession Law, 5725-1965, 19 LSI 215, s 77 (1964-65) (Isr)

11. *ibid*, s 83.

12. *ibid*, s 84.

13. Trust Law (n 1) s 36; Under Government Notice no 3250 of 22 September 1985, 2, the Public Trustee is the Administrator General.

14. PCA 9420/04 *Pub. Tr. v Agmon* [2005] IsrSC 59(1) 627.

15. Administrator General Law, 5738-1978, 883 LSI 61, s 2 (1978) (Isr).

16. Absentees' Property Law, 5710-1950, 4 LSI 68, s 2 (1949-50) (Isr)

17. Securities Law, 5728-1968, 541 LSI 234, ch E2 (1968) (Isr).

18. Income Tax Rules (Tax Relief on the Allotment of Shares to Employees) 2003, KT 6222, 448 (Isr).

19. *ibid*, s 2.

20. *ibid*, s 5.

### A 'Blind Trust'

Under the Notice for Preventing Conflict of Interests by Ministers and Deputy Ministers,<sup>21</sup> within 60 days of his or her appointment, a minister must transfer the funds and securities owned by him and his family members to a public and independent trust company, which will hold and manage them as a 'blind trust'. Analysis of the Notice leads to the conclusion that this is, in fact, an agency relationship, as this is a temporary arrangement, which terminates upon the minister's termination of office, or upon his or her demise.

### A charitable trust

A charitable trust is a trust which fulfills the requirements of section 26 of the Trust Law, and it is known as a 'Public Hekdesh'. Such charitable trust is registered with the Registrar of Public Trusts (Hekdesh),<sup>22</sup> and the trustee is required to file reports with respect thereof.<sup>23</sup>

### Obligation of the trustee of a Private Trust under section 17 of the Trust Law

As mentioned, the various trusts described under Section 2 above either refer to a fiduciary relationship which is not a trust *per se*, or to a trust that is already regulated under Israeli law. The focus of this article is, therefore, on the specific Israeli private trust, which is similar to the Common Law trust.<sup>24</sup> In our opinion, a good definition of such a trust can be found in the Hague Convention,<sup>25</sup> which provides as follows:

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A trust is the legal relationships created—*inter vivos* or on death—by a person, the settlor, when assets

have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose. A trust has the following characteristics:

- i. The assets constitute a separate fund and are not a part of the trustee's own estate;
- ii. Title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee; and
- iii. The trustee has the power and the duty, in respect of which he is accountable, to manage, employ, or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.

A trust as described above can be created under Israeli law in accordance with section 17 of the Trust Law, whereas section 17A(1) refers to an *inter vivos* trust, and section 17A(2) refers to a trust created on death, i.e. a testamentary trust.

The following sections will focus on the Trust Law, and the obligations and supervision it imposes on the trustee of an Israeli Private Trust. The last section, 'Reporting Obligations of Trustees who are Attorneys or Accountants', will address the obligations and supervision imposed specifically on attorneys and accountants.

### Accounts and reporting

Section 7 of the Trust Law deals with accounts and reporting obligations. Accordingly, section 7(a) provides that 'the trustee shall keep account as to all the affairs of the trust', and section 7(b) provides that:

the trustee shall render to the beneficiaries a report on the affairs of the trust once a year and upon termination of his tenure, and shall give them any further information they may reasonable request.

21. Notice on the Rules for Preventing Conflict of Interests by Ministers and Deputy Ministers, 2003, YP, 1139 (Isr) ('the Notice').

22. Trust Law (n 1) s 26(c).

23. *ibid*, s 29.

24. Angelique Devaux, Deanna Beckner, and Margaret Ryznar, 'The Trust as More Than A Common Law Creature' (2014–15) 41 Ohio NU L Rev 91, 92–96.

25. The Hague Convention on the Law Applicable to Trusts and on Their Recognition, 1 July 1985 <<https://www.hcch.net/en/instruments/conventions/full-text/?cid=59>> accessed 6 March 2016.

Section 11 of the Trust Law provides that these obligations to keep accounts and to report to the beneficiaries are subject to the terms of the trust deed. As a result, the trustee may be exempt from these duties entirely in the trust deed. However, under the Law for the Taxation of Trusts,<sup>26</sup> the trustee is required to keep accounts and to file annual tax reports regardless of the trust deed.

### **Responsibility for damages**

Section 12(a) of the Trust Law provides that the trustee is responsible for damage caused to the trust property of the beneficiaries in consequence of a breach of his duty as trustee, whereas section 12(c) provides that the trustee may apply to the court for directions, and he will bear no responsibility if he acted in good faith in accordance with its directions or with its approval.

### **Prohibition on benefit and conflict of interests**

Section 13 of the Trust Law prohibits the trustee from deriving any benefit for himself or for any of his relatives from the property or activities of the trust, or to act in a conflict of interest between the trust and himself or any of his relatives. However, section 13(c) provides that the court may approve such actions in advance.

### **Invalidation of actions by the court**

Section 14 of the Trust Law deals with certain actions of a trustee, that may affect a third party, and performed in violation of his duties as trustee. This section goes on to state that such actions, in certain cases detailed in the section, may be invalidated by the court. This section broadens the grounds upon which a lawsuit may be brought against the trustee before the court, in addition to ones mentioned in sections 12 and 13 above.<sup>27</sup>

### **Property of a revoked trust**

Section 16 of the Trust Law deals with a situation where a trust was revoked, yet the trust terms contain no instruction as to how the assets should be disposed of. Section 16 sets a default situation, and thus provides that an application should be made to the court in such circumstances, and the court will instruct how the property should be disposed of in accordance with the criteria stipulated in the section.

### **Appointment of a trustee and the safekeeping of the trust assets**

Section 21(b) of the Trust Law provides who in the absence of a trustee, the court may appoint one. Section 22(b) of the Trust law further provides that once a trustee is appointed by the court, his resignation requires the court's approval as well.

Furthermore, section 24 of the Trust Law provides that as long as a trustee has not been appointed, the Public Trustee<sup>28</sup> will take such measures as he deems appropriate to safeguard the trust property and the rights of the beneficiaries.

### **Supervision of the District Court**

Section 39 of the Trust Law lists the persons who are entitled to apply to the court in any matter under the Trust Law. Among these entities are the trustee, the beneficiaries, the settlor, the Attorney General, and any other 'interested person'. As evident, the scope of the section is broad. The purpose of this broad scope is to facilitate the inspection of the affairs of a trust, which is not managed properly, by the court.<sup>29</sup>

### **Supervision by the Administrator General and the court on testamentary trusts**

Section 17(a)(2) of the Trust Law provides that a trust can be created by a written will of the settlor, whereas

26. see n 32, and the section titled 'Reporting obligations to the Israeli Tax Authority' of this article.

27. Kerem (n 6) 581–82.

28. Trust Law (n 1).

29. Kerem (n 6) 807.

section 17(b) provides that the trust will commence upon the transfer of control of the trust property to the trustee. Furthermore, a Will is valid only if a probate order was issued with respect thereto.<sup>30</sup> Accordingly, a testamentary trust is validated only upon the issuance of a probate order with respect thereto as this in fact grants the trustee control over the trust property.

A testamentary trust, as any other Will, must therefore undergo a probate procedure. This procedure requires that every application for a probate order be examined by the Representative of the Administrator General, who may, at his full discretion, intervene and bring the testamentary trust for the examination of the court.<sup>31</sup>

### **Reporting obligations to the Israeli Tax Authority**

This article does not deal with the issue of taxation of trusts, yet one should note that the Law for the Taxation of Trusts,<sup>32</sup> came into force in 2006,<sup>33</sup> and was amended in 2015.<sup>34</sup> The Law for the Taxation of Trusts classifies trusts into categories, and imposes tax and reporting obligations on the trustees and beneficiaries in accordance with this classification.

### **Reporting obligations of trustees who are attorneys or accountants**

The Trust Law does not require the fulfilment of any prerequisites in order for an entity or a person to be

appointed as trustee in a private trust under section 17, other than the general requirement provided in section 21(d) of the Trust Law, whereby the trustee must have the legal capacity to act as such.<sup>35</sup>

However, due to the professional expertise required by the trustee, families often choose the services of attorneys or accountants for this purpose. Both of these professions are now regulated under law, and supervised by their respective professional statutory organization.<sup>36</sup>

When either an attorney or an accountant provides trusteeship services, he must comply with requirements stipulated in Anti-Money Laundering legislation, which includes the AML Law and the AML Order relating to business service providers ('BSPs').<sup>37</sup> Failure to comply with these requirements may result in an ethical offence.<sup>38</sup>

Under the AML Order, a BSP may not provide a service to a client without having first identified the client and without performing a client due diligence procedure pursuant to the form included in the First Schedule of the AML Order.<sup>39</sup> The BSP must gather all relevant documentation pursuant to the form.<sup>40</sup> The BSP must also obtain a declaration from the client as per the form contained in the First Schedule whereby the client is acting on behalf of himself, or alternatively, is acting on behalf of others, who must be identified.<sup>41</sup>

The BSP must then scrutinize the identification data provided to him pursuant to the form, and evaluate the risk of money laundering and of terrorist financing. The risk evaluation must be based, *inter*

30. Succession Law (n 10) s 39.

31. Succession Regulations, 1998, KT 5923, 1256, s 54 (Isr).

32. Income Tax Ordinance [New Version] 5721-1961, 6 LSI [NV] 120, Forth(2) ch: Trusts (1961) (Isr) (the 'Law for the Taxation of Trusts').

33. Amendment No 147 of the Income Tax Ordinance, 5765-2005, 2023 SH 766 (2005) (Isr), which came into force on 1 January 2006.

34. Amendment No 197 of the Income Tax Ordinance, 5773-2013, 2405 SH 116, 140 (2013), which came into force on 1 December 2015.

35. s 21(d) provides that 'a minor, a legally incompetent person, a bankrupt and a corporate body in respect of which a winding-up order has been made, are not qualified to be trustees of a Hekdesh'.

36. Attorneys in Israel are regulated by the Israel Bar Association, which operates under the Bar Association Law, 5721-1961, 347 LSI 178 (1961) (Isr); Accountants in Israel are regulated by the Accountants Council, which operates under the Accountants Law, 5715-1955, 173 LSI 26 (1955) (Isr).

37. Prohibition on Money Laundering Law, 5760-2000, 1753 LSI 293 (2000) (Isr) ('AML Law'), and Prohibition on Money Laundering (The Business Service Providers Requirements Regarding Identification, Record-Keeping for the Prevention of Money Laundering and the Financing Of Terrorism) Order, 2000, KT 7447, 310 (Isr) ('AML Order'). s 8B(a) of the AML Law defines a Business Service Provider as:

an attorney or an accountant when they provide or are asked to provide a business service for a client, as part of their professional services and Section 8B(c) defines 'business service' as such that includes the 'creation or operation of . . . trusts for another'.

38. Bar Association Rules (Professional Ethics), 1986 KT 4965, 1372, s 44A (Isr); Accountants Regulations (Conduct Unbecoming to the Profession), 1965 KT 1738, 2240, s 1A(15) (Isr).

39. AML Order (n 36) s 2(a).

40. *ibid*, s 3.

41. *ibid*, s 4.



*alia*, on the client's characteristics, the type of business service requested, the source of the funds for the business service, the reasonableness of the data included in the form, and the information published on the Internet website of the Supervisor, who is appointed by the Minister of Justice.<sup>42</sup> The BSP must take into account the 'Red Flags' detailed in the Forth Schedule of the AML Order,<sup>43</sup> and confirm that the client is not listed in the List of Terrorist Organizations and Individuals published by the Ministry of Defence.<sup>44</sup> The final risk evaluation will be documented in the client's form, and it must include further information and explanation, if there is an indication of a high risk for money laundering.<sup>45</sup>

A BSP must retain the documents and information gathered under this procedure for a period of at least five years after providing the business service.<sup>46</sup> The Supervisor is authorized to review said documents and information for the purposes of an investigation or in order to supervise implementation of the provisions of the AML Law. Moreover:

A BSP shall, upon demand, submit to the Supervisor or to any employee authorized by him, documents,

information and explanations concerning the performance of his obligations under this order.<sup>47</sup>

## Summary

Private trusts under Israeli law consist of a number of trusts relationships that exists under Israeli law. As shown, there are certain trust relationships which are regulated under specific legislation.

As for private trusts, trustees of such trusts are not required to file reports with an authorized entity concerning the affairs of the trust under their responsibility, other than tax reports.<sup>48</sup> However, the activity of a trustee of an Israeli trust is supervised by the court, since the Trust Law provides for various grounds to apply to the court in the matters of the trust, and broadens the scope of those who may apply. In this respect, as in other jurisdictions, the private trust is supervised by the court.

Furthermore, as many of the private trusts in Israel are created and managed by attorneys and accountants, they are subject to the AML legislation, and accordingly are under the scrutiny of the Supervisor.

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42. *ibid.*, s 2(c); According to AML Order, s 1, and AML Law (n 36) s 12, the Supervisor is 'an employee of the Ministry of Justice, appointed by the Minister of Justice'. According to Government Notice No. 7223 of 7 March 2016, 4194, Advocate Adi Kominer-Peled was appointed Supervisor by the Minister of Justice, whereas her appointment came into force as of 1 February 2016.

43. The 'Red Flags' are available at <<http://www.justice.gov.il/En/Units/FBPS/DNFBPDuties/Pages/Red-Flags.aspx>> accessed 6 March 2017.

44. The List of Terrorist Organizations and Individuals is available at <<http://www.justice.gov.il/En/Units/FBPS/DNFBPDuties/Pages/List-of-Terrorist-Organizations-and-Individuals.aspx>> accessed 6 March 2017.

45. AML Order (n 36) s 2(b).

46. *ibid.*, s 8. This section also provides that the Supervisor may instruct the BSP to retain said documents and information for a period longer than 5 years.

47. AML Order (n 36) s 10.

48. Nonetheless, a trustee may be required to file tax reports with the Israeli Tax Authority under certain conditions. For more on this matter, please see the chapter on taxation of trusts.