

# Estate planning for the family business

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## Abstract

This article provides an overview of the factors to be considered in order to structure and grow a family business in Israel.

## Introduction: Israel

Israel is a small country, about the same size as Belgium in Europe or New Jersey in North America. It is located on the eastern shore of the Mediterranean Sea and has excellent access by air and sea to Europe, Africa, Asia and North America.

Israel is a country of immigration. Formal statistics of the Central Bureau of Statistics show that at the time of its establishment, Israel's population was only 872,700 people, out of which 716,700 (82%) Jews and 156,000 (18%) Muslims. These statistics also show Israel's phenomenal population growth, as Israel's population in the end of 2017 was 8,797,900, out of which 6,554,500 (75%) Jews, 1,838,200 (21%) Muslims and 405,300 (5%) others. All of whom enjoy equal legal rights in all areas of life.

These figures demonstrate the enormous task faced by the Israeli government and society in providing the necessary financial, legal and social services to such a large community of immigrants, from over 70 countries, with great differences in culture and background.

## High net worth individuals in Israel

The Credit Suisse Global Wealth Report of November 2017 found that there were 120,464 Ultra-High-Net-Worth Individuals (UHNWIs) in Israel in 2017. The report further shows how these UHNWIs are divided: 104,609 adult HNWI's hold assets valued in between 1 and 5 million USD (86.83%); 9301 adult HNWI's hold assets valued in between 5 and 10 million USD (7.72%); 5,685 adult HNWI's hold assets valued in between 10 and 50 million USD (4.71%); 506 adult HNWI's hold assets valued in between 50 and 100 million USD (0.42%); 315 adult HNWI's hold assets valued in between 100 and 500 million USD (0.26%); 28 adult HNWI's hold assets valued in between 500 million and 1 billion USD (0.02%); 20 adult HNWI's hold assets valued in over 1 billion USD (0.01%).

Israel is known as a “start-up nation” when relating to high-tech and technology. This sector of the economy is a source of tremendous wealth and has created a new generation of rich families. The magazine *Israel 21c* reported that in the year 2017 Israeli high-tech exits totalled in \$7.44 billion. This amount represents an increase of 9% over 2016, and 9% of those deals were worth \$400 million to \$1 billion. It is expected that families of shareholders and employees of the Israeli companies where the above investments were made will now join the circle of HNWI in Israel.

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In addition to the high-tech exists, many wealthy families immigrate to Israel while continuing to operate and manage their businesses in their countries of origin, and Israel in one of the countries that has experienced the biggest inflows of HNWI in 2017.

### **Estate planning for family business under Israeli law**

In this economic environment, wealthy families that own and manage businesses encounter the need to find proper solutions to transfer of the family wealth as well as the family business to the next generation. The possible solutions available under Israeli law are presented hereunder.

#### **The family constitution**

In Israel, a family constitution may be constructed under the applicable law of contracts, which includes the Contracts Law (General Part), 1973, the Contracts Law (Remedies), 1970, and relevant case law. In such cases, the family constitution may be enforceable against the parties who've agreed to it only. Given that the family constitution is meant to regulate the family relations within the family business across generations, such a contract would most likely become ineffective over time as members of the family change. Moreover, to enforce such a contract, a claim must be filed with the court, which may result in unwanted litigation.

Due to these reasons, a founder of a family business should consider other means or structures under other laws to enable the transfer of the family business to the next generation more effectively.

#### **A gift**

The founders of the family business may transfer ownership of the business to other members of the family at any time they choose to by way of a gift. The Gift Law, 1968, governs this procedure. There's no gift tax in Israel.

### **Inheritance**

A family business may be transferred to the next generation by way of succession. The Succession Law, 1965, governs individuals who were residents of Israel or owned assets in Israel at the time of their death. The succession procedure has its perils, and the heirs or other members of the family may challenge the bequests under the testament, and litigation in court may arise.

The principle of *Freedom of Testation* is one of the cornerstones of the inheritance law in Israel. It provides that a testator/testatrix may bequeath his or her estate in any way they see fit. Accordingly, it enables the founder of the family business to bequest in his testament who will be the successive leaders of the business and what would be the share of the other members of the family in the business.

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#### **A trust**

Israeli Trust Law, 1979, enables the founder of a family business to transfer the family business to the next generation by creating a private trust.

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The Trust Law defines a trust as the duty imposed on a trustee to hold or to otherwise deal with assets under its control for the benefit of another or for some other purpose. The Trust Law further provides that a trust can be created by either a contract, by deed of *Hekdesh* or by a testament.

A trust created by a contract is governed by the contracts law and requires accordingly an agreement

between the settlor and the trustee with no specific procedure necessary for its validity.

A Trust created by a deed of *Hekdesh* (“Endowment”) must be in writing and signed in the presence of a notary. This Trust becomes operative during the lifetime of the settlor upon transfer of the assets of the trust to the control of the trustee.

A valid testamentary trust must comply with the formal requirements under the Succession Law for executing a will. These include signing the will in the presence of two witnesses or of a notary. A Testamentary trust will become valid after upon issuance of a probate order with respect thereof.

### **A corporate structure**

The Israeli Companies’ law of 1999 governs the incorporation, management and activity of a company. The Companies Law provides, *inter alia*, that a company must have a document known as by-laws or regulations, which together with the applicable companies’ law, provides the legal framework under which a company operates.

Accordingly, when a family business operates under a company, its “Family Constitution”—i.e. instructions regarding the proper manner to manage the family business, may then be incorporated into the company’s by-laws or regulations, thereby “upgrading” the Family Constitution from a mere agreement between the family members, to an enforceable instrument under companies’ law.

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## **The Family Office in Israel**

In Israel, there are commonly known two types of family offices: a Single-Family Office (SFO), which provides services to one family exclusively; and a Multi-Family Office (MFO), which provides services to more than one family at a time.

Israel’s growing economy provides a fertile environment for family offices, asset managers and trust and estate practitioners, as there is a growing need to provide various services to family businesses, such as legal structuring for the transfer of the family business to the next generation, management of the family’s wealth, as well as other personal services.

## **Conclusion**

Israel’s growing economy provides a fertile ground for the growth of family business and wealth. This in turn increases the need of each such family to properly structure the family business and its transfer to the next generation.

Israeli law provides a verity of tools to structure the family business, and it is therefore highly recommended that such families consult with professionals for this purpose, such as members of the international Society of Trusts and Estate Practitioners (STEP). Proper planning can significantly reduce costly and cumbersome court litigation, as well as assist to maintain the connections within the family members as well as the wishes of the founder of the family business.

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