

Israel: trusts and succession

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Abstract

The Israeli Foundation refers to the legal structure of an Israeli private trust, created in combination with an underlying company to hold the trust assets. This article will focus on this structure, as well as on the creation of the Israeli private trust by way of a deed (*hekdesh*) or by way of a contract. The article will continue by looking into the Israeli real estate trust, which is commonly created by a contract, and finally the article will explore the inheritance procedure in Israel and the issues arising from the conflict between the Trust Law, the Contracts Law, the Succession Law and the Gift Law.

Introduction

Trust arrangements in Israel include trusts created in various ways. The private trust is often created by an *inter vivos* trust deed, a testamentary trust or by a contract between the settlor and the trustee. The creation of a trust is often combined with the incorporation of an underlying company, whose purpose is to hold the trust assets on behalf of the trustee, a structure that may be referred to as the *Israeli Foundation*. This article will address the private trust as a vehicle for estate planning, as well as for the purpose of holding real estate, under the Trust Law, Contracts Law and the Succession Law, and the conflicts that may arise in this context.

The Israeli trust

The Israeli Trust Law¹ defines a trust as “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 or for some other purpose.” Section 2 of the Trust Law continues and provides that “a trust is created by law, by a contract with the trustee or by an instrument of *hekdesh deed*.”

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A trust created by law

Trusts created by law include fiduciary relationships, usually appointed by the courts that, by their nature, fulfil the definition of a trust irrespective of the intention of the parties to create a trust, such as corporate liquidators or receivers, guardians or estate administrators.

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1. Trust Law, 5739-1979, 33 LSI 41 (1966–1967) (Isr.).

A trust created by an instrument of *hekdes*

Section 17 of the Trust Law provides for the creation of a *hekdes*, when a property is dedicated in favor of a beneficiary or for some other purpose by a written document, in which the *hekdes*'s settlor expresses his intention to create the *hekdes*, determines its objectives, property and conditions, and when such written document takes one of the following forms:

- A written document signed by the *hekdes*'s creator before a notary. A trust created in this manner is commonly known as an *inter vivos* trust under Israeli law.
- A written will from the *hekdes*'s creator, created in accordance with the Succession Law which provides that a written will can be made before two witnesses, the court or a notary, or in handwriting by the testator. A trust created in this manner is commonly known as a testamentary trust under Israeli law.
- A payment instruction in accordance with Section 147 of the Succession Law,² which provides that payments made to beneficiaries under an insurance policy are not included in one's estate.

A trust created by a contract

Trusts created by contract include an agreement between the settlor and the trustee, whereby the trustee will hold certain assets owned by the settlor for the benefit of third parties. The rights and obligations of the parties, as well as the terms of the trusts created by contract are determined by the agreement between the parties which may be amended or revoked in accordance with the terms of the agreement. While trusts created by contracts are valid during the settlor's lifetime, they may be invalid instruments for the intergenerational transfer of assets from

the settlor to his heirs without the relevant court proceedings, whether probate or intestate, as discussed further below.

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A trust underlying company

The trust, including the *hekdes*, is not recognized as a legal entity in Israel³ and, therefore, it is common practice of trustees to hold the assets of a trust via an underlying company incorporated in accordance with the provisions of the Income Tax Ordinance,⁴ thereby creating a designated legal entity to hold the trust's assets on behalf of the trustee. This legal structure is referred to in this article as the *Israeli Foundation*.

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According to Section 75C of the Income Tax Ordinance, such an underlying company is defined as set forth below: "a company that directly or indirectly holds trust assets for a trustee and for which all the following hold true:

1. it was set up only in order to hold trust assets;
2. in respect of a company that holds trust assets of Israel resident trusts, or of an Israeli resident

2. Succession Law, 5725-1965, 19 SH 215 (1964-65) (Isr.).

3. PCA 46/94 *Zacks-Abramov v Land Registry Officer* 50(2) PD 202 [1996] (Isr.).

4. Income Tax Ordinance (New Version), 5721-1961, 6 DMI 120 (1961) (Isr.).

beneficiary trust, or assets of a testamentary trust in which there is an Israeli resident beneficiary, or trust assets that are in Israel, notice of its incorporation and status as such shall be communicated to the Assessing Officer at the tax authority within 90 days after the incorporation.

3. *the trustee directly or indirectly holds all its shares; for purposes of this paragraph, “holding indirectly” – only holding through another company to which the provisions of paragraphs (1) and (2) apply and all the shares of which the trustee holds.”*

A common trust created under a contract: a real estate trust

A Real Estate Trust (“RET”) is a legal structure under which real estate is purchased by a trustee, or is transferred to a trustee, and the trustee acts as a nominee, i.e. a “bare trustee”, for an identifiable beneficiary. This legal structure is governed by the Taxation of Real Property Law⁵ and the Trust Law.

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Under the RET, the trustee is recorded in the Land Registry⁶ as the legal owner of the real property – either directly or indirectly via a company incorporated for this purpose, i.e. a special purpose vehicle (SPV), whose shares are wholly held by the trustee. The trustee then acts with respect to the real estate in accordance with the terms of the trust contract, executed between the trustee and the settlor.

The merits of the relationship are to determine the existence of the trust with respect to the real property, as evidenced in the case of *Tauber*⁷ where a trustee was registered in the land registry as the owner of real property. The registration did not make a reference to the fact that the property was held in trust.⁸ The trustee was declared bankrupt and a creditor tried to attach the property for the satisfaction of his claim against the trustee. The court was presented with evidence that the property was held in trust for beneficiaries, and, upon accepting this evidence, ruled that the creditor had no right against the real property even though the land registry did not make any reference to the rights of the beneficiaries. This was an important precedent reconfirming the concept of holding real estate in trust for a beneficiary and ensuring beneficiaries’ rights against third parties.

In addition to the RET described above, it is worth noting is the “Israeli-made Constructive Trust”. This arrangement refers to a RET declared as such by the court, such as in the case of *Tzimblor*.⁹ In this case, the Tzimblor spouses purchased an apartment, but before the rights were registered in their names, the seller passed away, leaving the apartment to his widow, who refused to register the apartment under the name of the Tzimblor spouses. The Supreme Court held that the Tzimblor spouses had a beneficial right in the apartment, which is a semi-proprietary right, recognized under Israeli law, therefore a trust relation existed by law between them, and the widow held the title to the apartment for the benefit of the Tzimblor spouses as beneficiaries.

Inheritance in Israel

One of the more common ways to transfer assets to the next generation is by an inheritance procedure.

5. Taxation of Real Property Law (Capital Gains and Purchase), 5723-1963, 17 SH 193 (1963) (Isr.)

6. Under the Land Law, 5729-1969, 23 SH 293 (1968-1969) (Isr.), the Ministry of Justice keeps and manages a public record of property rights – the Land Registry. Under Section 125 of the Land Law, the records of Land Registry are regarded as conclusive evidence of the rights prescribed therein.

7. File no. 5955/09 Supreme Court, *The official Receiver v Tauber* (July 19, 2011), Nevo Legal Database (by subscription) (Isr.).

8. Such a reference is possible under a procedure named “caveat” under Section 4 of the Trust Law, and Land Law, 5729-1969, 23 SH 293, §127 (1968-1969) (Isr.).

9. CA 1559/99 *Tzimblor v Turgeman* 57(5) PD 49 [1993] (Isr.).

Inheritance in Israel is governed by the Succession Law. According to section 2 of the Succession Law, the estate of a deceased passes to his heirs in accordance with the law – intestate inheritance, unless the deceased left a valid will, in which case the estate is bequeathed in accordance thereto.

Probate proceedings in Israel

Under the Succession Law, the rights of the heirs in the estate are created only upon the issuance of an order with respect to the estate by a competent authority. In circumstances where the deceased left a will, an application should be made for a probate order, and only upon the issuance of the order the will becomes valid and enforceable. It should also be noted that only a probate order issued in Israel in accordance with the Succession Law is regarded as valid. Probate orders issued by foreign authorities are not recognized.¹⁰ However, in circumstances where the deceased left a will relating to only a part of his or her estate, or the deceased did not leave a will at all, an application should be made for an inheritance order.¹¹

Both an application for a probate order and an application for an inheritance order are made to the Registrar of Inheritance, which is authorized to declare the rights of the heirs accordingly.¹² However, under the circumstances described in Section 67A of the Succession Law, the Registrar of Inheritance must forward the application to the Family Court. Such circumstances arise, for example, when the application is contested, when the will has a fault or a defect, or when the Administrator General represents a minor in the application. The Family Court is authorized accordingly to issue the relevant order.¹³

The probate procedure in Israel requires that the original will be submitted to the Registrar of Inheritance,

except for an oral will. In the absence of an original will, for example when the original has already been submitted in another jurisdiction, a separate application should be made to the court to approve the submission of a copy.¹⁴

Section 54 of the Inheritance Regulations¹⁵ provides that a copy of any application, including an application for a probate or inheritance order, shall be submitted to the review of the Administrator General, who may, at its discretion, review the application and require further information and documents.

Section 17 of the Inheritance Regulations requires that a notice with respect to the application for the inheritance or probate order be published in one daily newspaper and in the formal publication of the State of Israel (*Reshumot*). The notice includes an invitation to contest the application.

Section 14 of the Inheritance Regulations provides that an application for a probate or inheritance order shall be dismissed, unless notifications are sent with respect thereof as follows:

- a. An application for an inheritance order – notifications to the legal heirs listed in the application.
- b. An application for a probate order – notifications to the beneficiaries under the will, together with a copy of the will. If the beneficiaries under the will do not include the children of the deceased or their children, the parents of the deceased or their children, or the deceased's spouse, then such notifications should be delivered to the deceased's children and spouse at the time of his death, and if none of them is then living – to the deceased's parents, and if none of the parents is then living – to the deceased's siblings.

As evident from the above, the inheritance procedure in Israel is a complex and cumbersome procedure.

10. Succession Law, § 39.

11. Succession Law, § 66.

12. Succession Law, § 66.

13. Succession Law, § 67A(b).

14. Succession Law, § 68(b).

15. Inheritance Regulations, 1998, KT 5923 (Isr.).

The Succession Law versus the Trust Law

Settlement of assets into a trust can be made during the lifetime of the settlor, when an *inter-vivos* trust is settled, or upon the issuance of a probate order when a testamentary trust is formed.

The Succession Law does not permit an agreement with respect to an individual's inheritance, and such an agreement is void under Section 8(a). In addition, Section 8(b) provides that a gift granted during an individual's lifetime which is to be finalized after the donor's death is invalid unless it is included in the donor's last will and testament. The formalities for the execution of an individual's last will include, among other options, the execution of the will by the testator before two independent witnesses.¹⁶

Lola Baer, (the "Deceased"), prior to her demise, sent a letter to the president of Ben Gurion University (the "University"), in which she has undertaken to make annual donations of USD 50,000 to the University up to a cap of USD 1 million, and stated that she had instructed the executors of her last will to continue to make these donations accordingly. The beneficiaries under her will contested this statement, and argued that it is invalid under Section 8(b) of the Succession Law in a case known as the case of *Lola Baer*.¹⁷

The Supreme Court distinguished between an *inter vivos* gift, valid under the Gift Law,¹⁸ and a gift to be finalized upon the donor's demise, which is invalid under Section 8(b) of the Succession Law, and held that the Deceased has lawfully undertaken to grant a gift to the University in accordance with Section 5 of the Gift Law, which also provides that the donor may revoke the undertaking to grant the gift, unless this right has been waived in writing. The Supreme Court further determined that the right to revoke the undertaking is a personal right, and therefore it cannot be executed by the Deceased's heirs or the administrator of her estate. Accordingly, and since the Deceased has not waived her right to revoke the gift in her letter, the undertaking is valid and cannot be revoked.

It follows from the *Lola Baer* case that a gift deed is viewed as a written undertaking to grant a gift to the donee, and for such undertaking to be valid, it must meet the conditions set forth below:

- a. The terms of a gift deed must be agreed upon in writing.
- b. The deed must expressly state that the gift is irrevocable.
- c. The granting of the gift must be finalized during the lifetime of the settlor, or at least, the intention of the donor is that the gift shall be finalized during his or her lifetime.

In the context of this article, the above can be implemented in a contractual trust, and it can be therefore argued that a trust contract that complies with the following conditions shall be valid:

- a. The trust contract is in writing.
- b. The trust contract states expressly that the trust is irrevocable.
- c. The terms of the trust provide that the assets are held by the trustee and distributed to the beneficiaries (excluding the settlor) during the lifetime of the settlor, and effectively causing the settlor to completely disassociate from the assets during his lifetime.

In the case of *Kasirer*,¹⁹ the settlor created a trust by a contract, where he appointed trustees and instructed them to see to his commemoration after his death. For this purpose, the settlor granted the trustees with control over his bank account prior to his death, but did not include such instruction in a valid last will and testament. The Supreme Court held that since the trust, by its nature, was intended to be created only after the death of the settlor, it does not comply with the requirements of Section 8 of the Succession Law, and therefore is void.

16. Succession Law, § 20.

17. CA 3727/99 *Ben-Gurion Univ. of the Negev v Ben-Bassat* (Jul. 7, 2002), Nevo Legal Database (by subscription) (Isr.).

18. Gift Law, 5728-1968, 22 LSI 113 (1968) (Isr.).

19. Family Appeal Motion 7033/15 *Doe v. Doe* (Apr. 16, 2008), Nevo Legal Database (by subscription).

As a result of the requirements of the Succession Law, contractual trusts which do not comply with the requirements of the Succession Law, cannot be used for the transfer of assets after the demise of the settlor if no probate/inheritance order is granted with respect to said transfer, as set forth above.

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settlor if no probate/inheritance order is granted with respect to said transfer, as set forth above

Conclusion

The Israeli trust can be considered as an efficient instrument for estate planning, yet in order to use it effectively, one must consider the proper manner to create the trust, while taking into account the Succession Law, including the requirements of Section 8(b) and the implications of conducting an inheritance procedure.

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