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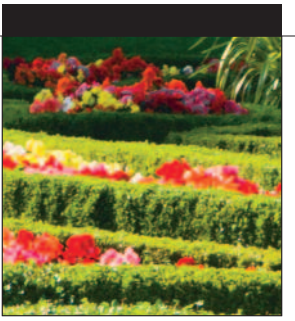

What Every Estate Planner Should Know About Estate Planning in Israel in a Nutshell

Estate planning and administration considerations for non-residents with assets in Israel.

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Estate planning is almost never done at a convenient time, is emotionally challenging and stressful and never easy. Add cross border considerations, legal advice in various jurisdictions and so many decisions required to the mix and it results in a crisis which too many people decide to avoid. Unfortunately, the lack of proper planning comes back to haunt them or their survivors at some point.

This article will summarize some of the most common issues that may be important for international advisors to be aware of from the Israeli estate planning perspective. It is not intended as a comprehensive treatise but rather as a general guide to pinpoint the issues.

The Succession Law 1965 (the "Succession Law") governs inheritance matters in Israel, including the validity of wills, including foreign wills, inheritance rights of intestate heirs, as well as estate administration, maintenance rights to payments from the estate to dependant family members, payment of a decedent's debts, executors, and private international law issues in this area. One of the main principles of the Succession Law is that of freedom of testation and the fulfilment and honouring of a decedent's last wishes[1] with no forced heirship rules similar to those imposed in some foreign jurisdictions and certain related rules such as the elective share in NY.

Foreign residents owning assets in Israel

An owner of assets in Israel, including, real estate, investment accounts, investments in Israeli start-up companies, or any other Israeli asset, irrespective of the owner's country of residence, should be aware that no proceedings granting a probate or an inheritance order in any foreign jurisdiction will be valid in Israel for the transfer of Israeli assets to heirs upon the demise of the owner. The Succession Law provides that an Israeli court has jurisdiction to hear matters involving the inheritance of an individual residing in Israel at the time of his death or an individual who owned assets in Israel.[2] Therefore, only a probate or an inheritance order issued by the relevant Israeli authority, i.e., the inheritance registrar for Israeli residents or the family court for non-residents will be a valid authority for the transfer of Israeli assets upon the demise of the owner.

Estate Administration

Intestate Succession. The Succession Law governs intestate succession and provides that an individual's legal heirs are as follows:

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1. The individual's married spouse;
2. The individual's common law spouse, under certain circumstances, including same sex spouses;
3. The children of the deceased and their issue (including illegitimate and adopted children and their issue), the parents of the deceased and their issue, the grandparents of the deceased and their issue.
4. The state of Israel—in the absence of any other heirs. The state is obligated by law to dedicate the estate for the purpose of education, science, health, and welfare. The Minister of Finance, however, is entitled to make a lump sum payment, or periodical payments out of the proceeds of the estate, to any person who was dependent on the deceased, or to a person upon whom the deceased was dependent, or a relative of the deceased who is not an heir by law.

A surviving spouse, as aforesaid, is entitled to receive the tangible personal property, including a motor vehicle, which customarily, or in the particular circumstances, belongs to the common household. If the couple did not maintain a common household, for example, if they were not living together at the time of the death, the surviving spouse is not entitled to the household tangible personal property which then forms part of the general estate and is divided between the heirs by law as detailed below.

In addition to the household tangible personal property, the surviving spouse is entitled to a share of the estate—which share depends upon the relationship to the deceased of the other heirs by law who are entitled to inherit together with the spouse:

1. if the deceased is survived by children or their issue, or if the deceased is survived by parents—the share of the surviving spouse is a half;
2. if the deceased is survived by siblings or their issue or if the deceased is survived by grandparents—the share of the surviving spouse is two-thirds. If, however, the surviving spouse and the deceased were married to one another for at least three years prior to the death and if they lived together in a residence which, in whole or in part, is an asset of the estate, the surviving spouse is entitled to all of the rights of the deceased in such residence and two-thirds of the remainder of the estate.

Probate/Inheritance Procedure. Probate/inheritance proceedings differ where the estate is that of an Israeli resident or a foreign resident. For an Israeli resident, the probate/inheritance process is via the Registrar of Inheritances and lasts approximately 3-4 months where the facts are simple and no objections to the procedure are involved.

For foreign residents, Israel does not recognize foreign probate court orders. Upon the death of a non-resident owning assets in Israel, a probate/inheritance proceeding in Israel is required in order to transfer the assets located in Israel to the beneficiaries under a will or to legal heirs. The process commences with the Registrar of Inheritances and is transferred to the Family court for the issuance of an order.

In all procedures, a governmental agency named the Guardian General reviews and accompanies the procedure and may intervene if deemed necessary.

Both procedures are via an e-filing system and the documents include the original last will.[3] For estates of non-residents, the procedure can take a few months to a few years, depending on the efficiency of obtaining the duly certified originals abroad and whether there are any objections involved (including interference by the Guardian General's office). The annexed documents must all be duly certified via the Apostille procedure[4] or at an Israeli Consulate abroad and include identification documents, death certificate, and a legal opinion on the laws of the decedent's country of residence to satisfy the Succession Law requirement set forth above. Probate fees are not calculated based on the value of the estate as in some other countries such as Canada and are relatively minimal (about US $100).

No proceedings granting a probate or an inheritance order in any foreign jurisdiction will be valid in Israel for the transfer of Israeli assets to heirs upon the demise of the owner.

Governing Law. While the probate/inheritance proceedings are to be filed in Israel, the governing law for the distribution of the decedent's assets is the law of the jurisdiction in which a testator resided at the time of the testator's death[5]. The determination of residence under Section 137 of the Succession

1 *Estate of S.M., Deceased*; C.A. 5420/08.

2 Section 136.

3 Where no original will is submitted, an application is needed for the submission of a duly certified foreign court copy of the will.

4 Hague Convention Abolishing the Requirement of Legalisation of Foreign Public Documents 1961.

Laws is determined by the "center of life" test described herein and not simply by the presence of the individual in Israel at any time.

While the "center of life" is not defined in the Succession Law, it is defined by the Tax Ordinance [New Version] 1961 (the "Tax Ordinance"). The Tax Ordinance provides for a rebuttable presumption based on the number of days spent in Israel whereby an individual is presumed to be an Israeli resident if he is present in Israel for 183 days per year or 30 days in the current tax year and 425 days cumulatively during the previous two years.[6] Notwithstanding the day count, an individual is an Israeli resident if his "center of life" is deemed to be in Israel. The "center of life" test is based on specific facts and circumstances such as: (i) the place of the individual's permanent home; (ii) the place of residence of family members; (iii) the individual's place of business or his place of employment; (iv) the individual's place of economic and social interests and activities; (v) the place in which the individual is active in various organizations. It has been established that one's "center of life" is not determined by the individual's intention at any given time but rather, the place to which the individual has the most factual ties.[7]

It is important to note that, notwithstanding the Succession Law,[8] under the *renvois* doctrine, where the laws of a decedent's country of residence refer to the laws of another foreign jurisdiction, the reference will not be recognized and the laws of the decedent's country of residence will be followed by the Israeli family court. However, where the laws of a decedent's country of residence refer to Israeli laws, the Israeli family court will rule based on Israeli laws.

The Supreme Court considered whether a testatrix may choose the governing law of her last will in order to avoid forced heirship provisions in her country of residence.[9] The case concerned a last will validly executed in Israel by Ms. Klein, a citizen of Israel and the Netherlands residing in the Netherlands at the time of her death. A will she signed in Israel bequeathed Ms. Klein's Israeli assets to two of her three daughters, contrary to forced heirship rules in the Netherlands. Based on the Succession Law, the Supreme Court held that the decedent's estate was to be distributed in accordance with the laws of the Netherlands, her place of residence at the time of her death.[10] As the laws of the Netherlands include forced heirship provisions, the Supreme Court found that said laws

would be considered by the Israeli family court and govern the distribution of the decedent's estate.

The Tel Aviv Family court, found similarly although to a different set of facts.[11] The case concerned a decedent who executed a last will and testament in 2010 bequeathing her estate to her son. The decedent passed away a few days after executing the will and her husband then objected to the probate on the grounds of undue influence and incapacity. During the probate proceedings, the decedent's husband also commenced a separate action seeking a declaratory order of his entitlement to the marital elective share under New York law asserting the couple were NY residents. These proceedings were added to proceedings in New York where the husband was appointed as the executor of the decedent's estate. The Court rejected the husband's claim for the marital elective share under New York law on the grounds that the husband did not raise an objection to probate based on the decedent's residence but rather filed a separate action. While the court did not rule on the merits but found that as the action was brought by the estate which is not a legal entity with capacity to sue or be sued, if the Court decided the ultimate issue, the determination would have applied the decedent's center of life test in arriving at the decision.

Executors. There is no legal requirement to appoint executors in Israel although where there are no Israel resident heirs such an appointment may simplify the sale of assets and/or the distribution to heirs. In addition, no estate or gift taxes are imposed under the Tax Ordinance and no tax returns are due upon an individual's death.

If an appointment is approved by the registrar or the family court, the appointed executor is subject to the supervision of the Guardian General requiring reporting on the assets held by the estate and income derived therefrom, and must receive court approval for various actions taken such as the sale of real estate or distribution of assets to the heirs.

As a general rule, no estate or gift taxes are imposed under Israeli laws. An exception to this rule is where an Israeli resident gifts assets in kind to a foreign resident.

Israeli Wills. As a result of the separate Israeli probate, it is advisable to execute an Israeli will to govern assets in Israel in addition to any testamentary documents executed under the laws of any foreign country of residence. While a foreign will is valid under the Succession Law in accordance with the conditions set forth below, the Israeli probate process is simpler with a separate will relating to Israeli assets.[12] A foreign will is valid in Israel if it is valid:

1. Under the laws of the country where it was executed.
2. Under the laws of the country of residence or citizenship of the testator at the time of execution of the will or at the time of his death.
3. Under the laws of the country where real property is located, if it bequeaths real property.

Planning for incapacity

Durable powers of attorney. Durable powers of attorney (DPA) are governed by the Legal Capacity and Guardianship Law 1962 (the "Guardianship Law") which was amended in 2017 to allow for DPA's. The Guardianship Law allows a competent adult to appoint an agent based on instructions included in the DPA form and the provisions of the Guardianship Law but without subjecting the agent to supervision by any governmental agency unless the principal requests such supervision. The execution, e-filing, and enforcement of the DPA require following strict administrative and technological processes. Depending on the principal's wishes, the DPA may govern personal matters such as well-being, residence, daily needs, physical, mental, or social issues as well as financial matters and certain health/medical matters. The DPA is initially executed and e-filed in a database managed by the Guardian General's Office and is valid upon the principal losing legal capacity in accordance with a medical opinion determining said incapacity. An important issue to note for non-residents is that under private international law provisions of the Guardianship Law, a DPA under Israeli laws is governed by the laws of the principal's country of residence at the time of the execution of the DPA.[13]

The agent under the DPA is, in most cases, an immediate family member of the principal, i.e., a spouse or child. The Guardianship Law provides the criteria for the appointment

5 Succession Law - 1965, Section 137.
6 Part 1, Section 1.
7 *Shtark v. Birenberg*; C.A. 587/85.
8 Section 137.
9 *Guardian General v. Anonymous*; C.A. 594/04.
10 Section 137.
11 *Anonymous Estate v. M.M.*; C.A. 42807-11-13.
12 Section 140(a).
13 Section 77(b).

as agent, including, a competent adult, financially solvent (if appointed for financial matters), not providing medical treatments to the principal, or residence for a fee, other than a family member. Also, the agent is not to be the attorney confirming the DPA and any agent cannot act for more than three principals unless they are the agent's family members.

Based on the Guardianship Law, the agent under a DPA may not act on behalf of the principal in the following matters:

1. Change of religion;
2. Actions of the principal on behalf of others (such as guardianship);
3. Adoption;
4. Voting;
5. Health care directives under the Deathbed Patient Law 2005; and
6. Execution of a last will and testament.

In addition, in connection with financial matters, the principal must specifically authorize the agent, in the DPA, to act within the limitations below. If no reference is made in the DPA form, any such actions will require the agent to obtain court approval:

1. Granting charitable donations, gifts, loans in amounts of up to 100,000 Shekels (about US $30,000);
2. Other legal actions involving amounts between 100,000-500,000 Shekels (about US $30,000 – US $151,000); and
3. Actions relating to certain pension funds.

Notwithstanding the actions requiring specific authorization in the DPA form, the actions listed below require that the agent receive court approval to act irrespective of authorization in the document:

1. Real estate transactions;
2. Renunciation of an inheritance in estate proceedings;
3. Charitable donations, gifts, or loans in amounts exceeding One Hundred Thousand (100,000) Shekels (about US $30,000);
4. Legal actions in amount exceeding Five Hundred Thousand (500,000) Shekels (about US $151,000); and
5. Transactions in provident funds.

A DPA may be terminated upon the death of the principal or the agent, if no successors are appointed, upon an event determined by the principal in the DPA to terminate the appointment, upon notification by the agent or if a spouse is the appointed agent and the spouses divorce.

Health Care Directives. An agent under a DPA is authorized to make any 'routine' medical decisions if the

principal authorizes an agent to act for medical matters. These include all medical decisions other than those governed by the Deathbed Patient Law 2005 described below. Also included under the DPA is authority for the agent to act on behalf of the principal in mental health issues.

Living wills and advanced health care directives are set forms provided by the Ministry of Health for terminal illnesses under the Deathbed Patient Law and are relevant where a patient has a life expectancy of up to 6 months as determined by their physician. These are signed before medical professionals (not attorneys) and are filed with the Ministry of Health.

Banking issues. A topic that is not directly connected with estate planning but is related thereto is the financial industry, specifically banking in Israel. Various valid legislation in this field, including the Banking Law (Client Service), 1981, Banking Rules (Client Service) (Due Diligence and Providing Documents) 1992, Anti Money Laundering Law 2000, Anti-Terrorist Financing Law 2005, governs the banking industry together with circulars and procedures published by the bank of Israel.

In practice the banks are concerned with two main issues, namely, tax compliance of the customer worldwide and the source of the funds transferred to the Israeli bank. Any international transaction is carefully scrutinized, and an in-depth due diligence process is undertaken by the legal and compliance departments of the bank. In many cases, self-certification by customers is insufficient and the facts, including the compliance and source of funds issues, need to be confirmed by professionals such as attorneys or accountants.

Planning with Trusts

Trusts are recognized in Israel, whether settled under the Israeli Trust Law 1979 (the "Trust Law") or under the laws of foreign jurisdictions. Under the Israeli Trust Law, a trust duly executed before an Israeli notary, known as an Hekdesh, is a will substitute if the trust is administered in a manner in which assets are transferred to the trust during the settlor's lifetime owned by the trustee, and do not form part of the settlor's estate upon their demise.[14] Precedent has established that trusts are not separate legal entities,[15] and therefore, assets are to be formally registered in the name of a trustee or an underlying company of the trust.[16]

Foreign trusts and foundations are recognized in Israel for many purposes, including corporate/high-tech investments, real estate ownership (with caveats mentioned below) and estate planning/probate. In addition, the Income Tax Ordinance, First Schedule, lists the legal entities recognized by the Tax Ordinance as follows: a Liechtenstein foundation, establishment, and a Reg. Trust, Panama, the Bahamas, and the Netherlands Antilles.

Taxation of Trusts. The Tax Ordinance sets forth the categories of trusts listed below[17]:

1. Foreign resident trust;
2. Israeli residents trust;
3. Israeli resident beneficiary trust;
4. Foreign beneficiary trust; and
5. Testamentary trust.

Foreign resident trust ("FRT")

Definition: All grantors/settlors and all beneficiaries are and have always been non-residents of Israel. Recognized Israeli charitable organizations, as beneficiaries, do not change the trust categorisation where all other characteristics of the foreign resident trust are applicable.

Taxation: The FRT is treated as a foreign resident for tax purposes and is subject to reporting and tax obligations in Israel only to the extent that it holds Israeli assets or derives income from Israeli sources.

Israeli residents trust ("IRT")

Definition: A trust in which, at the time of its settlement:

- At least one grantor/settlor and one beneficiary are residents of Israel; and
- During the tax year, at least one grantor/settlor or one beneficiary is an Israeli resident.

In addition, the IRT is the default category for any trust that does not match the definition of any other trust under the Tax Ordinance.

Taxation: An IRT is subject to annual reporting in Israel and is taxable in accordance with the Tax Ordinance on its worldwide income. Distributions to beneficiaries are not subject to additional tax payments once the relevant tax payments have been made by the trustee.

Israeli resident beneficiary trust ("IRBT")

Definition: A trust settled by a non-resident of Israel where at least one beneficiary is an Israeli resident.

Two additional criteria must be met for an IRBT to be classified also as an IRBT or Israeli relatives trust. First, the grantor/settlor and the beneficiaries must be immediate family members (i.e., the settlor is a spouse, parent, grandparent, child, or grandchild of the beneficiary), making this a relatives trust. A broader family relationship (siblings, nieces, nephews, aunts, uncles, etc.) will permit classifica-

14 Section 17 of the Trust Law.

15 *Ayala Zacks Abramov v. the Land Tax Supervisor*, CivA 46/94.

16 Defined in Section 75c of the Tax Ordinance.

17 Chapter Fourth 2 – Trusts.

tion as a relatives trust only if the assessment officer of the Israeli Tax Authority is satisfied that the trust was settled in good faith and that the beneficiary did not provide consideration for such settlement. Second, the settlor must be living.

Taxation: If even one of the above additional criteria is not met, the IRBT trust will be taxed as an IRT.

If all criteria are met the IRBT recognized as a relatives trust is subject to tax obligations as follows:

- The default tax option is that distributions to Israeli resident beneficiaries are taxed at the rate of 30% of the distribution amount unless the trustee provides evidence of the income and capital portions of the distribution. Where the distribution is comprised solely of capital and not of income, it is not taxable. Note, however, that the Tax Authority's position is that income is distributed prior to capital and in many cases, it may be difficult to provide the relevant distinction between capital and income.
- The trustee may opt, under certain circumstances, to subject trust income allocated to an Israeli resident beneficiary to tax at the rate of 25% in the tax year in which the income is accrued. This option requires annual reporting and annual tax payments on income and realised gains. If the tax payment is made annually by the trustee, distributions to beneficiaries are not subject to additional taxes.

Either option, i.e., distribution or annual, once chosen by the trustee, either actively or by default, is irreversible.

Foreign Beneficiary Trust ("FBT")

Definition: The FBT is a trust settled by an Israeli resident for the benefit of individual foreign residents.

The trust must meet all of the following conditions:

- It is irrevocable;
- All of the beneficiaries are identified individuals and are foreign residents; and
- At least one grantor/settlor is an Israeli resident.

If all above conditions are met upon the settlement of the trust, the trust deed must provide that no Israeli beneficiary can be added as a beneficiary of the trust and the grantor/settlor must declare that there is no Israeli resident beneficiary in the trust, or Israeli resident who may be appointed a beneficiary if he/she ceases to be an Israeli resident.

Taxation: A FBT is regarded as a foreign resident individual and is taxed in the same manner in which an individual foreign resident individual is taxed in Israel. If the assets and income are derived from sources outside Israel, there is no taxation in Israel. If the assets and income are derived from sources within Israel, they are subject to Israeli taxation. The trust is subject to reporting obligations upon its settlement and annually as confirmation of the beneficiaries' residence abroad. Exit tax may be applicable upon the settlement of assets in the trust.

Testamentary Trust. A testamentary trust is settled under an Israeli resident's last will and testament and is categorised as one of the above categories depending on the facts.

The trusts formed by foreign residents will usually be categorized as an IRT or an IRBT. The main issue to bear in mind is that upon the demise of the grantor of an IRBT, the trust is then an IRT, subject to Israeli taxes on its worldwide income although not all beneficiaries are residents on Israel.

Trusts holding Real Estate. Under the Trust Law, while real estate can be held by a trust, via the trustee or an underlying company as the trust is not a separate legal entity, the taxation of real estate transactions involving trusts are complex and unclear.

As a general rule, real estate transactions are taxed under the Real Estate Taxation Law (Gain and Purchase) 1963 and trusts are taxed under the Income Tax Ordinance. This results, in practice, in the taxation of real estate transactions held by trusts under the Real Estate Taxation Law as if there is no trust. While the two laws 'clash' relating to trusts holding real property at the time of writing, a Supreme Court Decision is very much awaited in this area.[18]

Gift, Estate, and Inheritance Taxes. As a general rule, no estate or gift taxes are imposed under Israeli laws. An exception to this rule is where an Israeli resident gifts assets in kind to a foreign resident.

In addition, as no estate taxes are imposed, for estate administration purposes, no step-up in basis is granted to date of death which may create some complexities for cross border estates. As a result, in many circumstances, once inherited assets are sold by heirs, the cost basis is the relevant amount from which to calculate gains for the purpose of determining the heirs' tax liability in Israel, where applicable. ■

18 *Samuel Gelis and others vs. Capital Gains on Land Director, Tel Aviv 1*; 49026-07-17.