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INTERGENERATIONAL TRANSFER OF A FAMILY BUSINESS

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Many businesses in Israel are owned and managed by families. In many cases, the businesses' founders are the family's father or mother, although there are also businesses that brothers and sisters establish. The result is that the founders of the businesses may include individuals who have established a successful business and have a family, second or even third generation, for whom the founders seek an estate planning program and preparation of legal business infrastructure for the intergenerational transfer of the business and its management. Below, we will refer to the business founders in the singular.

The founder of the business (the "founder") is considering retirement from the business, and the need arises to examine the appointment of new management and the transfer of business ownership to the next generation. Below, we will discuss some aspects of planning an intergenerational transfer of a family business.

1. "The Family Charter": Family Covenant and Contract Law

In many cases, a transfer of the business and control of it is carried out by appointing family members as managers and owners without documenting the transfer and expressing in writing who will receive the management functions.

In some businesses, and when there is an extended family, it is possible to create a document whereby the rules of transfer and management will be recorded after the retirement of the founder. In this article, the document will be defined as a "family charter.".

A family charter is a document that establishes the rights, values, responsibilities, and rules that apply to the owners of the family business and provides plans and structures for dealing with situations that may arise during the business's existence. Such a document may help the family cope with unforeseen events, maintain a focus on the issues that are most important to the family, resolve disputes, and create a common language and values that will serve as guidelines for the family, even for future generations who were not involved in the business at the time of its establishment.

Given the family charter's importance and its challenges, it would be advisable to supplement the family charter with additional legally binding and enforceable documents for the benefit of future generations.

In Israel, it is possible to draft a family charter according to contract law, which includes the Contracts Law (general part), the Contracts Law (remedies), and the relevant case law. In such cases, the charter may only be enforceable against the parties who have agreed to it. Given that the family charter is intended to regulate family relationships within the family business over generations, such a charter will likely not be enforceable over time as the family circle expands. Moreover, a lawsuit may be necessary to enforce it, which may cause unwanted litigation and tensions in the family.

Due to these reasons, the founder should consider additional legal structures according to other laws to allow the transfer of the family business and maintain the relationships into the next generations.

2. The Inheritance

A family business may be passed on to the next generation through a will. The Inheritance Law applies to individuals who are residents of Israel or who owned property in Israel at the time of death. The inheritance process is fraught with dangers and conflicts among family members. The heirs or other family members may object to the will's provisions, and litigation may arise in court. Such litigation can cause embarrassment, especially if published in the media.

3. Gifts

The founder of the family business may transfer ownership or control of the business to other family members during their lifetime at any time by way of donation or gift. The Gift Law in Israel regulates this procedure. There is no tax on gifts between family members in Israel.

The advantage of this procedure is that it allows the transfer of the family business during the founder's lifetime, who will be able to consider how effectively the business will be managed by members of the next generation and make changes accordingly. Moreover, this course of action eliminates the need for inheritance proceedings, which, as stated, may end up in expensive and unwanted litigation.

On the other hand, under certain circumstances, this option is impractical when none of the founder's children possess qualifications or are not interested in taking control of the family business. Moreover, such a transfer may not be desirable by the founder of the family business, who may refuse to give up control of the family business during his life. In such circumstances, the founder of the business will prefer to sell the business to a third party and distribute the proceeds to the next generation.

Gift after death

The law prohibits giving a gift that will take effect after death. Section 8 of the Succession Law states in subsection (a) that "an agreement regarding the inheritance of a person or a renunciation of his inheritance, made during the lifetime of that person, is void." Subsection (b) states that "a gift given by a person, so that it is given to the recipient only after the death of the granter of the gift, shall not have validity unless it was made in a will by the provisions of this Law." In the context of intergenerational transfer of the family business, it follows that if a founder chooses to transfer the family business by way of a gift, the execution of the gift must be implemented by transferring control of the business during his lifetime.

3. Corporate Structure

Another possible course of action that a founder can take to pass on the family business to the next generation is a combination of contract, inheritance, and company law.

In the context of the company, articles can be set forth in the company's articles of association that are legally considered a contract between the shareholders and the company and between the shareholders among themselves.

It is possible to formulate the articles of association of the company in a way that will meet the needs of the business and, in fact, implement the family charter within the company's framework. This arrangement allows shareholders to protect their rights and ensure the implementation of the family charter through the company law and the company's articles of association.

For example, the articles can provide for several types of shares, thereby allowing the founder to control the management of the company and the business while creating dividend shares that will be granted to family members but will not confer on them voting rights at the company meetings. The management shares can then be bequeathed by a will to selected family members whom the founder will choose to manage the business.

Additional relevant mechanisms may be added to the regulations, such as provisions for conducting mediation proceedings for dispute resolution or arbitration proceedings under the Arbitration Law.

4. Trusts

A trust structure under the Trust Law can be a good way to hold assets under centralized management and regulate the business activities according to the wishes of the head of the family business, who will be the trust's creator.

For many years, trusts have been part of Israeli society and continue to be so. The Trust Law defines a trust as the obligation imposed on a person to own or otherwise handle the assets under his control for the benefit of another purpose.

Due to the limitations outlined in Section 8 of the Succession Law mentioned above, a trust contract between the creator and the trustee, according to which control of the trust assets passes to the trustee only upon the creator's death, is invalid. Control must be given to the trustee during the life of the creator.

There is also the possibility of establishing a trust according to a will, in which case the trust will take effect upon issuing a probate order. Here, there is the risk that during the proceedings for the probate of the will, a conflict may develop between the family members and the heirs, and as a result, the establishment of the trust will be delayed, and problems may arise in the management of the business during the probate process.

Summary

The family charter is considered an important document. However, there are more efficient arrangements for the intergenerational transfer of ownership, control, and management of the business. Reality shows that situations such as marriage, divorce, death, and incapacity of the founder of the business or the person who received the management of the business require more than a contractual agreement between family members to deal with such events.

Legal structures for estate planning, such as making a lifetime gift, the wise use of company regulations, prenuptial agreements between spouses, a lasting power of attorney, and the creation of a trust, may provide solutions to ensure the orderly transfer of the business to future generations.

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