

# The International Family Offices Journal

Editor: Barbara R Hauser

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Raimund Kamp

## Interview with Sara Hamilton

By Barbara R Hauser

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Globe Law and Business would like to congratulate Barbara Hauser on being listed in *Spears 500* again in 2018 for Family Offices Services.

# The International Family Offices Journal

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# Case studies from Israel: family wealth transfers

Alon Kaplan and Meytal Liberman

## Introduction

### *Israel as a growing economy*

The state of Israel is a small country, about the same size as 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.<sup>1</sup> It is becoming an important jurisdiction for wealthy families.

The Credit Suisse Global Wealth Report of November 2016 has found that:<sup>2</sup>

- In 2016, 2% of Israelis (105,000 people) are defined as possessing more than \$1 million worth of holdings in cash, property and investments – an increase of 19% (17,000 people), out of which: 18 people are considered to be billionaires, 25 people are estimated to have between \$500 million and \$1 billion and 277 people have between \$100 million and \$500 million;
- In addition, 32% of Israelis are defined as possessing between \$100,000 and \$1 million; 42.5% of Israelis are defined as possessing between \$10,000 and \$100,000; and 23.5% of Israelis are defined as possessing between \$10,000 or less;
- The majority of wealth in Israel (70%) is financial instruments such as cash and securities, while the other 30% is comprised of real estate and other properties;
- Between 2000 and 2016, the average Israeli citizen's wealth has doubled from \$92,589 to \$176,263. The median wealth of an Israeli stood at only \$54,384 – about a third of the average wealth.

Furthermore, according to the 2017 report of PwC,<sup>3</sup> Israeli high-tech 'exits' (a merger, an acquisition or an initial public offering) in 2017 totalled \$7.44 billion – 110% more than the \$3.5 billion in 'exits' in 2016.

As is evident, Israel provides a fertile ground for both Israelis and foreign residents who wish to invest in the Israeli market and engage in business in order to increase their wealth.

### *The framework of this article*

This article will first present the reality of a few dominant wealthy families in Israel and of their family businesses, as well as the challenges

they face in their efforts to preserve the family wealth, and to transfer it to the next generation. These families and their stories can be considered as good examples of the challenges a wealthy family faces in Israel.

Based upon these cases, this article will discuss the relevant legal framework under Israeli law and the tools it provides for such families to deal with those challenges. The legal fields which will be discussed in this article include contracts, gifts, inheritance, trusts, legal capacity and guardianship, matrimonial property, and dispute resolution.

This method of drawing conclusions from selected cases is well accepted in this field of practice, as explained by Nicholas Smith:<sup>4</sup>

*Much family business writing and teaching is based on case studies of real life family business situations. By applying an extended treatment to a selected number of legal cases, we aim to use these to illustrate various issues of family business dynamics as well as to explain legal principles. It follows that some of the cases have been chosen on the basis that they illustrate issues of family business dynamics and whilst they are relevant to legal issues are by no means leading or landmark cases on the subject concerned.*

This article will also address the family office from an Israeli perspective.

## A family story

### *Stef and Eitan Wertheimer and the Iscar Company*

Iscar was founded in 1952 by Stef Wertheimer in the western Galilee town of Nahariya. In 1984, Stef handed over the reins to his son, Eitan. In 1995, Eitan Wertheimer handed over the CEO seat to Jacob Harpaz (a non-family executive), and went on to serve as Chairman, and later President, of Iscar. In 2006, the Wertheimer family sold 80% of Iscar's shares to Berkshire Hathaway, and subsequently sold the remaining 20% to Berkshire Hathaway for US\$2 billion.<sup>5</sup>

In an interview with the Israeli newspaper *Calcalist*, Eitan stated: "It was important for us to sell the business before family problems arise. We see what is happening in other family businesses, and there is no need to wait for problems." Eitan also added that "the best course of action would be not to transfer family businesses to the next generation, but rather that each generation will start his own new business".<sup>6</sup>

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*Israel provides a fertile ground for both Israelis and foreign residents who wish to invest in the Israeli market and engage in business in order to increase their wealth.*

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***The 'happy end' of Sami Segol and Keter Company***

Keter Plastics develops, manufactures and distributes a broad range of plastic consumer products throughout the world. It is regarded as an innovative global leader in the production of plastic products for the home and garden using the do-it-yourself method.<sup>7</sup>

The group has over 25,000 sales points around the world, 18 manufacturing plants, and two distribution centres spread over nine countries. It enjoys strong ties with retailers in all the markets in which it operates. The company has 4,000 workers, including nearly 2,000 in Israel, and its products are sold in 100 countries.<sup>8</sup>

Keter Plastics was founded in 1948 in Jaffa as a factory for making toys and household utensils, with Joseph Sagol being among its founders. His sons, Sami and Yitzhak Sagol, have managed the company since the early 1980s. In 2016, the Segol family sold their 80% stake in the company to the investment fund BC Partners. The acquisition is believed to be at a company value of \$1.3 billion.<sup>9</sup>

It is also reported that, according to a source close to the Segol family circle, the decision to sell Keter Plastics was made because the third and fourth generations of the family – four daughters and grandchildren – pursued careers in other fields and do not intend to continue the family business.<sup>10</sup>

***The successful story of the Strauss family Business***

In 1936, Dr Richard and Hilde Strauss immigrated to Israel from Germany with their son, Michael, and settled in Nahariya. Around the cabin in which they lived, they grew vegetables, set up a small cowshed and cared for two cows. Shortly afterwards, they began to sell dairy products from their farm, which slowly gained popularity. Eighty years later, Strauss Group is an international corporation that manages and develops its business in order to offer a wide range of food and beverage brands to entire populations, which are marketed through various commercial channels. The group has 14,000 employees worldwide, and is active in more than 20 countries. The group's turnover was estimated at IS 7.9 billion (\$2.3 billion) in 2016, of which its international operations account for 49%. Strauss has collaborations with Danone, PepsiCo, Haier and Virgin.<sup>11</sup>

In 1975, shortly after Dr Richard Strauss's demise, his children Michael and Raya took over the

management of the family business. In 2001, the baton was passed to the next generation with the appointment of Ofra Strauss, Michael's daughter, as chairperson of the group. Ofra's appointment followed a series of management positions she had held in the company. Ofra Strauss still runs the family business today.<sup>12</sup>

In a lecture by Ofra Strauss given at a scientific conference of the Israeli Cattle Breeders' Association in July 2013, she stressed the significance of long-term planning to a family business, and said:

*In Strauss, until 1995 the family was alone in the business. We made a principle decision not to sell the control over the business, to keep it a family business. ... we built an organizational identity to distinguish ourselves from our partners. ... Thus, when we came to the passing of the baton in the early 2000s, we implemented it based on organizational foundations laid down years beforehand. When the third generation joined the management of the company, the administrative infrastructure of the first and second generations was there and upon it the change of generations was executed.*<sup>13</sup>

***The court litigation of the Ofer family***

Ofer Investments Group was founded by Sammy and Yuli Ofer in 1957. They began their activities in the shipping industry under the name 'Mediterranean Lines'. By the 1960s, the brothers owned dozens of ships and decided to expand their operations into the income-generating real estate sector. The company has grown and expanded over the years, acquiring and constructing many properties, and becoming one of the leading players in its field. Today, the group is active in income-generating real estate, residential real estate, hotels and banks.<sup>14</sup>

Yuli Ofer passed away in 2011,<sup>15</sup> and after his demise a dispute arose between his son Doron, who was disinherited from his father's estate, and his daughter Liora. The long battle between the siblings was eventually concluded in a ruling of the Family Court in Tel Aviv in December 2013, whereby Liora receives the entire stake of her father in Ofer Investments, leaving her with 51% of the company.<sup>16</sup>

***Moshe (Muzi) Wertheim***

Moshe 'Muzi' Wertheim, a Mossad agent who became a billionaire by getting the rights to bottle Coca Cola

in Israel, died at age 86 in 2016. Central Bottling Company, which he formed in 1967, was a 'cash cow' that today controls 40% of the Israeli drinks market and generates annual revenues of IS 6 billion (\$1.6 billion) and operating profits in the hundreds of millions of shekels. Cola profits enabled Wertheim to build a business empire that included a 21.9% stake in Mizrahi-Tefahot, Israel's fourth-largest bank, control of the Channel 2 television franchisee 'Keshet', and a host of holding companies such as real-estate developer Alony Hetz, BMW importer Kamor and a financial services firm. He also invested in energy exploration.<sup>17</sup>

In 2013, three years prior to his death, Wertheim transferred 63% of his holdings in Coca Cola Israel to his son, David Wertheim, and the remaining 37% to his daughter, Drorit Wertheim. Furthermore, David became chairman of the company, while Drorit became a company director.<sup>18</sup>

Shortly after his death, it turned out that Wertheim had left an addendum to his last will and testament, where he provided protection to his daughter's rights as minority shareholder in Coca Cola Israel, mainly from possible dilution, as well as a protection of her rights to act as director in the company and to receive dividends. Drorit commented in response: "I am happy that father has made certain adjustments and left specific instructions, binding and clear, as to the changes that shall be implemented in the articles of association of the companies of the family allowing the protection of minority rights and other substantial rights he considered proper to implement during his lifetime."<sup>19</sup>

It can therefore be assumed, that after Wertheim had transferred the majority of the shares to his son, David, he had second thoughts, and worried that his son may use his majority shareholding in a negative manner, and thereby affect the status and rights of Drorit. This no doubt was what motivated him to prepare the necessary legal documents in advance, during his lifetime.

#### ***Gershon Salkind and Elco***

Elco Holdings Ltd's founder and controlling shareholder, Gershon (Georg) Salkind, passed away in September 2017 at age 87. Elco is one of the largest

Israeli industrial groups. Elco has several production centres in Israel, Italy, France and China, where it produces household appliances, air conditioning units and electro-mechanical equipment. Gershon Salkind founded the group in 1949 and owned 65% of its shares. In 2007, Michael and Daniel Salkind, Gershon's two sons, were appointed joint CEOs, and according to sources familiar with the company since their appointment, Gershon resigned from all the boards of directors on which he was previously active, and remained as a partner in strategic decisions only.<sup>20</sup>

After Gershon's demise and in accordance with his last will and testament, his shares in Elco were divided equally between his two sons, each half estimated at IS 700 million. In addition, the Salkind brothers had signed a shareholders' agreement designed to establish mechanisms for joint management of the company.<sup>21</sup>

In addition to his two sons, Gershon Salkind had a daughter, Dr Daphna Sessler. According to reports, Dr Sessler did not inherit any shares in Elco, but rather other private assets of her father's. As far as is known, there are no inheritance disputes within the Salkind family.<sup>22</sup>

It can therefore be assumed that Gershon Salkind took the trouble and made the necessary arrangements to efficiently transfer the family business to the next generation while minimising potential disputes among his children.

#### **The challenges entailed in the cross-generational transfer of the family business**

As is evident from the family stories outlined above, the cross-generational transfer of the family business may result in a costly and cumbersome court litigation that can, in turn, diminish the family wealth and disrupt the family business. Court litigation may arise in various circumstances, such as:

- Dispute between heirs under inheritance proceedings, as in the case of the Ofer family;<sup>23</sup>
- Granting control to the next generation over the family business may result in insolvency proceedings if these family members lack the skills to manage the business well. This may also bring about long court litigation. Liquidation of the family business may result from personal bankruptcy, class action against a family

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*The cross-generational transfer of the family business may result in a costly and cumbersome court litigation that can, in turn, diminish the family wealth and disrupt the family business.*

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member who owns the family business, and contested divorce proceedings;

- Court proceedings may also arise due to legal incapacity of the founder of the family business, prior to his demise. In such situations, the founder still holds control over the family business, but is not in a position to execute it. In such cases, a legal guardian may be appointed by the court,<sup>24</sup> who would effectively assume control over the family business, yet he may not necessarily have the required expertise for the position;
- Changes in the composition of the family members may also trigger disputes. Changes such as these occur as a result of death, marriage, divorce and in every change of generation. The longer the family business exists, the more changes are likely happen.

### **The legal environment for high net-worth individuals and family businesses**

#### *The 'family constitution' and contracts law*

A family constitution is a formal document which sets out the rights, values, responsibilities and rules applying to stakeholders in the family business and provides plans and structures to deal with situations which arise in the course of the family business. Such a document may assist the family to deal with unexpected events; keep focused on the matters that are most important to the family; manage disputes; and create a common language and values to serve as the guidelines for the family business, even for future generations who were not involved in the business when it was first established. A family constitution tends not to be legally binding on the family members.<sup>25</sup>

Given the importance of the family constitution and the challenges it is intended to face,<sup>26</sup> it would be advisable to complement the family constitution with separate documents, which are legally binding, and can therefore be enforced.

In Israel, a family constitution may be constructed under the applicable law of contracts, which includes the Contract Law (General Part),<sup>27</sup> the Contracts law (Remedies),<sup>28</sup> and relevant case-law. In such cases, the family constitution may be enforceable against only the parties who have agreed to it, but 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, in order 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 take into account 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<sup>29</sup> governs this procedure. There is no gift tax in Israel between family members.

The advantage of this procedure is that it allows the transfer of the family business during the lifetime of the founder, who may then assess how efficiently the business is managed by the next generation, and make changes accordingly. Furthermore, this course of action prevents the need to undergo inheritance proceedings, which may result in costly and unwanted litigation, such as in the case of the Ofer family.<sup>30</sup>

On the other hand, under certain circumstances this option is not available, such as in the case of the Segol family,<sup>31</sup> where none of the founder's children was in a position to assume control over the family business. Furthermore, such transfer may not be desirable by the founder of the family business, who would be reluctant to relinquish his control over the family business in his lifetime.

#### *Inheritance*

A family business may be transferred to the next generation by way of succession. The Succession Law<sup>32</sup> governs individuals who were residents of Israel or owned assets in Israel at the time of their death.<sup>33</sup> The succession procedure has its perils, and the heirs or other members of the family may challenge the bequests under the testament<sup>34</sup> and litigation in court may arise, such as in the case of the Ofer family above.<sup>35</sup>

#### *Freedom of Testation*

The principle of Freedom of Testation is one of the

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cornerstones of the inheritance law in Israel.<sup>36</sup> The high significance of this principle was most evident in the case of *Attorney-General v Lishitzky*,<sup>37</sup> where the Supreme Court applied the Trust Law<sup>38</sup> in order to overcome certain issues related to the validity of the deceased's will under the Succession Law.

In the *Lishitzky* case, the deceased made a will in which she left her assets to "a good soldier, a good person, who wishes to study but does not have the means of doing so, in order to assist him with his studies, to purchase an apartment for him, and to advance him in life. The soldier will recite Kaddish<sup>39</sup> in my memory." Section 33 of the Succession Law states, among other things, that a will from which it cannot be determined to whom the testator left his property is insufficiently precise, and as such is void. Although Section 29 of the Succession Law allows the testator to specify a group from which the inheritors will be selected by an agent appointed by him, this group needs to be sufficiently clearly defined. In *Lishitzky*, the court agreed that the testator's instruction in this instance was too broad to fall within the ambit of Section 29, and thus would be void if treated simply as a will, as per Section 33. But rather than voiding the will, the court ruled that the testatrix had, in effect, established a *hekdesh* (ie, a trust) under the Trust Law.<sup>40</sup>

Another interesting case which demonstrated the extent the court is willing to go to in order to enforce the wishes of the testator is *Fox v Weinstein*.<sup>41</sup> In this case, the Supreme Court held that a provision in a will that conditions the entitlement of the heirs to their settlement in Israel does not contradict public policy, and therefore is valid.

In the cross-generational transfer of the family business context, the freedom of testation 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 and role in the business of the other members of the family.

*The prohibition to grant a gift to be effective upon death*  
Another issue that must be taken into account for estate planning is the time upon which the transfer is

to become effective. Section 8 of the Succession Law states in Subsection (a) that "an agreement regarding a person's inheritance or a waiver of his inheritance, made during the lifetime of that person, is void". Subsection (b) states that "[a] gift made by a person, such that it shall be granted to the recipient only following the death of the donor, shall have no validity, unless made in a will pursuant to the provisions of this law".

In the *Lola Beer* case,<sup>42</sup> Lola Beer, the deceased, bequeathed her assets located in Israel to her family members; however, prior to her demise, she made a written undertaking to grant a certain amount to Ben-Gurion University, but failed to execute it prior to her death. The university later initiated legal proceedings in order to enforce the undertaking against the heirs. The Supreme Court, relying on the Gift Law, found that the letter given by Beer, in which she expressed her intention to make a gift to the university, was valid under the Gift Law as an undertaking by her to grant that gift. As Beer failed to fulfil the undertaking due to her death, that undertaking passed to her estate and became binding upon her heirs. Although the Gift Law permits a future gift to be revoked by its donor, that right of revocation is a personal prerogative of the donor, and cannot pass to the donor's heirs or estate upon the donor's death. It was therefore held that Beer's estate was bound to complete the gift to the university, which in her lifetime she had failed to effect. It follows that where there is no doubt that an undertaking to bestow a gift was made during the donor's lifetime to become effective during the donor's lifetime, the court will consider the gift as if it had been given during the donor's lifetime, and will enforce it.

In the context of the cross-generational transfer of the family business, it follows that should a founder choose to transfer the family business by way of gift, his intention must be implemented by the transfer of the control over the business during his lifetime. It also follows that a family constitution (a contract) containing provisions relating to the time period after the founder's demise will not be enforceable.



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*A trust structure can be a good way to hold assets under central management and regulate its activities according to the wishes of the head of the family business, who would be the settlor of the trust.*

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#### **A corporate structure**

Another possible course of action a founder can take in order to transfer the family business to the next generation is in accordance with both the applicable law of contracts,<sup>43</sup> the Succession Law and the Companies Law.<sup>44</sup>

In this context, the articles of association of the company can be regarded as a contract between the shareholders and the company, as well as a contract between the shareholders among themselves, in accordance with the well-known theory of 'Nexus of Contracts', that views the business as a collection of contracts among different parties.<sup>45</sup>

The articles of association of the company operating the family business can therefore be drafted to better meet the needs of the family business, and in effect, constitute the family constitution within a company framework. This allows the shareholders to protect their rights and to ensure the implementation of the family constitution through the Companies Law and the corporate documents of the company.

For example, the articles of association can provide several classes of shares, thereby allowing the founder to hold the management while assigning dividend shares, which do not grant voting rights to other family members. The management shares can afterwards be bequeathed to selected family members. Such separation of classes is also possible in the United Kingdom.<sup>46</sup>

In the *Salking* case,<sup>47</sup> it can be assumed that Gershon Salkind used such a mechanism to ensure the cooperation of his two sons in the management of Elco.

Other relevant mechanisms can be added to the articles of association, such as alternative dispute resolution clauses, for example under the Arbitration law.<sup>48</sup>

#### **A trust**

A trust structure can be a good way to hold assets under central management and regulate its activities according to the wishes of the head of the family business, who would be the settlor of the trust.

In Israel the trust has been part of society for many years, even before the establishment of the state in 1948. The Israeli Trust Law<sup>49</sup> defines a trust as the duty

imposed on a person to hold or to otherwise deal with assets under his or her control for the benefit of another or for some other purpose.

A trust may be created by a contract, by a deed or by a testament, as set out below:

- A trust created by contract requires an agreement between the settlor and the trustee with no specific procedure necessary for its validity;<sup>50</sup>
- A Trust created by a deed must be in writing and signed in the presence of an Israeli notary. This Trust is known as *hekdesh* (ie, *inter vivos* trust). It becomes operative during the lifetime of the settlor upon the transfer of the assets of the settlor to the control of the trustee;
- A testamentary trust, also referred to under the Trust Law as *hekdesh*, refers to a trust which is created by way of probate proceedings under the Succession Law. Accordingly, a 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 an Israeli notary. A testamentary trust becomes valid only upon the issuance of a probate order with respect thereof.

Due to the limitations set by Section 8 of the Succession Law mentioned above, a trust contract between the settlor and the trustee, under which control of the trust's assets passes to the trustee only upon the death of the settlor, is invalid. The control must be granted during the lifetime of the settlor, or alternatively, the trust must be a *hekdesh* (ie, *inter vivos* trust) with assets effectively transferred to the control of the trustee, or a testamentary trust, which becomes effective upon the issuance of a probate order with respect thereof.

It therefore follows that in a trust created pursuant to a contract the death of one of the parties to the contract will require a succession procedure to transfer the rights of the deceased to his or her heirs.

It should also be noted that the choice of the form of the trust, as mentioned above, requires consideration of personal and family circumstances, as well as tax planning considerations.

**Enduring power of attorney**

Amendment 18 of the Legal Capacity and Guardianship Law<sup>51</sup> introduced a new instrument into Israeli legislation – the enduring power of attorney. This power of attorney allows a competent person (the ‘appointer’) to appoint another person (the ‘delegate’) to attend to his or her personal, and/or medical, and/or property affairs when the appointer is no longer in a position to properly understand the matter and attend to these affairs by himself or herself, while certain matters require an express authorisation or approval of the court.

Amendment 18 details the relevant procedure. Generally, only an attorney who was specifically trained by the Administrator-General is allowed to provide this service, and such powers of attorney must be deposited with the Administrator-General.

Such a power of attorney may offer a good instrument for a founder of a family business who fears future legal incapacity, and who is also reluctant to transfer the ownership in the family business during his lifetime. As this power of attorney can be applied to personal and medical affairs, it can also be used as a complementary instrument together with other arrangements.

**The family office<sup>52</sup>****What is a family office?**

Out of all the various definitions of a family office, the following definition can be considered as one of the simplest:

*A family office is an organization that assumes the day-to-day administration and management of a family's affairs. To that end, to honestly call itself a family office, an organization needs to provide more than just the standard wealth management functions. Most people in the industry would agree that a family office should be able to provide for tax compliance work, access to private banking and private trust services, document management and recordkeeping services, expense management, bill paying, bookkeeping services, family member financial education, family support services, and family governance.<sup>53</sup>*

In this context, a family office can assist as a consultant in the preparation of the cross-generational

transfer of the family business by serving as a ‘one-stop-shop’ for the client, and provide different advisory services to implement the transfer through its various experts.

**How does a family office operate?**

A family office may appoint a person who will manage the financial assets of a family. It may also choose the appropriate administration offices and management of the economic strategy of the family.

The family office provides the following functions:

- tax reporting including bookkeeping, auditing by CPA and filing tax reports to the tax authorities;
- day-to-day life-style – payments to employees, insurance, cars, housing, education and household expenditures;
- estate planning for transfer of wealth – creating trusts, education and training of the next generation in preparation for integrating them into the family business.

**The family office in Israel**

In Israel there are two types of family office – the single-family office, which provides services to one family exclusively, and the multi-family office, which provides services to more than one family at a time.

The Israeli family businesses are usually composed of the first, second and third generations. It is believed that 70% of the wealth is still held by the first generation. Only 20% is managed by the first and second generation and 10% is managed by the third generation. The general trend is the development of the single-family office, which is usually established by the second generation.

In Israel's modern economy, we find new rich families whose wealth was created in the high-tech industry. When the entrepreneur makes his first ‘exit’, his life-style would continue but in order to enable him to go on with his business activities, he would need the family office to manage his wealth and take care of the family needs including transfer to future generations.

**Conclusion**

A common practice by families looking to regulate the

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*In Israel there are two types of family office – the single-family office, which provides services to one family exclusively, and the multi-family office, which provides services to more than one family at a time.*

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family internal relationships in the context of a family business is by using a family constitution. A family constitution is a formal document which sets out the rights, values, responsibilities and rules applying to stakeholders in the family business and provides plans and structures to deal with situations which arise in the course of the family business.<sup>54</sup>

From an Israeli perspective, we view the family constitution as an important document, as evident from Ofra Strauss's words. However, we believe that

such a constitution is not sufficient for the cross-generation transitions of the ownership, control and management of the family business. Reality shows us that situations such as marriage, divorce, death and incapacity require more than a contractual treaty among the family members, and the legal instruments of matrimonial agreements, succession and estate planning, corporate instruments and trusts may provide solutions that are more comprehensive.

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