'Nothing is certain but death and taxes'

By Daniel Paserman and Inbar Barak-Bilu

IN ISRAEL, an estate tax was levied on the worldwide assets of Israeli residents and on the Israeli assets of foreign residents until it was nullified by law in 1981. During the time when it was levied, a 'step-up' was provided for the value of the inherited property, such that its sale would not incur capital gains tax (CGT) in respect of the value of the property at the day of the deceased's passing. Moreover, a tax credit was also provided for foreign estate or inheritance tax paid outside Israel.

Today, since Israel applies no estate tax, Israeli tax legislation grants neither a tax credit nor a step-up with respect to estate tax paid in a jurisdiction outside Israel. Thus, when the deceased was an Israeli tax resident who owned foreign assets subject to estate tax outside Israel, although the foreign country may grant a step-up in order to prevent double taxation in the local country (such as the US and the UK), this will not prevent double taxation in Israel. This situation creates a clear asymmetry when contrasted with a case where the deceased would have sold the property prior to their passing, either paying CGT in the foreign country and receiving a tax credit for it in Israel or receiving an exemption in the foreign country and paying CGT in Israel.

As a matter of practice, the Israel Tax Authority is prepared to recognise the foreign estate tax as a deductible expense that shall reduce the CGT at the time of the property's sale. However, this is still not sufficient to eliminate the exposure to double taxation.

By way of example, in a case where an Israeli tax resident acquires property for USD10, and at their death the value of the property has risen to USD100, in the foreign country, they would pay estate tax at the relevant tax rate (e.g. 40 per cent of the property value), while, at the same time, the property's cost basis in the foreign country would rise to USD100. If the heir sells the property, no additional tax liability will arise in the foreign country. However, Israeli CGT of USD25 will be due, or USD14 if the estate tax payment is recognised as an expense. The effective tax rate will amount to nearly 54 per cent.

By contrast, in a case where the deceased sells their property before their passing, they would pay CGT in the foreign jurisdiction and receive tax credits for it in Israel, or be exempt in the foreign country and pay CGT in Israel, and the effective tax rate would be around 30 per cent.

The question of whether to grant a full tax credit in Israel on account of an estate tax paid abroad and not settle for the tax deduction derives *inter alia* from our perspective on estate tax. Many countries levy an estate tax, seeing it as an alternative to CGT, constituting a *de facto* advancement on account of CGT realised at the time of the property's sale. Indeed, estate tax is levied based on the property value (after deducting liabilities) and not on the profit, and the rate of estate tax may differ from the rate of CGT. However, the very fact that estate tax payments feature a step-up, which increases the property's cost basis, attests that the approach is that, in a place where estate tax was paid, an additional CGT should not be levied on account of the same value subjected to the estate tax. This, for example, is the established law in the US and the UK.

In Israel too, when estate tax was levied, a step-up was granted on the cost basis; ergo, the view of the Israeli tax legislature was to prevent double taxation as well.

Further, even the Israeli Court recognised the parallel that exists between estate tax and CGT when it established:

> 'From here [it is evident], the legislature sees estate tax as parallel to betterment tax [CGT], in the sense that the principle in tax continuity, where any rise in the value of a property shall not evade the net of taxation on the one hand, and on the other, should not incur a double taxation for the same rise in value, should be applied whether we are discussing a betterment tax [CGT] or whether we are discussing estate tax.'[1]

That very decision related to the Israeli estate tax levied in the past. Still, irrespective of the nullification of the estate tax in Israel, in an instance where estate tax was paid abroad, it seems that there is a basis for the claim that a step-up for the value of the property at the time of the deceased's passing, or a tax credit for the foreign estate tax, should be permitted.

When all is said and done, it seems appropriate to quote Benjamin Franklin, who established long ago that: 'In this world nothing can be said to be certain, except death and taxes.' Franklin was correct: death and taxes are truly intertwined, and taxes applied on death are certain.

In any case, our advice is quite simply: live life!

1 *Jack Twina v The Real Estate Tax Authority of Haifa* (2016)


DANIEL PASERMAN ADV (CPA) TEP is Head of Tax at Gornitzky & Co and Secretary of STEP Israel, and **INBAR BARAK-BILU ADV (CPA) TEP** is an Associate at Gornitzky & Co

Address: 45 Rothschild Blvd, Tel-Aviv 6578403, Israel
Phone: +972 3 710 9191
Email: office@gornitzky.com
Web: www.gornitzky.com