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# Israeli Court Rejects Tax on Real Estate Transfers Into Trusts

By Matthew Kalman

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- Says Tax Authority can't impose capital gains tax
- Chastises agency for overstepping powers

Well-to-do people who create trusts in Israel got a boost from a recent court ruling that the transfer of real estate into trusts doesn't trigger capital gains tax.

The Tel Aviv District Court ruling would spare them, as well as Israeli beneficiaries of trusts created by relatives abroad, from the tax, practitioners said.

The 30-page verdict contradicted the Israel Tax Authority's long-held policy and sharply rebuked it for creating legislation without proper authority.

If the ruling stands, it could trigger a wave of new trusts created by Israeli residents, said Harel Perlmutter, head of tax at Barnea law firm in Tel Aviv.

The Tax Authority says the transfer of real estate into trusts is a taxable event. Existing trust law doesn't specifically refer to the treatment of real estate, creating a gap that the authority has filled by imposing taxes.

The verdict came as a 10-year exemption for immigrants from tax or reporting on foreign assets and passive income expired for its first beneficiaries. As they organize their assets with full reporting to the Israeli authorities, the ability to vest real estate in trusts will be of increasing interest, Perlmutter said.

"This was a big barrier for people to establish trusts because they knew they would pay tax at the time of vesting and again at the time of allocating the assets to the beneficiary. This is why we don't see it a lot in Israel, though you do see it with people coming from abroad," Perlmutter said by phone July 25. "I see a lot of scenarios where Israelis will be able to use this tool and save taxes."

**Appeal Coming?**

The ruling was handed down by a three-person panel at the district court. It upheld an appeal of a Tax Authority decision brought by a Canadian couple against a capital gains tax assessment on the transfer of two Israeli properties into a trust. They had created the trust for the benefit of their family's younger generation.

The tax authority "will study the verdict," a spokesman said July 25.

“I am sure the decision will be appealed,” said Daniel Paserman, partner and head of tax at Gornitzky and Co. law firm in Tel Aviv. “It contradicts the policy of the Israel Tax Authority, absolutely.”

The ruling sets a precedent that could change the advice given by practitioners, but the decision isn’t binding on other cases unless it is upheld by the supreme court.

**Court’s Argument**

The court dismissed the authority’s argument that vesting Israeli real estate into a trust triggered a tax event.

The authority held that while the transfer of assets into a trust wasn’t normally taxable, the country’s separate law on real estate taxation took precedence over the law on trusts. Therefore, the authority argued, the transfer was a tax event on which capital gains tax was due.

The court rejected the authority’s stance that a change in beneficiaries also triggered a tax event.

Section 75 of the Israel Tax Ordinance that governs trusts doesn’t specifically mention real estate. In Israel, general real estate tax is governed by a separate law. The court said this “lacuna”—or gap in language—did “not imply the negative interpretation adopted by the tax authority.”

A special provision in Section 75 that determines that the granting of an asset to a trustee doesn’t constitute a sale “overrides the general provisions in the Real Estate Law. Therefore, the granting of a real estate asset will also not be considered a ‘sale’ for purposes of the Real Estate Law,” the court ruled.

“The official approach of the tax authority is that the tax regime governing trusts does not apply to Israeli real estate,” Paserman said by phone July 24. “Until now, if you had asked me whether you should transfer Israeli real estate into an Israeli trust, I would have advised that there’s a big chance the tax authority will claim that it should be taxable. The advice was not to do it.”

**No Inheritance Tax**

Since Israel doesn’t have inheritance tax, trusts aren’t as common as in some other countries, said Mirit Hoffman, a wealth planning and tax attorney in Jerusalem. However, with the expiry of the first phase of the 10-year tax and reporting exemption for new immigrants, and the growing number of Israelis becoming beneficiaries of trusts created by foreign family members, the court’s decision could have broad impact, Hoffman said by phone July 25.

“I salute the judges on this decision. I think it was the right decision. This verdict was really refreshing,” she said. “The trust section of the tax code here in Israel states specifically that the transfer from a settlor to a trustee is not a taxable event.”

"The court understood all the aspects of the trust. Not everything is to do just with taxes," she said. "It would be ridiculous to assume that once someone transfers an asset into a trust they are actually selling it to the trustee who will have to incur taxes, when in reality that's not actually what's happening."

**Exceeding Authority**

Perlmutter noted it was the second recent verdict that chided the tax authority in unusually harsh terms for creating legislation when it had no power to do so, establishing rules through its professional circulars without proper legal authority. A July 4 ruling in Nazareth District Court criticizing the authority in similar terms concerned the tax treatment of share options.

"It seems that the tax authority decided that for the purposes of the Real Estate Taxation Law, it is also the legislator regarding taxation of the chapter on trusteeship," the verdict said, rebuking the authority for "legislation by means of a circular."

"It's not clear from where the tax authority derives the authority," the court said, referring to the Tax Authority's stance that a change in beneficiary triggers a tax event. "There is no mention in the law of the possibility of this interpretation."

The tax authority declined to respond to the criticism.

To contact the reporter on this story: Matthew Kalman in Jerusalem at correspondents@bloomberglaw.com

To contact the editors responsible for this story: Meg Shreve at mshreve@bloombergtax.com; Vandana Mathur at vmathur@bloombergtax.com

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