

# A 'lacuna' to be resolved



**DANIEL PASERMAN AND YOAD COHAVY ANALYSE A RECENT ISRAELI COURT RULING DETERMINING TAXATION OF REAL ESTATE TRANSFERRED BY A FOREIGN RESIDENT TO AN ISRAELI-RESIDENT BENEFICIARY**

In a precedential ruling, the Tel Aviv District Court (the Court) ruled that the transfer of Israeli real estate property by a foreign resident to a trust whose beneficiary is an Israeli resident, for no consideration,<sup>1</sup> does not constitute a taxable event; therefore, neither land appreciation tax nor purchase tax shall be imposed.

## BACKGROUND

Generally, trusts are taxed in Israel based on the residency of the settlors and beneficiaries. The rules regarding the taxation of trusts are set forth in chapter 4 (the Trusts Chapter) of the Israeli *Income Tax Ordinance* (ITO).<sup>2</sup>

The rules provided in the Trusts Chapter apply to all types of assets. The definition of an 'asset' is extremely broad and includes real estate and movable property, as well as any right or benefit in an asset in or outside Israel. According to the Trusts Chapter, a contribution of an asset to a trust for no consideration is a tax-exempt transaction.

However, in principle, Israeli real estate taxation is not subject to the ITO, but rather to the *Land Appreciation Tax Law* (the Law). In light of this, the applicability of the Trusts Chapter, since its enactment in 2006, to the contribution of Israeli real estate to a trust and the distribution of Israeli real estate to beneficiaries, has been a source of debate.

## THE COURT RULING

The matter of *Samuel Galis v Director of Land Appreciation Tax Tel-Aviv*<sup>3</sup> involved a Canada-resident couple who settled a trust for the benefit of their granddaughter, an Israeli resident. The Canadian settlors transferred Israeli real estate to the trust for no consideration.

The taxpayer claimed that, according to the provisions of the Trusts Chapter, a contribution to a trust is exempt from land appreciation and purchase taxes. By contrast, the Israeli Tax Authority (ITA) argued that the Trusts Chapter does not apply to Israeli real estate, which should only be subject to the Law. Therefore, the transfer of the real estate to the trust is taxable for both land appreciation tax for the settlors and purchase tax for the trustee.

The appellate committee of the Court determined that the Law does not apply to the transfer of Israeli real estate to a trust.

Although in the Trusts Chapter there are specific provisions under which a transfer to a trust (under certain circumstances) is not considered a 'sale' for the purposes of the ITO, no reference is made to the Law.

On the other hand, although the Law contains certain provisions that address the holding of an asset by a nominee, it does not deal with the matters discussed in the Trusts Chapter.

The appellate committee ruled that the lack of any references to the Trusts Chapter in the Law and vice versa should not be viewed as a purposeful omission, but rather as creating a 'lacuna' that should be resolved. The appellate committee maintained that the legislation on trusts aims to limit any differences between rights in Israeli real estate and other assets that are subject to taxation, according to the ITO. Moreover, the legislation aims to create a more uniform approach among the various tax laws and other general laws. Therefore, the appellate committee ruled that the 'lacuna' should be determined by applying the relevant Trusts Chapter provisions to the Law and postponing the tax event to the distribution or sale.

## RAMIFICATIONS OF THE RULING

This ruling is precedential as it applies the Trusts Chapter in the ITO to the transfer of Israeli real estate, which is generally subject to the Law. At the time of writing, the ITA has filed an appeal with the Israeli Supreme Court in order to overturn this ruling.

**#TAXATION #RESIDENCY  
#LAND AND PROPERTY #TRUSTS**

<sup>1</sup> For no consideration' means a contribution of an asset to a trust was made without getting any payment for that contribution. <sup>2</sup> [new version] 5721-1961 <sup>3</sup> (49026-07-17)



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