

Israel: Inheritance and Related Taxation

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Many estate practitioners in Israel and around the world often state: “the Israeli tax system is free of Inheritance Tax. A Testator can therefore pass on his property to his heirs free of tax”.

In order to assess the correctness of this statement, it is necessary to analyse the Israeli laws of succession and examine Israeli Inheritance Tax laws.

I. Israeli Law of Succession

Inheritance in Israel is governed by the Succession Law of 1965. The Law enables any legally competent person to bequeath his estate after his death in accordance with his last will and testament. The laws do not impose any limitations upon the right to bequeath and a testator is therefore at liberty to bequeath his estate to whomever he wishes. This liberty has no bounds since there are no forced heirship rules in Israel.

Nonetheless, the Law gives a surviving spouse, children and other dependants a degree of protection by granting them a right to receive maintenance payments from the estate of the deceased, subject to certain limitations.

The Succession Law applies to all persons who, at the time of their death, were domiciled in Israel or who left assets in Israel.

Upon the death of the deceased, his estate passes to his heirs either by law (intestate succession) or by will (testate succession).

A. Intestate Succession

If the deceased did not leave a valid will, or if there are assets which were not bequeathed under the provisions of the will left by the deceased, or if the provisions made by the will are invalid, then the distribution of the estate of the deceased is governed by the rules of intestate succession.

The persons who are eligible to be heirs by law are the following:

The lawfully married spouse of the deceased at the time of his death.

n A common law spouse may also be regarded as the deceased’s married wife if the couple lived together in a common household and neither of them was married;

n The children of the deceased and their issue (including **illegitimate** and adopted children and their issue), the parents of the deceased and their issue, the grandparents of the deceased and their issue;

n The state of Israel; in the absence of any other heirs.

The state is obligated by law to dedicate the estate for the purpose of education, science, health or welfare. The Minister of Finance, however, is entitled to make certain payments out of the estate to any person who was dependent on the deceased, or to a person upon whom the deceased was dependent or a relative of the deceased who is not an heir by law.

The Succession Law provides that children of the deceased and their issue take precedence over the parents of the deceased, and the parents of the deceased and their issue take precedence over the grandparents of the deceased.

Heirs of the same class, namely children, parents or grandparents, are entitled to receive the share in the estate due to such class of heirs, in equal shares between themselves.

B. Testate Succession

An individual is entitled to make a will if he is over the age of 18 and has not been declared by a Court to be a legally incompetent person. At the time of drafting the will, the testator must be capable of understanding the nature and the legal consequences which ensue from it.

A testator can make a will in any one of the following forms:

- n in the testator's handwriting;
- n in the presence of two witnesses;
- n in the presence of an "authority" (e.g., court);
- n orally (special procedures apply to verification of the will).

A testator is entitled to revoke a will made by him at any time. Revocation may be in any one of the forms required for the making of a valid will or by destruction of the will revoked. The revocation must be unambiguous and, therefore, a will is only revoked by a later will if the later will expressly revokes the former will, or to the extent that any provisions in the later will contradict provisions in the earlier will. Subsequent revocation of the later will does not revive any provisions in the former will which had been revoked by the later will.

The rights of the heirs or beneficiaries are declared by way of an inheritance order if the deceased did not leave a will, or by a probate order in the case of succession by will. Where the will does not include assets which the deceased possessed at the time of death, then the courts may grant an inheritance and a probate order in one document.

The order is not a constitutive order creating the rights of the heirs and/or beneficiaries, but is merely a declarative order stating what the succession rights are.

An inheritance order declares who are the heirs by law and what is the share of the estate to which each heir by law is entitled, whereas a probate order declares that the will of the deceased is valid and specifies any provisions of the will which were found to be invalid. If an executor is appointed, this will be stated in the inheritance or the probate order.

C. Jurisdiction of Israeli Authorities in International Cases

The competent authorities in Israel, namely the Registrar of Inheritance Affairs or the Family Courts have jurisdiction to deal with the estate of every person who, at the time of his death, was domiciled in Israel or who left assets in Israel.

In the context of inheritance, domicile is widely defined as "the place of the centre of life" of the deceased.

The proper law which will apply is the law of the place of the centre of life of the deceased at the time of his death, subject to certain exceptions.

In cases of foreign wills, Israel does not recognise foreign Courts' probate or inheritance orders and a petition for an inheritance or probate order, as the case may be, must be filed with the competent Court in Israel. Such a probate or inheritance order may be dealt with according to the provisions of the foreign law in the framework of the rules of private international law.

In order to establish jurisdiction in Israel, evidence of the existence of assets of the estate in Israel must be provided with the petition for an inheritance or probate order; for example, there must be a Land Registry extract evidencing the ownership of real property, or a confirmation by a local bank as to the existence of a bank account in Israel, etc.

An expert opinion regarding the validity of the foreign will and its execution must be annexed to a petition relating to the estate of a deceased who was not domiciled in Israel at the time of death.

The inheritance or probate order will normally bear a comment restricting the application thereof to assets in Israel.

Israeli estate practitioners normally recommend separation of Israeli assets from the foreign assets by making a specific will relating to the Israeli assets only. Provision is then made in the Israeli will for the testator to change his foreign will without affecting his Israeli will, unless specifically stated otherwise.

II. Related Taxes

The inheritance of assets and rights, which are not real estate in Israel, are governed by part E of the Income Tax Ordinance. The Ordinance provides that bequeathing assets does not result in a taxable event regardless of the identity of the heir, the heir's legal status or residency. Nevertheless, from an international perspective, a bequest of assets or rights may give rise to several tax issues which are better dealt with during the lifetime of the testator.

A. A bequest from a foreign resident to an Israeli resident

Upon the receipt of an inheritance from a foreign resident, the Israeli heir "enters into the testator's shoes." The expression means that the price and date of the purchase of the inherited asset is the same as they were while the asset was in the hands of the testator. A problem may arise when an Israeli heir sells inherited assets. The original purchase price for the calculation of a capital gain is as it was for the testator which is usually much lower than the value of the asset at the date of the transfer thereof to the Israeli heir. For this purpose, the location of the asset is irrelevant. Consequently, the capital gain is much higher and includes value added to the asset while it wasn't in the hands of the Israeli heir. For example, if a U.S resident bequeaths a store in the U.S. in the year 2005 which he bought in 1982 and the following day the Israeli heir sells this store, the capital gain will be calculated as if the Israeli heir bought the store in 1982 and not as if he bought it in 2005. Tax rates on the capital gained calculated will be between 25% and 49%.

Since no step-up is allowed, thought must be given to other possibilities, such as selling the assets while the testator is still alive or the use of trusts.

B. A bequest from an Israeli resident to a foreign resident – assets in Israel

Israel is a party to 40 tax treaties all of which include a section (mostly 13) dealing with capital gains. The section which is based on the OECD model convention specifies a list of assets which can be taxed by the state of origin (the state in which the asset is situated). Any asset not specified in the treaty can be taxed only by the residency state of the seller. Consequently, any inherited asset in Israel which is sold by a foreign heir may be taxed by Israel only if the treaty permits it. For example, a U.K resident inherits shares in Israeli companies. Since according to the U.K-ISRAEL treaty a U.K resident can be taxed in Israel only on capital gains from real estate transactions and permanent establishments, the capital gains derived from the sale of the shares can't be taxed in Israel. The provisions of the treaties are significantly important and should be considered when planning the estate during the lifetime of the testator. To continue the example, if the Israeli testator would have gifted the shares to his English heir prior to his death, the gift would have been taxable, but if he would bequeath said shares, neither the bequest nor the sale by the U.K heir, would be a taxable event (in Israel).

C. A bequest from an Israeli resident to a foreign resident – assets outside Israel

The transfer of assets located outside Israel during the testator's lifetime is likely to result in the obligation for the payment of a capital gains tax. On the other hand, the bequeathing of the assets is not likely to result in a taxable event. The sale of the asset by the heir will not be taxed in Israel regardless of any treaty provision. Even if the heir becomes an Israeli resident after receiving the bequest, he will be entitled to certain tax exemptions on the sale of the assets inherited, due to his "New Immigrant" status.

D. The bequeathing of Real Estate in Israel

Real Estate in Israel is governed by the Land Taxation Law. A real estate bequeathing of real estate is not a taxable event, yet, it is a misconception to overlook the tax aspect of an inheritance of real estates. The fact that Israel does not levy an inheritance tax on an estate may not be conclusive that no tax will be paid by heirs after the distribution of an estate. Subsequent transfers of assets between heirs and balance payments may give rise to various local taxes, such as capital gains tax and acquisition tax. Another example is where an executor is appointed by the Court decides to sell the assets of the estate and distribute the proceeds to the heirs. This may also trigger capital gains tax. If the estate consists of, *inter alia*, a residential apartment, it may be advisable to first transfer the apartment to the heirs (tax free) who may then sell it. This way the heirs may enjoy several tax exemptions available to residential properties.

III. Conclusion

Having analysed the Israeli succession laws and inheritance tax issues, a conclusion may be reached that Israel provides a convenient succession environment: Freedom of testation (no “forced heirship”) accompanied by no inheritance tax provides the testator with reasonable certainty that his estate will pass to his heirs according to his wishes and at full value.

However, we have also noted that certain taxes may become payable after the distribution of an estate and may thereby diminish the value of the estate.

Testators possessing assets in Israel and in other jurisdictions are advised to consult local estate practitioners in order to plan the proper execution of their estate and a tax efficient distribution of their assets.

The authors of this article have used, inter alia, the following sources:

Chapter entitled “Israel”, by Alon Kaplan and Jeffrey Cohen, “Tolley’s International Succession Laws”, Issue 2, October 2002; “Israeli Business Law – An Essential Guide”, Editor: Alon Kaplan, Kluwer 1996 and 1999; ISBN 9041103236.

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Israeli Business Law – An Essential Guide; Kluwer 1999

Trusts in Prime Jurisdictions; Kluwer 2000

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