

Trusts according to the Israeli Land Tax Law.

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Transfer of land from "trustee" to "beneficiary"

According to the provisions of the Land Tax Law (Gains, Sale and Purchase) – 1963 ("the Law") the "sale of a right in land" - including the transfer of ownership in land – obligates the seller to pay capital gains (sec. 6 of the Law) and the purchaser to pay purchase tax (sec. 9 of the Law). These obligations that apply to the seller and purchaser do not apply to the sale of a right in land from a "trustee" to a "beneficiary". This sale is exempt from both capital gains and purchase tax. Regarding capital gains, section 69 of the Law provides as follows:

69 (a) The sale of a right in land and the transfer of a right in an entity, from trustee to beneficiary, will be exempt from tax.

(b) For the purposes of this section –

"trustee" – is a person who holds in his own name for someone else a right in land or a right in an entity;

"beneficiary" – is a person on whose behalf the said right is held;

(c) a person will not be considered as a trustee for the purposes of this clause unless he gives notice under section 73 (f), 74 or 119, respectively, and no exemption will be given other than to the beneficiary on whose behalf the said notice was given.

The sale of a right in land from a trustee to a beneficiary is therefore exempt from capital gains. The same transaction is exempt from purchase tax as well. In accordance with regulation 27(a) of the Capital Gains on Land Regulations (Purchase Tax) – 1974 "the Regulations":

27 (a) The sale of a right in land which is exempt from tax under sections ... 69 of the Law, is exempt from purchase tax.

This exemption from capital gains and from purchase tax is conditioned on the fulfillment of the provisions of section 69 (c). These provisions refer to (for our purposes) sec. 74 of the Law, which provides as follows:

74. Any person who purchases in his own name for someone else a right in land or a right in a land company, is entitled to notify the Land Authority, within 30 days of the date of purchase, that he purchased the right in his name for someone else, and following this notification he will be regarded as a trustee for the purposes of section 69.

The meaning of this is as follows: a person who claims to be a trustee of a certain property that he purchased – in favour of someone else – will not be regarded as trustee unless he provides the Land Authority, within 30 days of the date of purchase, with a notice that he bought the property in his own name but for someone else. Only in this manner will he be recognized as a trustee, and only under this condition will the future

transfer of the property from trustee to beneficiary be exempt from capital gains and purchase tax.

The "trustee" is therefore, under sec. 69(b) of the Law, a person who holds "in his own name for someone else a right in land" and a "beneficiary" is "the person for whom the said right is held". This definition of "trustee" and "beneficiary" is the acceptable legal definition of trustee and beneficiary.

The question may be asked whether the beneficiary for whom the right in land is held by the trustee must be a specific and known beneficiary or is it sufficient that a declaration that a person is the trustee for "another" will make him such trustee. The answer is that the "beneficiary" must be known and definite i.e. a person cannot be considered a trustee unless it is clear and declared who the beneficiary is. This is determined from the language and certainly from the essence of the Law.

A "trustee" is, by definition of sec. 69(b): "A person who holds in his own name for someone else a right in land...". The definition of "someone else" relates to a specific and known person, and not a virtual person. The same applies to the definition of "beneficiary" who is the same "person for whom the said right is held". This definition of "beneficiary" is strengthened by sec. 74, that refers also to the purchase of a right in a land "for someone else", and the notification to the Land Authority that the trustee holds a right in land "for" a definite other. In addition, sec 69(c) provides that the exemption will only be given in the case of a transfer to a beneficiary regarding whom the said notification was given.

A trustee who has purchased a right in land (for a beneficiary), paid all the necessary taxes, and thereafter transferred the asset from the trustee to the beneficiary, is in effect making a formal transfer to the person for whom the land was originally purchased.

The legislator's intention in sec. 69(a) is clear: It envisioned a trustee that "lent his name" to another person in purchasing land or a right in a land company, without having any personal benefit or fiscal interest in the land. In such a case, the trustee should not be obligated to pay capital gain tax for transferring a right in land or in a land company, from himself to the beneficiary, as such an action offers the trustee no financial gain.

It therefore appears that the exemption under sec. 69 is conditioned, amongst others, in the trustee undertaking the following two actions – the first whilst purchasing the right, and the second – whilst selling it:

- At the time of purchasing the right for the beneficiary, the trustee notifies the Land Authority, within 30 days of the date of purchase, that he bought the right in the property or in the land company for another person.
- At the time of selling the right, the trustee declares, according to sec.73(f), that he sold the right in land or land company on behalf of another person.

Professional Directive on Capital Gains Tax regarding "trustee" and "beneficiary"
("the Directive")

Within the Directive reference is made to the above issue, and there are clear definitions of "trustee" and "beneficiary": a trustee under the Capital Gains Tax Law is a person who purchased "in his name for another person" as stated in sec. 74 of the law. To provide evidence of the trusteeship the parties will have to prove all or part of the following facts:

- The right was purchased with the beneficiary's money, for the beneficiary and according to his instructions (that is, the relationship is created firstly between the trustee and the beneficiary, and only thereafter between the trustee and the seller).
- The trustee lent no more than his name, in order to act for the benefit of the beneficiary, and has no right or benefit from the asset.
- The beneficiary took possession of the asset, used it , received income therefrom etc, or is entitled to any of the aforesaid.

The Directive also includes specific reference to a beneficiary that is a land company: it should be determined, in addition to other terms required under the Directive, the following:

- The land company existed at the date of purchase
- The land company was a company in the process of formation at the date of purchase
- A land company that was in the process of liquidation or dissolution at the date of purchase, or was not in the process of formation at the date of purchase will not be recognized as a beneficiary for the purposes of sec 74 and 69 of the Capital Gain Tax Law.
- In order to remove any doubt, it is hereby emphasized that all the above checks must be carried out, even if the notice of trusteeship was given within 30 days, as the notice itself cannot be used as evidence that the case is indeed that of trustee and beneficiary.

Professional Directive on Capital Gains Tax in the matter of extension of time ("the Directive")

Within the Directive there is reference to the possibility of an extension of time. In a case where the trust declaration was not provided to the authority, on reasonable grounds, an application may be made to request an extension for filing the notification. All such applications are transferred to the Income Tax Authority.

The Income Tax Authority will check each application as follows:

- Whether at the time of purchase of the right by the trustee, a trust relationship existed in accordance with the substantive test in sec.69 (b) of the Capital Gain Tax Law.
- If the answer is positive, beyond any reasonable doubt, than the application for an extension will be examined on the merits, that is the reasons for the

delay in filing will be checked and the longer the period, the better the reasoning has to be.

- An application for an extension must be made jointly by the trustee and beneficiary.

The application for an extension is dealt with by the tax authorities according to the following rules:

- The amount of time that has elapsed from the purchase until the filing of the extension application.
- The level of negligence that has caused the delay in filing, checked against the following:
 - Whether the trustee is a body dealing in real estate or trusts and should be aware of the provisions of the law
 - Whether there are sufficient grounds for the trustee to conceal the identity of the beneficiary, even from the capital gains tax authority, such as the beneficiary residing in a hostile state, or any other valid reason for the beneficiary to conceal his identity
 - If the reason for not handing in the notice on the due date could not be prevented by the parties

In the event that the Capital Gains Tax administration decides to extend the period for filing the trust notice, it will confirm having received the trustee notification forms. If it decides not to extend the time period, the applicant must be notified thereof in writing.

No response from the administration to an extension request, to which a trust notice is attached, may be interpreted as consent (silence as consent).

In the event of an extension request being turned down, an appeal may be filed before an appeals committee within 30 days of having the request turned down.

Recommendations of the Tax Committee on Trusts regarding the Identity of the Beneficiary

The current Tax Law has been in effect since 1963.

Prior to this, there was the Capital Gains on Land Law of 1949. This law with its many flaws caused the legislator to decide to replace the entire law with a new law in 1963.

This new law solved most of the flaws prevalent in the old 1949 law.

Since its enactment in 1963, there have been many changes and amendments which have created a very complex law (when the new law was enacted in 1963, it included only 120 sections in total).

In recent years the law has also undergone frequent changes and amendments, the most significant of those being amendment 50 of the law and a temporary amendment that was passed by the Knesset on 13.03.02. It took effect 60 days after its publication on 13.05.02 and had retroactive validity from 07.11.01 for land transactions from 7.11.01 and following. It included more than 100 changes and amendments to the law.

On 1.1.03 the Tax Reforms came into effect (Amendment 132 to the Tax Regulations), changing to a method of personal taxation so that residents of Israel are obligated to pay tax on a worldwide basis.

The trust concept did not find expression in the Reforms even though the use of this concept for holding and executing of investments abroad has become prevalent and acceptable in recent years.

The Rabinowitz Commission on Tax Reform was aware of this issue, although the complexity and scope of the different types of trusts did not allow the Commission to deal with this and it recommended that tax arrangements for trusts be dealt with separately, as well as drafting legislation if required. As a result of this, on the 2.9.02 a Committee for Taxation of Trusts ("the Committee") was appointed to make recommendations regarding the taxation of trusts. On the 24.7.03, the Committee filed its report with the then Tax Commissioner Tali Yaron Adler which included the Committee's recommendations agreed on by all the members of the Committee.

The Committee recommended determining capital gains liability on the transfer of fixed property ("property") to a trust as follows:

- Any person who creates a trust during the course of which property is transferred, will have to give notice to the Capital Gains Tax authority by stating the name of the trustee and attaching the trust deed and details of the rights in the property. The said notice must be transferred to the authority within 30 days of creating the trust.
- In order to examine the applicability of the exemption provisions in the Land Tax Law, the property will be viewed as if it was transferred directly from the settlor to the beneficiary. However, no exemption will be given for the transfer of the property to the trust unless at the time of transfer it is possible to identify with certainty all the beneficiaries and their share of the rights.
- All the principles determined in section 69 of the Land Tax Law are abided by.
- It should be noted that if it is not possible to identify the beneficiaries or their share at the time of transfer of the property to the trust, then the future transfer of the property from the trustee to the beneficiary will also be considered a taxable event without the right to an exemption. If the identification of the beneficiaries is made only after the transfer to the trust, then the transfer to the beneficiary as set out above, will also be considered a taxable event with no entitlement to an exemption.

The Committees' report contained the following explanations to the recommendations:

- This section of the report deals with irrevocable trusts in the Land Tax Law. Some of the issues dealt with by the Committee are already included in the provisions of the Land Tax Law. Thus, the

recommendations of the Committee serve to partly clarify the existing law and partly to add to it, for the purpose of adapting the existing legislation to the general recommendations of the Committee.

- In accordance with the above, the Committee recommends to determine as a general principle that transfer of property from the settlor of a trust to a trustee, will be a taxable event, which will obligate the settlor to report this to the tax authorities. The Committee further recommends, within the framework of the existing exemptions in the Land Tax Law, to determine that the applicability of the said exemptions, will view the property as if it was transferred directly from the settlor to the beneficiary, provided that at the time of the transfer of the property to the trust, it was possible to determine all the beneficiaries and their share in the trust.
- It is proposed to determine that a transfer to a trust where the beneficiaries are not identified, whether referring to an identifiable group whose members or some of whom are not identifiable or whether they do not have identifiable rights or whether there are beneficiaries which are not known at all, the transfer to the trustee will be considered as a sale liable to tax with no entitlement to an exemption, whether fully or partly.

Conclusion

The question whether a trust can be created under section 69 of the Law in favour of an unknown beneficiary, must be answered in the negative. This is according to the law, case precedents, the professional directive, the opinion of legal scholars, and in accordance with the recommendations of the Committee for the Taxation of Trusts (which in this respect sought to "clarify the existing law").

The legislator does not refer in clear language to situations where trustees or beneficiaries are changed, where the trustee is a legal entity or an individual, where the settlors, trustees or beneficiaries are Israeli residents or where the beneficiaries are unknown.

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