Appreciating gifts, and reducing their taxes

Israel's Tax Authority offers a procedure under which fair market value basis is granted to certain assets.

3 August 10 14:47, **Yuval Navot**

According to a proverb in Mishlei, "He who hates gifts will live". Another known Hebrew proverb says that “inheritance won’t enrich us”. The fact is, however, that gifts and bequests increase our wealth, and therefore their tax consequences should be considered.

Israel has no gift tax, inheritance tax, or estate tax. Its estate tax, which included a gift tax component, was repealed almost thirty years ago. All proposals to reinstate it, the most significant of which was following the 2000 Ben Bassat report, were never adopted into law.

Generally, a donor is exempt from capital gains tax on any bona fide gift of appreciated property given to an Israeli individual. Gift recipients and inheritors are not subject to any income tax either.

When a gifted or bequested property is sold by the donee, there is a question as to what its tax basis is. Suppose, for example, that a father purchased a share for NIS 10, gifted it to his son when it was worth NIS 15 and the son later sold it for NIS 20.

If the son “steps into his father's shoes” and the father’s basis is transferred to him, the basis would be the father's cost, which is NIS 10, and therefore the gain from selling the share would be NIS 10 (20-10). If, however, the son gets a basis equal to the share's fair market value on the gift's date, then his tax basis would be NIS 15, and his gain from selling the share would be only NIS 5 (20-15).

The general rule in Israel is that gift recipients and inheritors “step into the shoes” of the donor and therefore receive the donor's tax basis. However, the Israeli Tax Authority offers a quick private ruling procedure under which fair market value basis is granted to certain assets. The significance of such ruling is that upon a future sale of the asset by the Israeli resident donee, capital gains tax will apply only on the appreciation that occurred after the gift or inheritance's date.

The ruling applies only to assets that are located overseas and that do not represent rights to Israeli property. Such assets can be, for example, securities in foreign corporations or foreign real estate. Also, the ruling procedure applies only where an Israeli resident receives a gift or inheritance from a non-Israeli resident.

The ruling requires the gift recipient or inheritor to concede to some adverse tax limitations. It denies any losses and depreciation deductions on the asset and it limits the ability to credit foreign taxes imposed in connection with the future sale of the asset. However, even with these and certain other important limitations, such a ruling would generally result in substantial Israeli tax savings.

The author is a US and Israeli tax lawyer with Elieser Kaplan Law Offices.