

News Analysis: The Israeli Tax Court's Purposive Construction vs. The Letter of the Law

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Reprinted from *Tax Notes Int'l*, June 7, 2010, p. 787

COUNTRY DIGEST

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When it comes to purposive construction, few courts can beat the Israeli Supreme Court. In a recent decision, the Court departed from the clear and unambiguous language of the Israel Income Tax Ordinance (ITO) in order to accord the provisions under consideration their purposive effect.

Mano, decided May 5, concerned the tax ramifications of a company's liquidation. The ITO erroneously provided that although the capital gains tax a company paid on the disposition of its assets could be credited against the capital gains tax due on the liquidation dividend, no gross-up of that dividend was required. Thus, the taxpayer enjoyed double relief. The company tax was deducted from the liquidation dividend, and the full credit of the tax paid on the entire consideration the company received on its sale of assets was allowed on the liquidation dividend (which amounted to the capital gain derived by the company less the capital gains tax paid thereon).

Tax scholars pointed out this long-standing anomaly for years, until in 1994 the tax authorities adopted the position that the clear language of the statute could be surpassed by a purposive construction leading to their desired result of grossing up the liquidation dividend.

That's exactly what the Supreme Court did in *Mano*: It held that relief from income tax must have an economic or social purpose and must be accorded only when specifically spelled out by the statute.

Comments

Double relief is no better than double taxation; neither should be condoned by the judiciary. Nonetheless, the statutory language had to be superseded by the purposive construction rules.

But what about the fact that a few years after the tax year under consideration, the legislature finally amended the ITO and removed the anomaly? Wasn't that a sign that even the tax authorities thought the ITO's language prescribed double relief, albeit unwarranted?

No, said the Supreme Court. The legislation was a mere clarification and heralded no change.

The result is astounding. Taxpayers rely on legal opinions in preparing their tax returns and planning their income-producing activities. Those opinions usually look to the letter of the law. But if purposive construction may ignore that letter, so may legal opinions. Aggressive tax planning backed by no less aggressive legal opinions may soon become the hallmark of the Israeli tax environment. ♦

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