

Tax Avoidance by Real Estate Purchase Groups Scrutinized

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A government committee reporting to the Israeli Tax Authority on June 21 recommended halting a widely used scheme to partially avoid the graduated purchase tax and 16 percent VAT imposed on the gross price of apartment buildings.

The scheme is quite simple: An entrepreneur organizes a “purchase group” whose members buy land directly from a private party, thereby avoiding the VAT on the value of the land. The group then enters into contracts with a builder to construct an apartment building and with a bank to finance the acquisition. The net result is that no purchase tax is payable on the construction fee, and the total price is lower because the entrepreneur’s profit margin is lower than that of a building contractor.

In short, the purchase group realizes a tax savings equivalent to 7.3 percent of the gross price of the

apartment building (the 16 percent VAT on the value of the land, which is equivalent to 5.3 percent of the total price, and the purchase tax on the construction fee, which is approximately 2 percent). The only drawback is the dependence of each group member on the other members to abide by their agreements so that the building is completed.

The Committee for Examining the Tax Aspects of Purchase Groups has recommended that members of purchase groups be treated the same way as ordinary purchasers doing business with building contractors.

The proposal is part of a government effort to cool the real estate market and goes hand in hand with a plan to eliminate a tax exemption granted to qualified residential apartment buildings. Building contractors will especially welcome the enactment of these measures because purchase groups have become their most aggressive competitors. ◆

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