

When Does Retroactive Become Prospective Under Israeli Law?

by **Amnon Rafael and Elad Brauner**

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The Supreme Court of Israel, in the recent case *Mordecai v. Ministry of Finance*, was asked to issue an *order nisi* requiring the minister of finance to show why a 2002 amendment to the Income Tax Ordinance should not be held null and void, because it retroactively taxes the petitioning taxpayers.

Under the Israeli Income Tax Ordinance, married couples generally are taxed as a household — that is, their income is computed jointly. However, when the source of the income of one spouse is not dependent on the source of the income of the other spouse, filing separate returns is permitted. In the recent case, the parties seemed to agree that in the absence of specific legislation to the contrary, the petitioners were required to file a joint return.

However, because of public opposition to the so-called marriage penalty, the Knesset (Israeli legislature) intervened and prescribed that in some cases, a married couple may be allowed to file separate returns even if the source of the income of one spouse is dependent on the source of the other. Acknowledging that its legislation could be costly to the Treasury, the Knesset allowed the finance minister to postpone the legislation's entry into force by notifying the Knesset Finance Committee one month before the close of the tax year in which the new provisions were to enter into force and obtaining the committee's approval.

In 2001 the finance minister and the chair of the Knesset Finance Committee were at odds. The Finance Committee chair did not bring the finance minister's request for postponement before the committee before the close of the 2001 tax year, and the new legislation entered into force on January 1, 2002.

In June 2002 the finance minister brought a bill before the Knesset, which enacted a law changing the date of effectiveness of the provision allowing for the filing of separate returns from January 1, 2002,

to January 1, 2004. The income tax authorities maintained that with that legislation, no separate filing by couples was allowed during the 2002 tax year.

The petitioners argued that the legislation was null and void because its retroactivity violates Israel's Basic Law on Human Dignity and Liberty. However, the government argued that such retroactivity is permissible in the case under consideration because the petitioners had never been granted the absolute right to file separate returns, and because of the mistiming resulting from the rift between the finance minister and the Finance Committee chair.

The Court was reluctant to hold the law null and void, but under Israeli precedent, retroactive fiscal legislation is seldom acceptable. The Court resolved the matter by stating that the legislation was not retroactive (although it changed its year of effectiveness from 2002 to 2004), but rather "prospective" in that it applied as of the date of its publication in the official gazette. The result was that couples with dependent income sources had to split their reporting for the 2002 tax year. In other words, up until the publication of the 2002 amendment, they could file separate returns, but thereafter they had to go back to filing joint returns.

In reaching its conclusion, the Court relied on the statutory language of the 2002 amendment, in which it found no desire for retroactive applicability — a strange conclusion, considering that the language specifically changed "2002" to "2004." The Court also relied on the presumption of legal stability, which holds that a retroactive change in a fiscal law usurps its stability and therefore should not be regarded as a purpose of any legislation. In that respect, the Court also stressed that under a general presumption, a law should not be deemed to have the goal of impeaching basic rights, including the basic right to property.

It is difficult to accept the Court's reasoning. A change in the year of a law's effectiveness sometime after the law has already entered into effect is, by its nature, retroactive. Perhaps the need to maintain the balance between the Knesset and the Court played a role in safeguarding the amendment to the Israeli Income Tax Ordinance. ♦