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LAW FIRM

## Real Estate in Israel

*In Israel, unlike the United States, there is no strict procedure forcing the parties in a real estate transaction to conduct examinations about the status of the property.*

In 1997, Scott, a US citizen, bought a luxury penthouse with a floor area of approximately 100 sq.m. in one of the high-end areas of Jerusalem. Some of the time, the property was used as the family's residence, and the rest of the time – it served as an investment property and was rented to tenants.

Approximately 10 years after the purchase, Scott decided to sell his rights in the property. He received an offer that would have netted him a handsome profit, and the parties commenced negotiations. Simultaneously, the potential buyer's lawyer conducted several preliminary examinations, and found that only 25 sq.m. of the property had been built pursuant to lawful building permits, while most of the property was built in violation of the permits.

Construction in violation of a valid building permit is a criminal violation in Israel. In addition to demolition of the unauthorized construction, penalties may include heavy fines and even imprisonment. Furthermore, the government authorities may initiate criminal proceedings against the owners, even if they were not the ones who performed the violation and merely purchased a property that violated the permit.

The potential buyer understandably withdrew his offer. For several years, Scott was unable to find anyone who would purchase the property as is. He tried unsuccessfully to obtain permits for those parts of the property that violated the building permit, and after two years sued the sellers and his own lawyer for more than NIS 1 million (approximately \$250,000 in 2009). Only in 2017,

some 10 years after the problem first came to light, Scott's claim was granted and he was awarded the damages he had claimed. This delay lost Scott 10 years of appreciation in the value of his property, while the Israeli market raced ahead and property values rose by more than 70%.

How is it possible that Scott, who was represented by a lawyer when he purchased the property, did not know the status of the property and paid a full price as if all lawful permits had been granted? Why did it take 10 years from purchase, and a potential buyer's lawyer, to first find out? Unfortunately, the answer is very simple. In Israel, unlike the United States, there is no strict procedure forcing the parties, as part of a transaction, to conduct examinations about the status of the property. In fact, the type and scope of examinations carried out depend only on the lawyers selected by the party and their skills.

As a rule, in the United States, only after the parties sign the sale agreement and the buyer deposits an advance, the buyer begins to investigate the physical, legal and planning status of the property. Only once the investigation has deemed that the property is in order, with no debts or liens, is the consideration released to the seller.

The underlying rationale is clear – until an agreement is executed, the buyer and seller are not bound toward one another, and may withdraw their offers. The seller may receive a higher bid, terminate negotiations and accept the new bid, and the buyer can find another property, withdraw the offer and cause the seller (who may have foregone other offers

in the meantime) serious damages. The parties therefore execute an agreement that precludes them from withdrawing from their understandings. Only then, once they are mutually committed, is the buyer given time to perform all necessary investigations: ascertaining that the seller indeed has good title, checking that the property was built in accordance with required permits, and discovering material defects, liens or violations. Some of these examinations are performed by the buyer's lawyer, and some through a title company.

The title company makes sure that title to the property is legitimate and clear, such that the purchaser can be certain that once the transaction closes and he has paid the consideration in full, he can be recognized as the lawful owner. In order to assure title validity, the title company conducts a thorough search through the records of the property. The title company ascertains that the seller is indeed the lawful holder of the deed and that there is no third party who may claim full or partial rights to the property.

As part of this search, the title company checks for outstanding mortgages, liens, judgments or unpaid taxes and for any restrictions, easements, leasehold rights or any other matter that may adversely affect the title. The title company also checks whether neighbors or others are trespassing or squatting or whether any person has been given a right of use that is liable to adversely affect the title.

Once title has been cleared, the title company issues an insurance policy that protects lenders and owners against claims or legal costs they may incur in connection with title-related disputes.

There are no title companies in Israel. Moreover, contrary to the standard course of dealing in the US, the legal approach here is that the buyer should perform all investigations before the purchase agreement has been signed. The agreement is binding only upon signing. Most of the payments are transferred directly to the seller, shortly after execution, and only certain amounts are held in trust against specific payments that the seller must make (which if not paid would preclude registration of title in the buyer's name).

Since in Israel too, either party may withdraw until a binding agreement has been signed, and since there are no title companies in Israel, it falls upon the lawyers to perform the preliminary examinations.



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Only some of these examinations are legal, and since they involve several authorities and must be performed within a very short time, not all lawyers strictly perform all of them.

## **The legal approach in Israel is that the buyer should perform all investigations before the purchase agreement has been signed.**

A summary of the main investigations that need to be carried out ahead of signing an agreement for the purchase of real estate property in Israel is provided below. This is not an exhaustive list, and a lawyer who specializes in real estate should be consulted in order to make sure that the necessary examinations are conducted as required for that type of property.

### THE SELLER'S RIGHTS IN THE PROPERTY

In general, the rights registry is conducted by the Land Registry Office.

The Land Registry Office conducts a computerized registry, which includes maps indicating the boundaries and ownership of each plot. Approximately 95% of the land in Israel has been checked for boundaries and ownership, and with respect to this land, the records of the Land Registry Office constitute conclusive evidence. In special cases, it can be proven that a title is not as shown in the Registry. For land that has not yet undergone a formal governmental procedure of land settlement, Land Registry records are prima facie evidence only, and in some cases, further evidence of the seller's title may be required.

When a unit in a building that has not yet been registered as a cooperative house is purchased, a scheme certifying that the buyer is indeed the owner of the transacted property must be produced. In some cases, the documents from the first sale by the developer to the first purchaser must be located, which in most cases include the scheme of the transacted property.

Approximately 92% of the land in Israel is owned by the government. Much of the land is leased to contractors, who build and sell units to buyers (apartments, offices, shops, etc.), but a large portion of the new land is leased to contractors pursuant to maps that conflict with Land Registry records.

Consequently, the State of Israel, through the Israel Lands Authority ("ILA"), conducts a parallel registry – in addition to records maintained by the building contractors. Such provisional records may be maintained for decades, until the Land Registry records are updated. In such case, the buyer must obtain information about the leasehold from both the ILA and the contracting company that built the building in which the purchased property is located.

### PLANNING STATUS INFORMATION

Planning status inquiries must be made with the municipality in which the property is located. The inquiry should include permitted use pursuant to the applicable city plan, in order to make sure that the property has been used as permitted by law. For example, in some cases, such inquiries have found that the property sold as a residential apartment, was designated in the city plan to serve for storage or laundry room, or that property sold as office space, was designated to be used for commercial purposes. In such cases, the owner can be indicted for unlawful use, and such use may be stopped and fines may be imposed.

Thorough lawyers would also check whether new plans have been approved with regard to the property or its area, which might adversely affect the value of the property or, conversely, cause its value to go up; whether unexercised building rights exist (if so, an architect must be consulted as to whether such rights can be exercised in connection with the purchased property); whether local or city plans have been issued, which, if approved, might affect the property or its value; whether the building in which the property is located is used in any way

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The standard records of the Land Registry (known by the Ottoman name "*Tabu*") do not include details of surface area of the plot or buildings situated there. However, the Land Registry Offices maintain a separate database for buildings with more than one unit (apartment, shop, hall, storage room) where each unit is recorded separately (as a sub-plot). Such buildings are registered in the Registry of Cooperative Houses (*Mirsham Ha-Batim Ha-Meshutafim*), but many buildings in Israel have not yet been registered there.

Any person, regardless of any connection to the property, may obtain a copy of the Land Registry records, known in Hebrew as a *nesakh*. Such a printout would include, among other things, the identity of the owners, boundaries, size, mortgages, liens, encumbrances, various notes regarding sale to third parties, etc.

that violates the approved city/local plan; etc.

## PERMIT STATUS

A building permit is the authorization granted by the local planning and building committee to perform construction or demolition work or change the use made of the property. The main document comprising the building permit includes a literal description of the approved application to which a drawing is attached.

The perimeter of the property and the location of external openings (windows and doors) are stipulated in the building permit. Under Israeli law, changes to the inside of the property do not require a permit, but outside boundaries and openings do. In many cases, especially in older buildings, differences can be found between the perimeter as stipulated in the permit and the actual condition of the property, because of works that were performed over the years. For example, splitting or combining apartments in a building requires a permit. The grant of a permit to split an apartment will depend, among other things, on restrictions on the number of units authorized for that building, and may be more complicated.

In some cases, unauthorized construction trespasses onto the outside perimeter of the building or service areas such as heating or storage rooms. In other cases, unauthorized construction includes walling-in balconies, creating doors without a permit, etc. With old construction violations too, the scope should be examined and the date of construction ascertained, and it should be checked whether a permit can be obtained for the violations.

Such examination should include a comparison of the permit drawings to the as-is condition of the property and to the plan of the cooperative house as registered with the Land Registry.

## DEBTS

Under Israeli law, rights in the property can be transferred from the seller to the buyer only after certain debts with regard to the property have been settled. As a condition for registration, the parties must submit certificates proving that there are no outstanding purchase or betterment taxes, and that various payments to the local authority have been made.

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held in escrow are those required to ensure that the seller satisfies all such payments for which he is responsible and without which the property cannot be registered in the buyer's name. Such amounts are paid out of the last installment, into an escrow account held by the seller's lawyer, who is authorized to use them in order to obtain the necessary clearance certificates. Alternatively, the counsel for the buyer can release the money to the seller upon receipt of such certificates.

## RESPECTIVE OBLIGATIONS IN A REAL ESTATE TRANSACTION

**Purchase Tax** – Purchase tax is imposed by law on the purchaser of any real estate right. The payable amount is calculated as a fixed percentage of the property value, except in some cases (e.g., residential properties) when the percentage is graduated. The tax is paid in addition to the consideration paid to the seller, and must be paid within 60 days from execution of the purchase agreement.

**Betterment Tax** – Land betterment tax is due with respect to capital gains on the sale of real estate in Israel. The seller is taxable on the betterment (gain) accruing to him upon the transaction, i.e., on the difference between the selling price (or, in special cases, the consideration he is supposed to receive based on the true market value of the property) and the price he had paid when he purchased the property himself (index). Improvements performed during this interval (less depreciation), are also deducted from the purchase.

The specific rate applicable to each transaction must be checked on a case by case basis, because betterment tax rate varies according to the date of purchase. If the seller owns no other apartment – he may be eligible for an exemption. Following several recent regulatory amendments, in some cases the buyer can pay the Tax Authorities directly, 7.5% to 15% of the consideration, and obtain a certificate authorizing him to procure registration of title in his name.

**Payments to the Local Authorities** – In order to transfer the rights into the name of the buyer, the seller must satisfy any outstanding debts to the local authority. Such debts will always include current city tax (*arnona*) with regard to the property.

City tax is collected from all residents of that city, and used in order to finance the operations of

the city. In Israel, the primary criteria determining city tax rate include: use (residential, commercial, office, industry, etc.), floor area, financial condition of the resident, and location of the property (luxury neighborhood, developed commercial area, lower socioeconomic neighborhood, etc.).

In some cases, the seller will also be required to pay improvement levy (*heitel hashbakha*) in connection with the property. In Israel, this is a mandatory payment that landowners or long-term lessees are required to pay by the Local Planning & Building Council that approved a plan that increases the value of the property (e.g., by allowing construction of another floor). The levy is due and payable by the seller upon the sale transaction, even though the seller has not yet lawfully exercised such new rights under the plan. By law, the duty to pay improvement levy is upon the owner or long-term

the purchase agreement, preferably through appropriate professionals, such as experienced civil engineers.

This is of particular importance with respect to material defects that cannot be seen by the naked eye, such as hidden water damage or leaks, piping problems, etc. Following the findings, the parties can agree to reduce the price, or, the sellers may warrant that they will repair some of the defects, prior to delivery of possession.

Rarely will sellers agree to reduce the price for defects arising from reasonable wear and tear.

## IMPORTANT POINTS FOR FOREIGN PURCHASERS OF REAL ESTATE IN ISRAEL

### Purchase of State-Owned Land

By law, rights in real estate owned by the State of Israel may not be transferred to foreigners, except subject to authorization by the Chairperson of the Israel Lands Council or the Director of the Israel Lands Authority.

A “foreigner”, as defined by law, is any person who is (i) not a citizen or resident of Israel, (ii) not entitled to immigrate to Israel pursuant to the Law of Return, or (iii) a corporate entity controlled by a person who is not an Israeli citizen or resident or who is not entitled to immigrate to Israel pursuant to the Law of Return.

By law, authorization to hold rights in real estate will be granted to foreigners subject to the following criteria: public interest and safety, affinity of the foreigner to Israel, including his personal specifics, period of residence in Israel and family relation to any non-foreigner; the purpose for which the foreigner intends the property; the scope of property purchased by or transferred to such foreigner prior to the application; attributes of the property, including size, location and authorized use.

Note that these restrictions do not apply to inheritance by individuals.

### Purchase and Betterment Tax Breaks for Foreign Residents Who Can Prove That The Transacted Apartment Is Their Only One

A foreign resident that is purchasing a residential apartment in Israel and can prove to the Israeli Tax Authorities that he does not own any other apartment in his country of residence, shall be

## Under Israeli law, authorization to hold rights in real property will be granted to foreigners subject to a number of criteria.

lessee. Therefore, although the sale agreement can stipulate that it would be paid by the buyer, this would only be binding as between the buyer and the seller, but not against the Local Council.

### PHYSICAL CONDITION OF THE PROPERTY

The general rule in real estate transactions in Israel is that the property is sold “as is”. The seller is not liable for the condition of the property, unless he knew about a defect that could not have been discovered by reasonable inquiry, or if he concealed this defect from the buyer. Therefore, in order not to have unpleasant post-purchase surprises, buyers are advised to conduct an inspection of the physical condition of the property before signing

eligible for reduced tax brackets.

Similarly, a foreign resident who can prove to the Israeli Tax Authorities that the apartment he is selling in Israel is his only one and that he does not own any other apartment in his country of residence, may be eligible for an exemption from betterment tax upon sale of that apartment.

A certificate from the tax authorities in the foreigner's country of residence showing that he does not own an apartment there, would be sufficient.

If such certificate cannot be obtained, the foreign resident will have to provide objective evidence proving that he does not own such other apartment in his country of residence, and convince the Israel Tax Authority. He would, initially, have to demonstrate where his permanent residence is in his country of residence, and substantiate the rights he has to such residential property. He would have to submit a lease or other agreement showing that he is a leaseholder rather than owner, and a certificate equivalent to city tax, showing that he pays taxes abroad in the capacity of a possessor rather than an owner – to the extent any such certificate can be produced. Alternatively, he could submit a certificate from the tax authority in his country of residence, confirming that he has not reported rent income on residential or other real estate property, or submit his tax returns for the relevant period (if he has rent income on non-residential real estate property, he may, in addition, submit an affidavit pursuant to the Israeli Evidence Ordinance confirming that such income did not accrue on residential property but on a different kind of property).

In support of such certification, the foreigner must submit an affidavit in which he declares he has no rights in any residential property in his country of residence.

In case of a federation such as the United States, the applicant must make sure that the certificates confirm that he has no residential property in any of the counties in that state or in any of the states within the federation.

Such certificates could result in significant tax savings, both upon purchase and upon sale. Note that this tax break is available only with respect to residential property.

## CONCLUSION

When buying real estate property in Israel, the buyer is advised to make sure that before signing the purchase agreement, his lawyers conduct all the necessary inquiries with regard to the property and the seller's rights therein. In some cases, lawyers will connect the buyer to appropriate experts, such as civil engineers or real estate appraisers.

The importance of these inquiries before signing the agreement is paramount, because once the agreement has been executed, it would be very difficult to revoke or terminate the transaction or amend the agreed consideration, even if a material defect is discovered only after execution. Termination and restitution under such circumstances would be subject to the seller's consent or a court order – a situation that sensible buyers would seek to avoid. ■

## ABOUT THE AUTHOR

Lee Maor is a partner in the Real Estate group of Yigal Arnon & Co. She provides ongoing legal advice to real estate companies and contractors and represents clients in a broad range of issues including complex real estate transactions, the purchase and sale of various properties, housing and commercial projects, combination deals, urban renewal projects, land registration, project finance and construction and management agreements.

Lee received her law degree from The Hebrew University in Jerusalem in 2006 and was admitted to the Israel Bar in 2007.

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