CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE STATE OF ISRAEL WITH RESPECT TO TAXES ON INCOME

GENERAL EFFECTIVE DATE UNDER ARTICLE 31: 1 JANUARY 1995

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TAX CONVENTION WITH THE STATE OF ISRAEL

MESSAGE

FROM

THE PRESIDENT OF THE UNITED STATES

TRANSMITTING

THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE STATE OF ISRAEL WITH RESPECT TO TAXES ON IN COME, SIGNED AT WASHINGTON ON NOVEMBER 20, 1975

LETTER OF SUBMITTAL

DEPARTMENT OF STATE,
Washington, January 23, 1976.

The PRESIDENT,
The White House.

THE PRESIDENT: I have the honor to submit to you, with a view to its transmission to the Senate for advice and consent to ratification, the Convention between the Government of the United States of America and the Government of the State of Israel with respect to taxes on income, signed at Washington on November 20, 1975. Also I have the honor to recommend that you request the withdrawal from the Senate of the Convention for the avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income between the Government of the United States of America and the Government of Israel which was signed at Washington on June 29, 1965, (Executive F. 89th

Congress, 1st Session) but which never received the Senate's advice and consent to ratification. There is presently no treaty on this subject in force between the United States and Israel.

The proposed treaty with Israel of November 20, 1975, is similar in many essential respects to other recent United States income tax treaties. However, there are several novel provisions, which are described below. In general, these special provisions reflect Israel's status as a developing country and would not be considered as precedents for treaties with other industrial countries.

Article 10 (Grants) contains rules not found in previous American tax treaties. The article provides that if Israel makes a cash grant to an American investor, and the grant is not in payment for goods or services and is not measured by the amount of profits or tax liability, the United States will treat the grant as a nontaxable contribution to capital. This merely confirms by treaty the treatment which would generally apply in these circumstances under United States law.

The draft treaty also provides that Israel's compulsory loans are to be treated as taxes so that, under Article 26, the United States will allow a foreign tax credit for the loans, on condition that when the loans are repaid, they are to be treated as a refund of taxes with appropriate adjustments to U.S. tax liability at that time.

Though the draft treaty provides the normal general rule that capital gains are taxable in the state of residence and exempt in the state of the source of the income, there are several exceptions to this rule. The principal exception, not found in previous treaties, is that Israel may tax the gain of a U.S. resident on the sale of the shares of stock in an Israeli corporation if the resident owns more than 50 percent of the voting power of the Israeli corporation and a majority of that corporation's business assets are located in Israel. This is analogous to the treatment provided for gains on the sale of the assets of an Israeli branch owned directly by a U.S. resident.

With respect to dividend withholding rates an exception has been made to our normal policy of strict reciprocity. The maximum U.S. rate in general will be 15 percent with a 5 percent rate applicable where the Israeli recipient owns at least 10 percent of the voting stock of the paying corporation. For Israeli source dividends, the comparable maximum Israeli withholding rates will be 25 percent and 12.5 percent respectively.

The general withholding rate on interest will be l7.5 percent. This higher than normal rate was acceptable because of the further agreement that interest derived by a financial institution would be taxed at a maximum rate of 10 percent and interest derived, guaranteed or insured by a government or agency thereof would be exempt by the other state.

The maximum withholding rate on industrial royalties will be 15 percent while that on copyright or film royalties will be 10 percent.

The remaining provisions of the draft treaty dealing with the taxation of business profits, personal service income and administrative matters are patterned largely after other recent United States income tax treaties.

Attached to the treaty is a note of transmittal similar to the note presented at the signing of our treaty with Trinidad and Tobago, in which the United States agrees when appropriate and feasible to reopen discussions with Israel with a view toward reaching agreement on provisions which would minimize the conflicts between the United States tax system and incentives to foreign investors offered by the Israeli Government.

The Convention will enter into force thirty days after the date of exchange of instruments of ratification and then have effect as follows: with respect to the rate of withholding of tax, it shall have effect with regard to amounts paid on or after the first day of the second month following the date on which this Convention enters into force; with respect to other taxes, it shall have effect with regard to taxable years beginning on or after January 1 of the year following the date on which this Convention enters into force. Once entered into force. the Convention will remain in effect for a minimum of five years and in definitely thereafter subject to the right of either party to terminate it by giving six-month's notice for that purpose pursuant to the provisions of the Convention.

The Department of the Treasury, with the cooperation of the Department of State, was primarily responsible for the negotiation of this Convention. It has the approval of both Departments.

Respectfully submitted,

JOSEPH J. SISCO.

Enclosure: Convention.

LETTER OF TRANSMITTAL

THE WHITE HOUSE, *February 11, 1976.*

To the Senate of the United States:

I transmit herewith, for Senate advice and consent to ratification, the Convention signed at Washington on November 20, 1975, between the Government of the United States of America and the Government of the State of Israel with respect to taxes on income. Also I desire to withdraw from the Senate the Convention for the avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income between the Government of the United States of America and the Government of Israel which was signed at Washington on June 29, 1965 (Executive F. 89th Congress, 1st Session).

There is no convention on this subject presently in force between the United States and Israel.

The Convention signed on November 20,1975, is similar in many essential respects to other recent United States income tax treaties.

I also transmit, for the information of the Senate, the report of the Department of State with respect to the Convention.

Conventions such as this one are an important element in promoting closer economic cooperation between the United States and other countries. I urge the Senate to act favorably on this Convention at an early date and to give its advice and consent to ratification.

GERALD R. FORD.

THE WHITE HOUSE.

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE STATE OF ISRAEL WITH RESPECT TO TAXES ON INCOME

The Government of the United States of America and the Government of the State of Israel, desiring to conclude a convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income have agreed as follows:

ARTICLE 1
Taxes Covered

1. The taxes which are the subject of this Convention are:

(a) In the case of the United States, the Federal income taxes imposed by the Internal Revenue Code, and

(b) In the case of Israel-

(i) The income tax (including capital gains tax),

(ii) The company tax,

(iii) The tax on gains from the sale of land under the land appreciation tax law,

(iv) The tax on income levied under the services tax law (banking institutions and insurance companies), and

(v) The war loans and security loans, hereinafter referred to as "compulsory loans".

2. This Convention shall also apply to taxes substantially similar to those covered by paragraph (1) which are imposed in addition to, or in place of, existing taxes after the date of signature of this Convention.

3. For the purpose of Article 27 (Nondiscrimination), this Convention shall also apply to taxes of every kind imposed at the national level.

4. The competent authorities of the Contracting States shall notify each other of substantial amendments of the tax laws referred to in paragraph (1) and of the adoption of any taxes referred to in paragraph (2) by transmitting the texts of any substantial amendments or new statutes.

5. The competent authorities of the Contracting States shall notify each other of the publication by their respective contracting States of any material concerning the application of this Convention, whether in the form of regulations, rulings, or judicial decisions by transmitting the texts of any such materials.

ARTICLE 2
General Definitions

1. In this Convention, unless the context otherwise requires:

(a) (i) The term "United States" means the United States of America; and

(ii) When used in a geographical sense, the term "United States" means the states thereof and the District of Columbia.

Such terms also includes:

(A) The territorial sea thereof, and

(B) The seabed and subsoil of the submarine areas adjacent to the coast thereof, but beyond the territorial sea, over which the United States exercises sovereign rights, in accordance with international law, for the purpose of exploration for and exploitation of the natural resources of such areas, but only to the extent that the person, property, or activity to which the Convention is being applied is connected with such exploration or exploitation.

(b) (i) The term "Israel" means the State of Israel; and

(ii) When used in a geographical sense the term "Israel" includes:

(A) The territorial sea thereof, and

(B) The seabed and subsoil of the submarine areas adjacent to the coast thereof, but beyond the territorial sea, over which Israel exercises sovereign rights, in accordance with international law, for the purpose of exploration for and exploitation of the natural resources of such area, but only to the extent that the person, property, or activity to which this Convention is being applied is connected with such exploration or exploitation.

(c) The term "Contracting State" means the United States or Israel, as the context requires.

(d) The term "State" means any national State, whether or not one of the Contracting States.

(e) The term "person" includes an individual, a partnership, a corporation, an estate, or a trust.

(f) (i) The term "United States corporation" means a corporation (or any unincorporated entity treated as a corporation for United States tax purposes) which is created or organized under the laws of the United States or any state thereof or the District of Columbia; and

(ii) The term "Israeli corporation" means any body of persons taxed as a body of persons resident in Israel under the income tax ordinance.

(g) The term "competent authority" means:

(i) In the case of the United States, the Secretary of the Treasury or his delegate, and

(ii) In the case of Israel, the Minister of Finance or his delegate.

(h) The term "tax" means tax imposed by the United States or Israel, whichever is applicable, to which this Convention applies by virtue of Article 1 (Taxes Covered).

(i) The term "international traffic" means any voyage of a ship or aircraft operated by a resident of one of the Contracting States except where such voyage is confined solely to places within a Contracting State.

2. Any other term used in this Convention and not defined in this Convention shall, unless the context otherwise requires, have the meaning which it has under the laws of the Contracting State whose tax is being determined. Notwithstanding the preceding sentence, if the meaning of such a term under the laws of one of the Contracting States is different from the meaning of the term under the laws of the other Contracting State, or if the meaning of such a term is not readily determinable under the laws of one of the Contracting States; the competent authorities of the Contracting States may, in order to prevent double taxation or to further any other purpose of this Convention, establish a common meaning of the term for the purposes of this Convention.

ARTICLE 3
Fiscal Residence

1. In this Convention:

(a) The term "resident of Israel" means:

(i) An Israeli corporation, and

(ii) Any other person (except a corporation or any entity treated under Israeli law as a corporation) resident in Israel for purposes of Israeli tax, but in the case of a partnership, estate, or trust only to the extent that the income derived by such partnership, estate, or trust is subject to Israeli tax as the income of a resident either in the hands of the respective entity or of its partners or beneficiaries.

(b) The, term "resident of the United States" means:

(i) A United States corporation, and

(ii) Any other person (except a corporation or any entity treated as a corporation for United States tax purposes) resident in the United States for purposes

of United States tax, but in the case of a partnership, estate, or trust only to the extent that the income derived by such partnership, estate, or trust is subject to United States tax as the income of a resident either in the hands of the respective entity or of its partners or beneficiaries.

2. Where by reason of the provisions of paragraph (1) an individual is a resident of both Contracting States:

(a) He shall he deemed to be a resident of that Contracting State in which he maintains his permanent home. If he has a permanent home in both Contracting States or in neither of the Contracting States, he shall be deemed to be a resident of that Contracting State with which his personal and economic relations are closest (center of vital interests). In the case of a person who is an "oleh" (as defined in section 9(16) of the Israeli Income Tax Ordinance), his center of vital interests shall be deemed to be in Israel.

(b) If the Contracting State in which he has his center of vital interests cannot be determined, he shall be deemed to be a resident of that Contracting State in which he has a habitual abode;

(c) If he has a habitual abode in both Contracting States or in neither of the Contracting States, he shall be deemed to be a resident of the Contracting State of which he is a citizen; and

(d) If he is a citizen of both Contracting States or of neither Contracting State, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. A corporation which is both a United States corporation within the meaning of paragraph (1) (f) (i) of Article 2 (General Definitions) and an Israeli corporation within the meaning of paragraph (1) (f) (ii) of such Article 2 shall be considered to be outside the scope of this Convention except for purposes of Article 27 (Nondiscrimination) and Article 29 (Exchange of Information).

ARTICLE 4
Source of Income

For purposes of this Convention:

1. Dividends shall be treated as income from sources within a Contracting State only if paid by a corporation of that Contracting State.

2. Interest shall be treated as income from sources within a Contracting State only if paid by such Contracting State, a political sub-division or a local authority thereof, or by a resident of that Contracting State. Notwithstanding the preceding sentence, if such interest is paid on an indebtedness incurred in connection with a permanent establishment which bears such interest, then such interest shall be deemed to be from sources within the State (whether or not a Contracting State) in which the permanent establishment is situated.

3. Royalties described in paragraph (2) of Article 14 (Royalties) for the use of, or the right to use, property or rights described in such paragraph shall be treated as income from sources within a

Contracting State only to the extent that such royalties are for the use of, or the right to use, such property or rights within that Contracting State.

4. Income and gains (including royalties) to which Article 7 (Income from Real Property) applies shall be treated as income from sources within a Contracting State only if the real property (or, in the case of property referred to in paragraph (3) of such Article 7, the underlying real property) is situated in that Contracting State.

5. Income from the rental of tangible personal (movable) property shall be treated as income from sources within a Contracting State only to the extent that such income is for the use of such property in that Contracting State.

6. Income from the purchase and sale, exchange, or other disposition of intangible or tangible personal property (other than gains described in paragraph (2) of Article 14 (Royalties)) shall be treated as income from sources within a Contracting State only if such sale, exchange, or other disposition is within that Contracting State. Notwithstanding the preceding sentence, gains from the sale, exchange, or other disposition of stock to which paragraph (1) (e) of Article 15 (Capital Gains) applies shall be treated as income from sources within Israel.

7. Income received by an individual for his performance of labor or personal services, whether as an employee or in an independent capacity, shall be treated as income from sources within a Contracting State only to the extent that such services are performed in that Contracting State. Income from personal services performed aboard ships or aircraft operated by a resident of one of the Contracting States in international traffic shall be treated as income from sources within that Contracting State if rendered by a member of the regular complement of the ship or aircraft. Notwithstanding the preceding provisions of this paragraph, remuneration described in Article 22 (Governmental Functions) and payments described in Article 21 (Social Security Payments) paid from the public funds of a Contracting State or a political subdivision or local authority thereof shall be treated as income from sources within that Contracting State only.

8. Notwithstanding paragraphs (1) through (6), industrial or commercial profits which are attributable to a permanent establishment which the recipient, a resident of one of the Contracting States, has in the other Contracting State, shall be treated as income from sources within that other Contracting State. Industrial or commercial profits attributable to such permanent establishment include any item of income described in paragraphs (1) through (6) to the extent provided in paragraph (6) of Article 8 (Business Profits).

9. The source of any item of income to which paragraphs (1) through (8) are not applicable shall be determined by each of the Contracting States in accordance with its own law. Notwithstanding the preceding sentence, if the source of any item of income under the laws of one Contracting State is different from the source of such item of income under the laws of the other Contracting State or if the source of such income is not readily determinable under the laws of one of the Contracting States, the competent authorities of the Contracting States may, in order to prevent double taxation or further any

other purpose of this Convention, establish a common source of the item of income for purposes of this Convention,

ARTICLE 5
Permanent Establishment

1. For the purpose of this Convention, the term “permanent establishment" means a fixed place of business through which a resident of one of the Contracting States engages in industrial or commercial activity.

2. The term "fixed place of business" includes but is not limited to:

(a) A branch;

(b) An office;

(c) A factory;

(d) A warehouse;

(e) A workshop;

(f) A farm or plantation;

(g) A store or other sales outlet;

(h) A mine, quarry, or other place of extraction of natural resources;

(i) A building site, or construction or assembly project, or supervision activity connected therewith and conducted within the Contracting State where such site or project is located, where such site, project, or activity continues for a period of more than 6 months; and

(j) The maintenance of substantial equipment or machinery within a Contracting State for a period of more than 6 months.

3. Notwithstanding paragraphs (1) and (2), a permanent establishment shall not include a fixed place of business used only for one or more of the following:

(a) The use of facilities for the purpose of storage, display, or delivery of goods or merchandise belonging to the resident;

(b) The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of storage, display, or delivery (other than goods or merchandise held for sale by such resident in a store or other sales outlet);

(c) The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of processing by another person;

(d) The maintenance of a fixed place of business for the purpose of purchasing goods or merchandise, or for collecting information for the resident;

(e) The maintenance of a fixed place of business for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the resident;

(f) A building site, or construction or assembly project, or supervision activity connected therewith, where such site, project, or activity continues for a period of not more than 6 months, or

(g) The maintenance of substantial equipment or machinery within a Contracting State for a period of not more than 6 months.

4. Even if a resident of one of the Contracting States does not have a permanent establishment in the other Contracting State under paragraphs (1), (2), and (3), nevertheless, such resident shall be deemed to have a permanent establishment in the other Contracting State if such resident sells in that Contracting State goods or merchandise which either-

(i) were subjected to substantial processing in that Contracting State (whether or not purchased in that Contracting State), or

(ii) were purchased in that Contracting State and not subjected to substantial processing outside that Contracting State.

5. A person acting in one of the Contracting States on behalf of a resident of the other Contracting State, other than an agent of an independent status to whom paragraph (6) applies, shall be deemed to constitute a permanent establishment in the first-mentioned Contracting State if such a person has, and habitually exercises in the first-mentioned Contracting State, an authority to conclude contracts in the name of that resident, unless the exercise of such authority is limited to the purchase of goods or merchandise for that resident.

6. A resident of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because such resident engages in industrial or commercial activity in that other Contracting State through a broker, general commission agent, or any other agent of an independent status, where such broker or agent is acting in the ordinary course of his business.

7. A resident of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because such resident sells at the termination of a trade fair or convention in such other Contracting State goods or merchandise which such resident displayed at such trade fair or convention.

8. In determining whether a resident of one Contracting State has a permanent establishment in the other Contracting State there shall not be taken into account the fact that such resident may be related to either a resident of the other Contracting State or to any other person who engages in business in that other Contracting State.

9. The principles set forth in paragraphs (1) through (8) shall be applied in determining for purposes of this Convention whether there is a permanent establishment in a State other than one of the Contracting States or whether a person other than a resident of one of the Contracting States has a permanent establishment in one of the Contracting States.

ARTICLE 6
General Rules of Taxation

1. A resident of one of the Contracting States may be taxed by the other Contracting State on any income from sources within that other Contracting State and only on such income, subject to any limitations set forth in this Convention. For this purpose, the rules set forth in Article 4 (Source of Income) shall be applied to determine the source of income.

2. The provisions of this Convention shall not be construed to restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded--

(a) By the laws of one of the Contracting States in the determination of the tax imposed by that Contracting State, or

(b) By any other agreement between the Contracting States.

3. Notwithstanding any provisions of this Convention except paragraph (4), a Contracting State may tax its residents (as determined under Article 3 (Fiscal Residence) and its citizens as if this Convention had not come into effect.

4. The provisions of paragraph (3) shall not affect:

(a) The benefits conferred by a Contracting State under Articles 10 (Grants), 21 (Social Security Payments), 26 (Relief from Double Taxation), 27 (Nondiscrimination) , and 28 (Mutual Agreement Procedure); and

(b) The benefits conferred by a Contracting State under Articles 22 (Governmental Functions), 23 (Teachers), 24 (Students and Trainees), and 30 (Diplomatic and Consular Officers) upon individuals who are neither citizens of, nor have immigrant status in, that Contracting State.

5. The United States may impose its personal holding company tax and its accumulated earnings tax notwithstanding any provision tax of this Convention. However, an Israeli corporation shall be exempt from the United States personal holding company tax in any taxable year unless any resident or citizen of the United States owns, directly or indirectly, within the meaning of section 544 of the Internal Revenue Code, 10 percent or more in value of the outstanding stock of the corporation at any time during the taxable year. An Israeli corporation shall be exempt from the United States accumulated earnings tax in any taxable year unless such corporation is engaged in trade or business in the United States through a permanent establishment at any time during such year and at least 25 percent of the voting stock of such corporation is owned by citizens or residents of the United States.

6. The competent authorities of the two Contracting States may each prescribe regulations necessary to carry out the provisions of this Convention.

ARTICLE 7

Income from Real Property

1. Income from real property, including royalties and other payments in respect of the exploitation of natural resources and gains derived from the sale, exchange, or other disposition of such property or of the right giving rise to such royalties or other payments, may be taxed by the Contracting State in which such real property or natural resources are situated. For purposes of this Convention, interest or indebtedness secured by real property or secured by a right giving rise to royalties or other payments in respect of the exploitation of natural resources shall not be regarded as income from real property.

2. Paragraph (1) shall apply to income derived from the usufruct, direct use, letting, or use in any other form of real property.

3. Gains from the alienation of shares of a real estate association (as defined in the Israeli Land Appreciation Tax Law) may be taxed by Israel.

ARTICLE 8
Business Profits

1. Industrial or commercial profits of a resident of one of the Contracting States shall he exempt from tax by the other Contracting State unless the resident has a permanent establishment in that other Contracting State. If the resident has a permanent establishment in that other Contracting State, tax may be imposed by that other Contracting State on the industrial or commercial profits of the resident but only on so much of them as are attributable to the permanent establishment.

2. Where a resident of one of the Contracting States has a permanent establishment in the other Contracting State, there shall in each Contracting State be attributed to the permanent establishment the industrial or commercial profits which would reasonably be expected to have been derived by it if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the resident of which it is a permanent establishment.

3. In the determination of the industrial or commercial profits of a permanent establishment, there shall be allowed as deductions expenses which are reasonably connected with such profits, including executive and general administrative expenses, whether incurred in the Contracting State in which the permanent establishment is situated or elsewhere.

4. No profits shall be attributed to a permanent establishment of a resident of one of the Contracting States in the other Contracting State merely by reason of the purchase of goods or merchandise by that permanent establishment, or by the resident of which it is a permanent establishment, for the account of that resident.

5. For purposes of this Convention, the term "industrial or commercial profits" includes but is not limited to, income derived from manufacturing, mercantile, banking, insurance, agricultural, fishing or mining activities, the operation of ships or aircraft, the furnishing of services, the rental of tangible personal (movable) property, but not the rental or licensing of motion picture films or films or tapes used for radio or television broadcasting. Such term does not include the performance of personal services by an individual either as an employee or in an independent capacity.

6. For purposes of paragraph (1), industrial or commercial profits which are attributable to a permanent establishment include income from dividends, interest, royalties described in paragraph (2) of Article 14 (Royalties), and capital gains and income derived from property and natural resources, but only if such income is effectively connected with the permanent establishment. To determine whether income is effectively connected with a permanent establishment, the factors taken into account shall include whether the rights or property giving rise to such income are used in or held for use in carrying on an activity giving rise to industrial or commercial profits through such permanent establishment and whether the activities carried on through such permanent establishment were a material factor in the realization of such income. For this purpose, due regard shall be given to whether or not such property or rights or such income were accounted for through such permanent establishment.

7. Where industrial or commercial profits include items of income which are dealt with separately in other articles of this Convention, the provisions of those articles shall, except as otherwise provided therein, supersede the provisions of this Article.

ARTICLE 9
Shipping and Air Transport

1. Notwithstanding Article 8 (Business Profits) and Article 15 (Capital Gains:

(a) Where a resident of the United States derives income from the operation in international traffic of ships or aircraft, or gains from the sale, exchange, or other disposition of ships or aircraft used in international traffic by such resident, Israel shall exempt such income or gains from taxation if the ships or aircraft are registered in either Contracting State or in a State with which the United States has a convention which exempts such income or gains.

(b) Where a resident of Israel derives income from the operation in international traffic of ships or aircraft, or gains from the sale, exchange, or other disposition of ships or aircraft used in international traffic by such resident, the United States shall exempt such income or gains from taxation.

2. For purposes of this Article, income derived from the operation in international traffic of ships or aircraft includes--

(a) Income derived from the rental of ships or aircraft operated in international traffic if such rental income is incidental to other income described in paragraph (1); and

(b) Income derived from the use, maintenance, and lease of--

(i) Containers,

(ii) Trailers for the inland transport of containers, and

(iii) Other related equipment

in connection with the operation by the resident in international traffic of ships or aircraft described in paragraph (1).

ARTICLE 10
Grants

1. For the purpose of computing United States tax, if Israel, a political subdivision thereof, or any agency of either makes a qualifying cash grant to a resident of the United States, then-

(a) the amount of such grant shall be excluded from the gross income of such resident,

(b) if the resident is a corporation the amount of such grant shall be treated as a contribution to its capital,

(c) the resident shall be considered to have contributed as a shareholder the amount of such grant to the Israeli corporation designated by the terms of the grant, and

(d) the resident's basis for the stock of the Israeli corporation shall not be increased by the amount contributed under subparagraph (c).

2. For purposes of paragraph (1), a qualifying cash grant is one approved by Israel for investment promotion in Israel, but shall not include any amount which in whole or part, directly or indirectly-

(a) is in consideration for services rendered or to be rendered, or for the sale of goods,

(b) is measured in any manner by the amount of profits or tax liability, or

(c) is taxed by Israel.

ARTICLE 11
Related Persons

1. Where a person subject to the taxing jurisdiction of one of the Contracting States and any other person are related and where such related persons made arrangements or impose conditions between themselves which are different from those which would be made between independent persons, any income, deductions, credits, or allowances which would, but for those arrangements or conditions, have been taken into account in computing the income (or loss) of, or the tax payable by, one of such persons may be taken into account in computing the amount of the income subject to tax and the taxes payable by such person.

2. Where a redetermination has been made by one Contracting State to the income of one of its residents in accordance with paragraph (1), then the other Contracting State shall, if it agrees with such redetermination and if necessary to prevent double taxation, make a corresponding adjustment to the income of a person in such other Contracting State related to such resident. In the event the other Contracting State disagrees with such redetermination, the two Contracting States shall endeavor to

reach agreement in accordance with the mutual agreement procedure in paragraph (2) of Article 28 (Mutual Agreement Procedure).

3. For purposes of this Convention, a person is related to another person if either person owns or controls directly or indirectly the other, or if any third person or persons own or control directly or indirectly both. For this purpose, the term "control" includes any kind of control, whether or not legally enforceable, and however exercised or exercisable.

ARTICLE 12
Dividends

1. Dividends derived from sources within one of the Contracting States by a resident of the other Contracting State may be taxed by both Contracting States.

2. The rate of tax imposed by one of the Contracting States on dividends derived from sources within that Contracting State by a resident of the other Contracting State shall not exceed-

(a) 25 percent of the gross amount of the dividend paid; or

(b) When the recipient is a corporation, 12.5 percent of the gross amount of the dividend paid, but only if-

(i) During the part of the paying corporation's taxable year which precedes the date of payment of the dividend and during the whole of its prior taxable year (if any), at least 10 percent of the outstanding shares of the voting stock of the paying corporation was owned by the recipient corporation, and

(ii) Not more than 25 percent of the gross income of the paying corporation for such prior taxable year (if any) consists of interest or dividends (other than interest derived from the conduct of a banking, insurance, or financing business and dividends or interest received from subsidiary corporations, 50 percent or more of the outstanding shares of the voting stock of which is owned by the paying corporation at the time such dividends or interest is received).

3. Dividends paid by a corporation of one of the Contracting States to a person other than a resident of the other Contracting State (and in the case of dividends paid by an Israeli corporation, to a person other than a citizen of the United States) shall be exempt from tax by the other Contracting State.

4. Paragraphs (2) and (3) shall not apply if such dividends are treated, under paragraph (6) of Article 8 (Business Profits), as industrial or commercial profits attributable to a permanent establishment which the recipient has in the other Contracting State. In such case, the provisions of Article 8 (Business Profits) shall apply.

ARTICLE 13

Interest

1. Interest derived by a resident of one of the Contracting States from sources within the other Contracting State may be taxed by both Contracting States.

2. Interest derived by a resident of one of the Contracting States from sources within the other Contracting State shall not be taxed by the other Contracting State at a rate in excess of 17.5 percent of the gross amount of such interest, except that, if the interest is derived from a loan of whatever kind granted by a bank, savings institution, or insurance company or the like, the interest shall not be taxed at an amount in excess of 10 percent of the gross amount of such interest.

3. Notwithstanding paragraphs (1) and (2), interest beneficially derived by (a) one of the Contracting States, or by an instrumentality of that Contracting State, not subject to tax by that Contracting State on its income, or (b) a resident of such Contracting State with respect to debt obligations guaranteed or insured by that Contracting State or an instrumentality thereof, shall be exempt from tax by the other Contracting State.

4. Interest paid by a resident of one of the Contracting States to a person other than a resident of the other Contracting State (and in the case of interest paid by a resident of Israel, to a person other than a citizen of the United States) shall be exempt from tax by the other Contracting State unless such interest is treated as income from sources within the other Contracting State under paragraph (2) of Article 4 (Source of Income).

5. Paragraphs (2), (3), and (4) shall not apply if the interest is treated, under paragraph (6) of Article 8 (Business Profits), as industrial or commercial profits attributable to a permanent establishment which the recipient has in the other Contracting State. In such a case, the provisions of Article 8 (Business Profits) shall apply.

6. Where an amount is paid to a related person and would be treated as interest but for the fact that it exceeds an amount which would have been paid to an unrelated person, the provisions of this Article shall apply only to so much of the amount as would have been paid to an unrelated person. In such a case the excess amount may be taxed by each Contracting State according to its own law, including the provisions of this Convention where applicable.

7. The term "interest" as used in this Convention means income from money lent and other income which under the taxation law of the Contracting State in which the income has its source is assimilated to income from money lent.

ARTICLE 14

Royalties

1. Royalties derived by a resident of one of the Contracting States from sources within the other Contracting State-

(a) May be taxed by both Contracting States, but

(b) Shall not be taxed by the other Contracting State at a rate in excess of 10 percent of the gross amount of a copyright or film royalty or at a rate in excess of 15 percent of the gross amount of an industrial royalty.

2. For purposes of this Article-

(a) Copyright or film royalties are payments of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works, including copyrights of motion picture films or films or tapes used for radio or television broadcasting;

(b) Industrial royalties are payments of any kind made as consideration for the use of, or the right to use, patents, designs, models, plans, secret processes or formulae, trademarks, or other like property or rights and

(c) Copyright or film royalties and industrial royalties include gains derived from the sale, exchange, or other disposition of any such property or rights to the extent that the amounts realized on such sale, exchange, or other disposition for consideration are contingent on the productivity, use, or disposition of such property or rights.

3. Paragraph (1) (b) shall not apply if the royalty is treated, under paragraph (6) of Article 8 (Business Profits), as industrial or commercial profits attributable to a permanent establishment which the recipient has in the other Contracting State. In such a case, the provisions of Article 8 (Business Profits) shall apply.

4. Where an amount is paid to a related person and would be treated as a royalty but for the fact that it exceeds an amount which would have been paid to an unrelated person, the provisions of this Article shall apply only to so much of the amount as would have been paid to an unrelated person. In such a case, the excess amount may be taxed by each Contracting State according to its own law, including the provisions of this Convention where applicable.

ARTICLE 15
Capital Gains

1. A resident of one of the Contracting States shall be exempt from tax by the other Contracting State on gains from the sale, exchange, or other disposition of capital assets unless-

(a) The gain is from the sale, exchange or other disposition of property described in Article 7 (Income from Real Property) situated within the other Contracting State,

(b) The gain is from the sale, exchange or other disposition of property described in paragraph (2) of Article 14 (Royalties),

(c) The gain is treated, under paragraph (6) of Article 8 (Business Profits), as industrial or commercial profits attributable to a permanent establishment which the resident has in such other Contracting State,

(d) The resident, being an individual, is present in the other Contracting State for a period or periods aggregating 183 days or more during the taxable year, or

(e) The gain is derived by a resident of the United States from the sale, exchange, or other disposition of stock in an Israeli corporation, but only if-

(i) The resident of the United States owns either actually or constructively within the 12-month period preceding such sale, exchange, or other disposition, stock possessing more than 50 percent of the voting power of the Israeli corporation, and

(ii) More than 50 percent of the fair market value of the Israeli corporation's gross assets used in its trade or business are physically located in Israel on the last day of each of the 3 taxable years preceding the sale, exchange, or other disposition (or, if the corporation has been in existence for less than 3 years, on the last day of each preceding taxable year of the corporation).

2. In the case of gains described in paragraph (1) (a), the provisions of Article 7 (Income from Real Property) shall apply. In the case of gains described in paragraph (1) (b), the provisions of Article 14 (Royalties) shall apply. In the case of gains described in paragraph (1) (c), the provisions of Article 8 (Business Profits) shall apply.

ARTICLE 16
Independent Personal Services

1. Income derived by an individual who is a resident of one of the Contracting States from the performance of personal services in an independent capacity may be taxed by that Contracting State. Except as provided in paragraph (2), such income shall be exempt from tax by the other Contracting State.

2. Income derived by an individual who is a resident of one of the Contracting States from the performance of personal services in an independent capacity in the other Contracting State may be taxed by that other Contracting State, if the individual is present in that other Contracting State for a period or periods aggregating 183 days or more in the taxable year.

ARTICLE 17
Dependent Personal Services

1. Except as provided in Article 2 (Governmental Functions), wages, salaries, and similar remuneration derived by an individual who is a resident of one of the Contracting States from labor or personal services performed as an employee, including income from services performed by an officer of a corporation or company, may be taxed by that Contracting State. Except as provided by paragraph (2) and in Articles 20 (Private Pensions and Annuities), 22 (Governmental Functions), 23 (Teachers), and 24 (Students and Trainees), such remuneration derived from sources within the other Contracting State may also be taxed by that other Contracting State.

2. Remuneration described in paragraph (1) derived by an individual who is a resident of one of the Contracting States shall be exempt from tax by the other Contracting State if-

(a) He is present in that other Contracting State for a period or periods aggregating less than 183 days in the taxable year;

(b) He is an employee of a resident of, or of a permanent establishment maintained in, the first-mentioned Contracting State;

(c) The remuneration is not borne as such by a permanent establishment which the employer has in that other Contracting State; and

(d) The remuneration is subject to tax in the first-mentioned Contracting State.

3. Remuneration derived by an employee of a resident of one of the Contracting States for labor or personal services performed as a member of the regular complement of a ship or aircraft operated in international traffic by a resident of that Contracting State may be taxed by that Contracting State.

ARTICLE 18
Public Entertainers

Notwithstanding Article 16 (Independent Personal Services) and 17 (Dependent Personal Services), the income derived by an individual who is a resident of one Contracting State from his performance of personal services in the other Contracting State as a public entertainer, such as a theater, motion picture, radio or television artist, a musician, or an athlete, may be taxed by the other Contracting State, but only if the gross amount of such income exceeds 400 United States dollars or its equivalent in Israeli pounds for each day such person is present in the other Contracting State for the purpose of performing such services therein.

ARTICLE 19
Amounts Received for Furnishing Personal Services of Others

1. Amounts received by a resident of one of the Contracting States in consideration of furnishing in the other Contracting State the personal services of one or more other persons, including a public entertainer referred to in Article 18 (Public Entertainers), shall not constitute industrial or commercial profits under Article 8 (Business Profits) to the extent that-

(a) (i) The person for whom the services were rendered designated the person or persons who would render the services, whether or not he had the legal right to do so and whether or not the designation was made formally;

(ii) The person for whom the services were rendered had the right to designate the person or persons who would render the services; or

(iii) By reason of the facts and circumstances the arrangement for personal services had the effect of designating the person or persons who would render the services; and

(b) The resident of the first-mentioned Contracting State directly or indirectly pays compensation for such services to any person, other than another resident of he first-mentioned Contracting State or of that other Contracting State who is subject to tax on such compensation.

2. Paragraph (1) shall not apply to any amount received if it is established to the satisfaction of the competent authority of that other Contracting State with respect to such amount that neither the creation nor organization of the resident of the first-mentioned Contracting State (where such resident is a corporation or other entity) nor the furnishing of the services through such resident has the effect of a substantial reduction of income, war profits, excess profits, or similar taxes.

ARTICLE 20
Private Pensions and Annuities

1. Except as provided in Article 22 (Governmental Functions), pensions and other similar remuneration paid to an individual shall be taxable only in the Contracting State of which he is a resident.

2. Alimony and annuities paid to an individual who is a resident of one of the Contracting States shall be taxable only in that Contracting State.

3. Child support payments made by an individual who is a resident of one of the Contracting States to an individual who is a resident of the other Contracting State shall be exempt from tax in that other Contracting State.

4. The term "pensions and other similar remuneration", as used in this Article, means periodic payments other than social security payments covered in Article 21 (Social Security Payments) made (a) by reason of retirement or death and in consideration for services rendered, (b) by way of compensation for injuries or sickness received in connection with past employment, or (c) by reason of payments made under a plan benefiting self-employed individuals all or some of the contributions to which qualify for special tax treatment.

5. The term "annuities", as used in this Article, means a stated sum paid periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services rendered).

6. The term "alimony", as used in this Article, means periodic payment made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support which payments are taxable to the recipient under the internal laws of the Contracting State of which he is a resident.

7. The term "child support payments", as used in this Article, means periodic payments for the support of a minor child made pursuant to a written separation agreement or a decree of divorce, separate maintenance, or compulsory support.

ARTICLE 21
Social Security Payments

Social security payments and other public pensions paid by one of the Contracting States to an individual who is a resident of the other Contracting State shall be exempt from tax in both Contracting States. This Article shall not apply to payments described in Article 22 (Governmental Functions).

ARTICLE 22
Governmental Functions

Wages, salaries, and similar remuneration, including pensions, annuities, or similar benefits, paid from public funds of one of the Contracting States:

(a) To a citizen of that Contracting State, or

(b) To a citizen of a State other than a Contracting State who comes to the other Contracting State expressly for the purpose of being employed by the first-mentioned Contracting State,

for labor or personal services performed as an employee of the national Government of that Contracting State, or any agency thereof, in the discharge of functions of a governmental nature shall be exempt from tax by the other Contracting State.

ARTICLE 23
Teachers

1. Where a resident of one of the Contracting States is invited by the Government of the other Contracting State, a political subdivision, or a local authority thereof, or by a university or other recognized educational institution in that other Contracting State to come to that other Contracting State for a period not expected to exceed 2 years for the purpose of teaching or engaging in research, or both, at a university or other recognized educational institution and such resident comes to that other Contracting State primarily for such purpose, his income from personal services for teaching or research at such university or educational institution shall be exempt from tax by that other Contracting State for a period not exceeding 2 years from the date of his arrival in that other Contracting State.

2. This Article shall not apply to income from research if such research is undertaken not in the public interest but primarily for the private benefit of a specific person or persons.

ARTICLE 24

Students and Trainees

1. (a) An individual who is a resident of one of the Contracting States at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State for the primary purpose of-

(i) Studying at a university or other recognized educational institution in that other Contracting State, or

(ii) Securing training required to qualify him to practice a profession or professional specialty, or

(iii) Studying or doing research as a recipient of a grant, allowance, or award from a governmental, religious, charitable, scientific, literary, or educational organization,

shall be exempt from tax by that other Contracting State with respect to amounts described in subparagraph (b) for a period not exceeding 5 taxable years from the date of his arrival in that other Contracting State.

(b) The amounts referred to in subparagraph (a) are-

(i) Gifts from abroad for the purpose of his maintenance, education, study, research, or training;

(ii) The grant, allowance, or award; and

(iii) Income from personal services performed in that other Contracting State in an amount not in excess of 3,000 United States dollars or its equivalent in Israeli pounds for any taxable year.

2. An individual who is a resident of one of the Contracting States at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State as an employee of, or under contract with, a resident of the first-mentioned Contracting; State, for the primary purpose of-

(a) Acquiring technical, professional, or business experience from a person other than that resident of the first-mentioned Contracting State or other than a person related to such resident, or

(b) Studying at a university or other recognized educational institution in that other Contracting State,

shall be exempt from tax by that other Contracting State for a period not exceeding 12 consecutive months with respect to his income from personal services in an aggregate amount not in excess of 7,500 United States dollars or its equivalent in Israeli pounds.

3. An individual who is a resident of one of the Contracting States at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State for a period not exceeding 1 year, as a participant in a program sponsored by the Government of that other Contracting State, for the primary purpose of training, research, or study, shall be exempt from tax by that other Contracting State with respect to his income from personal services in

respect of such training, research, or study performed in that other Contracting State in an aggregate amount not in excess of 10,000 United States dollars or its equivalent in Israeli pounds.

4. The benefits provided under Article 23 (Teachers) and paragraph (1) of this Article shall, when taken together, extend only for such period of time, not to exceed 5 taxable years from the date of arrival of the individual claiming such benefits, as may reasonably or customarily be required to effectuate the purpose of the visit. The benefits provided under Article 23 (Teachers) shall not be available to an individual if, during the immediately preceding period, such individual enjoyed the benefits of paragraph (1) of this Article.

ARTICLE 25
Investment or Holding Companies

A corporation of one of the Contracting States deriving dividends, interest, royalties or capital gains from sources within the other Contracting State shall not be entitled to the benefits of Articles 12 (Dividends), 13 (Interest), 14 (Royalties) or 15 (Capital Gains) if-

(a) By reason of special measures the tax imposed on such corporation by the first-mentioned Contracting State with respect to such dividends, interest, royalties or capital gains is substantially less than the tax generally imposed by such Contracting State on corporate profits, and

(b) 25 percent or more of the capital of such corporation is held of record or is otherwise determined, after consultation between the competent authorities of the Contracting States, to be owned, directly or indirectly, by one or more persons who are not individual resident of the first-mentioned Contracting State (or, in the case of an Israeli corporation, who are citizens of the United States).

ARTICLE 26
Relief from Double Taxation

Double taxation of income shall be avoided in the following manner:

1. In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended front time to time without changing the general principle hereof), the United States shall allow to a citizen or resident of the United States as a credit against the United States tax the appropriate amount of taxes paid or accrued to Israel and, in the case of a United States corporation owing at least 10 percent of the voting stock of an Israeli corporation from which it receives dividends in any taxable year, shall also allow credit for the appropriate amount of taxes paid or accrued to Israel by the Israeli corporation paying such dividends with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid or accrued to Israel, but the credit shall not exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources within Israel or on income from sources outside of the United States) provided by

United States law for the taxable year. For the purpose of applying the United States credit in relation to taxes paid or accrued to Israel, the rules set forth in Article 4 (Source of Income) shall be applied to determine the source of income. For purposes of applying the United States credit in relation to taxes paid or accrued to Israel, the taxes referred to in paragraphs (1) (b) and (2) of Article 1 (Taxes Covered) shall be considered to be income taxes.

2. If for any taxable year a citizen or resident of the United States takes as a credit against tax under paragraph (1) an amount with respect to a compulsory loan to Israel (which is included as a tax under paragraph (1) (b) (v) of Article 1 (Taxes Covered)), then-

(i) Any interest received on such loan shall not be included in taxable income for purposes of United States income tax and no deduction shall be allowed for any interest assessed or collected to which clause (iv) applies;

(ii) Upon repayment or recoupment of the principal of the loan, the amount of the value in United States dollars received shall be treated as a refund for the year the loan was made of taxes paid to Israel for such year equal to the basis for such loan;

(iii) Any such amount in excess of such basis shall be included in taxable income for purposes of United States tax for the year the repayment or recoupment is made; and

(iv) No interest shall be assessed or collected by the United States on any amount of tax due for the year the loan was made except to the extent that interest referred to in clause (i) was received.

The Secretary of the Treasury or his delegate shall prescribe regulations he deems necessary to carry out the purposes of this paragraph including rules for determining whether all amount included as a tax under paragraph (1) (b) (v) of Article 1 (Taxes Covered) has been taken as a credit against tax.

3. Israel shall allow to a resident of Israel as a credit against Israeli tax the appropriate amount of income taxes paid or accrued to the United States and, in the case of an Israeli corporation owning at least 10 percent of the voting stock of a United States corporation from which it receives dividends in any taxable year, shall also allow credit for the appropriate amount of taxes paid or accrued to the United States by the United States corporation paying such dividends with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid or accrued to the United States but shall not exceed that portion of Israeli tax which such resident's net income from sources within the United States bears to his entire net income for the same taxable year. For the purpose of applying the Israeli credit in relation to taxes paid or accrued to the United States, the rules set forth in Article 4 (Source of Income) shall be applied to determine the source of income. For purposes of applying the Israeli credit in relation to taxes paid or accrued to the United States, the taxes referred to in paragraphs (1) (a) and (2) of Article 1 (Taxes Covered) shall be considered to be creditable taxes.

ARTICLE 27
Non-discrimination

1. A citizen of one of the Contracting States, who is a resident of the other Contracting State shall not be subject in that other Contracting State to more burdensome taxes than a citizen of that other Contracting State who is a resident thereof.

2. A permanent establishment which a resident of one of the Contracting States has in the other Contracting State shall not be subject in that other Contracting State to more burdensome taxes than a resident of that other Contracting State carrying on the same activities. This paragraph shall not be construed as obliging a Contracting State to grant to individual residents of the other Contracting State any personal allowances, reliefs, or deductions for taxation purposes on account of civil status or family responsibilities which it grants to its own individual residents.

3. A corporation of one of the Contracting States, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirements connected with taxation which is other or more burdensome than the taxation and requirements to which a corporation of the first-mentioned Contracting State carrying on the same activities, the capital of which is wholly owned or controlled by one or more residents of the first-mentioned Contracting State, is or may be subjected.

ARTICLE 28
Mutual Agreement Procedure

1. Where a resident or citizen of one of the Contracting States considers that the action of one or both of the Contracting States results or will result for him in taxation not in accordance with this Convention, he may, notwithstanding the remedies provided by the national laws of the Contracting States, present his case to the competent authority of the Contracting State of which he is a resident or citizen. Should the resident's or citizen's claim be considered to have merit by the competent authority of the Contracting State to which the claim is made, it shall endeavor to come to an agreement with the competent authority of the other Contracting State with a view to the avoidance of taxation not in accordance with the provisions of this Convention.

2. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the application of this Convention. In particular, the competent authorities of the Contracting States may agree-

(a) To the same attribution of industrial or commercial profits to a resident of one of the Contracting States and its permanent establishment situated in the other Contracting State;

(b) To the same allocation of income, deductions, credits, or allowances between a resident of one of the Contracting States and any related person and to the readjustment of taxes imposed by each Contracting State to reflect such allocation;

(c) To the same determination of the source of particular items of income; or

(d) To the same characterization of particular items of income.

3. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of this Article. When it seems advisable for the purpose of reaching agreement, the competent authorities may meet together for an oral exchange of opinions.

4. In the event that the competent authorities reach such an agreement, taxes shall be imposed on such income, and refund or credit of taxes shall be allowed, by the Contracting States in accordance with such agreement, notwithstanding any procedural rule (including statutes of limitations) applicable under the law of either Contracting State.

ARTICLE 29
Exchange of Information

1. The competent authorities of the Contracting States shall exchange such information as is necessary for the carrying out of this Convention and of the domestic laws of the Contracting States concerning taxes covered by this Convention insofar as the taxation thereunder is in accordance with this Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any persons or authorities other than those concerned with the assessment, including judicial determination, or collection of the taxes which are the subject of the Convention.

2. In no case shall the provisions of paragraph (1) be construed so as to impose on one of the Contracting States the obligation-

(a) To carry out administrative measures at variance with the laws or the administrative practice of that or of the other Contracting State;

(b) To supply particulars which are not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

(c) To supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would he contrary to public policy.

ARTICLE 30
Diplomatic and Consular Officers

Nothing in this Convention shall affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or under the provisions of special agreements.

ARTICLE 31
Entry into Force

This Convention shall be subject to ratification in accordance with the constitutional procedures of each Contracting State and instruments of ratification shall be exchanged as soon as possible. It shall enter into force 30 days after the date of exchange of instruments of ratification and shall then have effect for the first time:

(a) As respects the rate of withholding of tax, to amounts paid on or after the first day of the second month following the date on which this Convention enters into force.

(b) As respects other taxes, to taxable years beginning on or after January 1 of the year following the date on which this Convention enters into force.

ARTICLE 32
Termination

1. This Convention shall remain in force until terminated by one the Contracting States. Either Contracting State may terminate the Convention at any time after 5 years from the date on which this Convention enters into force provided that at least 6 months' prior notice of termination has been given through diplomatic channels. In such event, the Convention shall cease to have force and effect as respects income of calendar years or taxable years beginning (or, in the case of taxes payable at the source, payments made) on or after April 1 next following the expiration of the 6-month period.

2. Notwithstanding the provisions of paragraph (1), and upon prior notice to be given through diplomatic channels, the provisions of this Convention exempting social security payments from taxation in the Contracting State which makes the payments may be terminated by either Contracting State at any time after this Convention enters into force.

DONE at Washington, in duplicate, in the English and Hebrew languages, the two texts having equal authenticity, this twentieth day of November, 1975.

For the Government of the United States of America:
WILLIAM E. SIMON.

For the Government of the State of Israel:
SIMCHA DINITZ.

PROTOCOL 1

PROTOCOL AMENDING THE 1975 INCOME TAX CONVENTION WITH ISRAEL

MESSAGE

FROM

THE PRESIDENT OF THE UNITED STATES

TRANSMITTING

A PROTOCOL AMENDING THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE STATE OF ISRAEL WITH RESPECT TO TAXES ON INCOME SIGNED AT WASHINGTON ON NOVEMBER 20, 1975. THE PROTOCOL WAS SIGNED AT WASHINGTON ON MAY 30, 1980, WITH THREE RELATED EXCHANGES OF NOTES

LETTER OF SUBMITTAL (PROTOCOL 1)

DEPARTMENT OF STATE,
Washington, June 13, 1980.

The PRESIDENT,
The White House.

THE PRESIDENT: I have the honor to submit to you, with a view to its transmission to the Senate for advice and consent to ratification, a Protocol Amending the Convention between the Government of the United States of America and the Government of the State of Israel with Respect to Taxes on Income signed at Washington on November 20, 1975. The Protocol was signed at Washington on May 30, 1980. Also submitted for transmission to the Senate are three related exchanges of notes.

The Convention was transmitted to the Senate on February 11, 1976, but, at the request of the Department of the Treasury, Senate consideration of the Convention was delayed until certain technical problems in the text had been resolved. The Protocol resolves these problems by making certain amendments to the Convention. For example, Article 10 (Grants) is modified to conform more closely to United States and Israeli law with regard to the treatment of Israeli grants to United States investors.

The Protocol modifies the withholding tax rates applicable to dividends paid by a subsidiary to a parent corporation by providing that dividends paid out of income benefitting from Israeli tax holiday provisions will be subject to a 15 percent withholding rate rather than the 12.5 percent rate otherwise provided for subsidiary dividends.

The Protocol adds a new article dealing with charitable contributions. This article provides that, for United States tax purposes, a United States citizen or resident may claim as a charitable contribution donations to qualifying Israeli charities amounting to 25 percent of the taxpayer's Israeli source income. An Israeli resident may similarly claim as a charitable contribution donations to qualifying United States charities.

The Convention provides that Israeli compulsory loans will be treated as taxes for United States foreign tax credit purposes, with appropriate adjustments at the time the loan is repaid. The Protocol modifies that rule to limit the credit to corporations which become subject to compulsory loans prior to April 1, 1977.

The three related notes set forth certain understandings reached between the two Governments as follows:

1. Exchange of information shall be made in accordance with Article 29 of the Convention. It is understood, however, that at present Israel is not yet able to exchange income tax information on a routine basis but that it is prepared to provide such information as soon as it has developed the necessary capability for the acquisition and compilation of tax information.

2. The two Governments will take steps to avoid duplication in the certification of eligible recipients of the charitable contributions described in Article 15-A of the Convention.

3. The United States is not able to accept the inclusion in the Protocol of provisions to create incentives to promote the flow of investment to Israel. However, the United States Government would be prepared to reopen discussions on the subject should circumstances change.

The Protocol will enter into force upon the expiration of thirty days following the date on which instruments of ratification are exchanged and shall thereupon have effect in accordance with Article 31 of the Convention.

A technical memorandum explaining in detail the provisions of the Protocol is being prepared by the Department of the Treasury and will be submitted to the Senate Committee on Foreign Relations.

The Department of the Treasury, with the cooperation of the Department of State, was primarily responsible for the negotiation of the Protocol. It has the approval of both Departments.

Respectfully submitted,

EDMUND S. MUSKIE.

LETTER OF TRANSMITTAL (PROTOCOL 1)

THE WHITE HOUSE, *July 3, 1980.*

To the Senate of the United States:

I transmit herewith, for Senate advice and consent to ratification, a Protocol Amending the Convention between the Government of the United States of America and the Government of Israel with Respect to Taxes on Income, signed at Washington on November 20, 1975. The Protocol was signed at Washington on May 30, 1980. I also transmit three related exchanges of notes and the report of the Department of State with respect to the Protocol.

Consideration of the Convention by the Senate has been delayed pending the correction of certain technical problems in its text. The Protocol accomplishes this by making certain amendments to the Convention. For example, Article 10 (Grants) is modified to conform more closely to United States and Israeli law with regard to the treatment of Israeli grants to United States investors.

The Protocol also modifies the withholding rates applicable to dividends paid by a subsidiary to a parent corporation and adds a new article dealing with charitable contributions.

It is most desirable that this Protocol, together with the Convention, be considered by the Senate as soon as possible and that the Senate give advice and consent to ratification of both instruments.

JIMMY CARTER.

PROTOCOL AMENDING THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE STATE OF ISRAEL WITH RESPECT TO TAXES ON INCOME SIGNED AT WASHINGTON ON NOVEMBER 20, 1975

The Government of the United States of America and the Government of the State of Israel, desiring to conclude a Protocol to amend the Convention with respect to taxes on income signed at Washington on November 20, 1975 (hereinafter referred to as "the Convention") have agreed as follows:

ARTICLE I

1. Subparagraph (a) of paragraph (1) of Article 1 (Taxes Covered) of the Convention shall be deleted and replaced by the following:

> "(a) In the case of the United States the Federal income taxes imposed by the Internal Revenue Code, and the tax on insurance premiums paid to foreign insurers (but only to the extent that the relevant risk is not reinsured, directly or indirectly, with a person not entitled to relief from such tax), and"

2. Clauses (iv) and (v) of subparagraph (b) of paragraph (1) of Article 1 (Taxes Covered) of the Convention shall be deleted and replaced by the following:

"(iv) The tax on profits levied on banking institutions and insurance companies under the Value Added Tax Law, and

"(v) Compulsory loans made with respect to taxable years ending before April 1, 1988 with respect to corporations that became subject thereto before April 1, 1977."

ARTICLE II

Paragraph (3) of Article 3 (Fiscal Residence) of the Convention shall be deleted and replaced by the following:

"(3) A corporation which is both a United States corporation within the meaning of paragraph (1) (f) (i) of Article 2 (General Definitions) and an Israeli corporation within the meaning of paragraph (1) (f) (ii) of such Article 2 shall be considered to be outside the scope of this Convention except for purposes of paragraph (1) of Article 4 (Source of Income), Article 27 (Nondiscrimination), Article 29 (Exchange of Information), and Article 31 (Entry Into Force)."

ARTICLE III

1. Subparagraph (a) of paragraph (4) of Article 6 (General Rules of Taxation) of the Convention shall be deleted and replaced by the following:

"(a) The benefits conferred by a Contracting State under Articles 10 (Grants), 15-A (Charitable Contributions), 21 (Social Security Payments), 26 (Relief From Double Taxation), 27 (Nondiscrimination), and 28 (Mutual Agreement Procedure); and"

2. Paragraph (5) of Article 6 (General Rules of Taxation) of the Convention shall be deleted and replaced by the following:

"(5) The United States may impose its personal holding company tax and its accumulated earnings tax notwithstanding any provision of this Convention. However, an Israeli corporation shall be exempt from the United States personal holding company tax in any taxable year unless residents or citizens of the United States own, directly or indirectly, within the meaning of Section 544 of the Internal Revenue Code, 10 percent or more in value of the outstanding stock of the corporation at any time during the taxable year. An Israeli corporation shall be exempt from the United States accumulated earnings tax in any taxable year unless at least 25 percent of the voting stock of such corporation is owned by citizens or residents of the United States."

3. Paragraph (6) of Article 6 (General Rules of Taxation) of the Convention shall he renumbered as paragraph (7) and a new paragraph (6) shall be added, to read as follows:

"(6) Where under any provision of this Convention income arising in one of the Contracting States is relieved from tax in that Contracting State and, under the law in force in the other Contracting State a person, in respect of said income, is subject to tax by reference to the amount thereof which is remitted to or received in that other Contracting State, and not by reference to the full amount thereof, then the

relief to be allowed under this Convention in the first-mentioned Contracting State shall apply only to so much of the income as is remitted to or received in the other Contracting State during the year such income accrues."

ARTICLE IV

Paragraph (3) of Article 7 (Income From Real Property) of the Convention shall be deleted and replaced by the following:

"(3) Gains from the alienation of shares of a company the property of which consists, directly or indirectly, principally of immovable property situated in a Contracting State may be taxed by that State."

ARTICLE V

The following new paragraph (8) shall he added to Article 8 (Business Profits):

"(8) The United States tax on insurance premiums paid to foreign insurers shall not be imposed on insurance or reinsurance premiums which are the receipts of a business of insurance carried on by a resident of Israel whether or not that business is carried on through a permanent establishment in the United States (but only to the extent that the relevant risk is not reinsured, directly or indirectly, with a person not entitled to relief from such tax)."

ARTICLE VI

Paragraph (1) of Article 9 (Shipping and Air Transport) of the Convention shall be deleted and replaced by the following:

"(1) Notwithstanding Article 8 (Business Profits) and Article 15 (Capital Gains): Where a resident of a Contracting State derives income from the operation in international traffic of ships or aircraft, or gains from the sale, exchange, or other disposition of ships or aircraft used in international traffic by such resident, the other Contracting State shall exempt such income or gains from taxation."

ARTICLE VII

Paragraph (1) of Article 10 (Grants) of the Convention shall he deleted and replaced by the following:

"(1) For the purpose of computing United States tax, if Israel, a political subdivision thereof, or any agency of either makes a qualifying cash grant to a resident of the United States, the amount of such grant shall be included in the gross income of such resident, unless the resident elects to exclude it from gross income. If the resident elects to exclude it from gross income, then-

"(a) if the resident is a corporation the amount of such grant shall be treated as a contribution to its capital,

"(b) the resident shall be deemed to have contributed the amount of such grant to the Israeli corporation designated by the terms of the grant,

"(c) the resident's basis for the stock of the Israeli corporation shall not be increased by the amount deemed contributed under subparagraph (b), and

"(d) the basis of property of the Israeli corporation shall be reduced by the amount of the deemed contribution under subparagraph (b) in accordance with rules prescribed by the Secretary of the Treasury of the United States."

ARTICLE VIII

1. Subparagraph (b) of paragraph (2) of Article 12 (Dividends) of the Convention shall be deleted and replaced by the following:

"(b) When a corporation is the recipient of a dividend from a paying corporation of income derived during any period for which the paying corporation is not entitled to the reduced tax rate applicable to an approved enterprise under Israel's Encouragement of Capital Investments Law (1959), 12.5 percent of the gross amount of the dividend paid, but only if-

"(i) During the part of the paying corporation's taxable year which precedes the date of payment of the dividend and during the whole of its prior taxable year (if any), at least 10 percent of the outstanding shares of the voting stock of the paying corporation was owned by the recipient corporation, and

"(ii) Not more than 25 percent of the gross income of the paying corporation for such prior taxable year (if any) consists of interest or dividends (other than interest derived from the conduct of a banking, insurance, or financing business and dividends or interest received from subsidiary corporations, 50 percent or more of the outstanding shares of the voting stock of which is owned by the paying corporation at the time such dividends or interest is received)."

2. The following new subparagraph (c) of paragraph (2) shall be added to Article 12 (Dividends) of the Convention:

"(c) When a corporation is the recipient of a dividend from a paying corporation of income derived during any period for which the paying corporation is entitled to the reduced tax rate applicable to an approved enterprise under Israel’s Encouragement of Capital Investments Law (1959), 15 percent of the gross amount of the dividend paid, but only if the conditions of subparagraph (b) (i) and (ii) are met."

ARTICLE IX

Subparagraph (b) of paragraph (1) of Article 15 (Capital Gains) of the Convention shall be deleted and replaced by the following:

"(b) The gain is from the sale, exchange or other disposition of property described in subparagraph (2) (c) of Article 14 (Royalties)."

ARTICLE X

The following new Article shall be added as Article 15-A (Charitable Contributions):

"ARTICLE 15-A
"Charitable Contributions

"(1) In the computation of taxable income of a citizen or a resident of the United States for any taxable year under the revenue laws of the United States, there shall be treated as a charitable contribution under such revenue laws contributions to any organization created or organized under the laws of Israel (and constituting a charitable organization for the purpose of the income tax laws of Israel) if and to the extent such contributions would have been treated as charitable contributions had such organization been created or organized under the laws of the United States; provided, however, that this paragraph shall not apply to contributions in any taxable year in excess of 25 percent of taxable income for such year (in the case of a corporation) or of adjusted gross income for such year (in the case of an individual) from sources in Israel.

"(2) In the computation of tax liability of a resident of Israel for any taxation year under the income tax laws of Israel, there shall be treated as charitable contributions eligible for credit or deduction, as the case may be, under such income tax laws, gifts to any organization constituting a charitable organization for the purpose of the revenue laws of the United States, if and to the extent such contributions would have been treated as charitable contributions had such organization been a charitable organization for the purpose of the income tax laws of Israel; provided, however, that this paragraph shall not apply to contributions in any taxation year in excess of 25 percent of taxable income for such year from sources in the United States."

ARTICLE XI

Article 17 (Dependent Personal Services) of the Convention shall be deleted and replaced by the following:

“ARTICLE 17
"Dependent Personal Services

"(1) Except as provided in Articles 22 (Governmental Functions), 23 (Teachers), and 24 (Students and Trainees), wages, salaries, and similar remuneration derived by an individual who is a resident of one of the Contracting States from labor or personal services performed as an employee, including income from services performed by an officer of a corporation or company, may be taxed by that Contracting State. Except as provided by paragraph (2) and in Articles 20 (Private Pensions and Annuities), 22 (Governmental Functions), 23 (Teachers), and 24 (Students and Trainees), such

remuneration derived from sources within the other Contracting State may also be taxed by that other Contracting State.

"(2) Remuneration described in paragraph (1) derived by an individual who is a resident of one of the Contracting States shall be exempt from tax by the other Contracting State if-

"(a) He is present in that other Contracting State for a period or periods aggregating less than 183 days in the taxable year; and

"(b) He is an employee of a resident of, or of a permanent establishment maintained in, the first-mentioned Contracting State; and

"(c) The remuneration is not borne as such by a permanent establishment which the employer has in that other Contracting State; and

"(d) The remuneration is subject to tax in the first-mentioned Contracting State.

"(3) Notwithstanding paragraphs (1) and (2), remuneration derived by an employee of a resident of one of the Contracting States for labor or personal services performed as a member of the regular complement of a ship or aircraft operated in international traffic by a resident of that Contracting State may he taxed by that Contracting State."

ARTICLE XII

Clauses (i) and (ii) of subparagraph (a) of paragraph (1) of Article 19 (Amounts Received for Furnishing Personal Services of Others) of the Convention shall be deleted and replaced by the following:

"(a) (i) The person for whom the services were furnished designated the person or persons who would render the services, whether or not he had the legal right to do so and whether or not the designation was made formally;

"(ii) The person for whom the services were furnished had the right to designate the person or persons who would render the services; or"

ARTICLE XIII

Clause (ii) of paragraph (2) of Article 26 (Relief From Double Taxation) of the Convention shall he deleted and replaced by the following:

"(ii) Upon repayment or recoupment of the principal of the loan, the amount of the value in United States dollars received shall be treated as a refund for the year the loan was made of taxes paid to Israel for such year equal to the basis for such loan, and the amount of such credit against tax shall he recomputed notwithstanding the operation of any law or rule of law;"

ARTICLE XIV

Subparagraphs (c) and (d) of paragraph (2) of Article 28 (Mutual Agreement Procedure) of the Convention shall be deleted and replaced by the following:

"(c) To the same determination of the source of particular items of income;

"(d) To the same characterization of particular items of income; or

"(e) To the mode of application of Articles 15-A (Charitable Contributions) and 29 (Exchange of Information)."

ARTICLE XV

Paragraph (1) of Article 29 (Exchange of Information) of the Convention shall he deleted and replaced by the following:

"(1) The competent authorities of the Contracting States shall exchange such information as is pertinent to carrying out the provisions of this Convention or preventing fraud or fiscal evasion in relation to the taxes which are the subject of this Convention. Any information so exchanged shall he treated as secret and shall not he disclosed to any persons or authorities other than those concerned with the assessment, including judicial determination, or collection of the taxes which are the subject of the Convention."

ARTICLE XVI

1. This Protocol shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

2. This Protocol shall enter into force immediately after the expiration of thirty days following the date on which the instruments of ratification are exchanged and shall thereupon have effect in accordance with Article 31 of the Convention.

IN WITNESS WHEREOF, the undersigned, duly authorized thereto by their respective Governments, have signed this Protocol.

DONE at Washington, in duplicate, in the English and Hebrew languages, the two texts having equal authenticity, this 30th day of May 1980.

For the Government of the United States of America:
HAROLD H. SAUNDERS.

For the Government of the State of Israel:
EPHRAIM EVRON.

NOTES OF EXCHANGE (PROTOCOL 1)

May 30, 1980.

HIS EXCELLENCY
EPHRAIM EVRON,
Ambassador of Israel.

EXCELLENCY: I have the honor to refer to the Convention between the Government of the United States of America and the Government of the State of Israel with respect to taxes on income, signed at Washington on November 20, 1975 and amended by a Protocol which was signed today. In the process of negotiating this Convention, the Israeli delegation emphasized the necessity of including in the Convention additional provisions, such as an investment credit for foreign investment, which will create incentives to promote the flow of investment to Israel.

The United States delegation is not able to accept such provisions at this time. However, I wish to assure you that my Government realizes the importance your government attaches to the increase of investments in Israel. Should circumstances change, including any changes in the manner in which the United States imposes income tax upon the income of the United States investments in Israel, our Government would be prepared to re-open the discussions on provisions which would minimize the conflicts between the United States tax system and the incentives proposed by the Israeli Government to foreign investors and which would be consistent with the income tax policies of the United States, including treaty policies, with respect to other developing countries.

I have the honor to propose that this note and your Excellency's reply confirming the above points of understanding on behalf of your Government shall be regarded as constituting an agreement between our two Governments concerning this matter, which will enter into force on the date of the entry into force of the Convention between the Government of the United States of America and the Government of the State of Israel with respect to taxes on income, signed at Washington November 20, 1975.

Accept, Excellency, the renewed assurances of my highest consideration.

For the Secretary of State:

(s) HAROLD H. SAUNDERS.

EMBASSY OF ISRAEL
Washington, D.C., June 2, 1980.

THE SECRETARY OF STATE,
The Department of State,
Washington, D.C.

EXCELLENCY: I have the honor to acknowledge your note of May 30, 1980, which reads as follows:

"EXCELLENCY: I have the honor to refer to the Convention between the Government of the United States of America and the Government of the State of Israel with respect to taxes on income, signed at Washington on November 20, 1975 and amended by a Protocol which was signed today. In the process of negotiating this Convention, the Israeli delegation emphasized the necessity of including in the Convention additional provisions, such as an investment credit for foreign investment, which will create incentives to promote the flow of investment to Israel.

"The United States delegation is not able to accept such provisions at this time. However, I wish to assure you that my Government realizes the importance your Government attaches to the increase of investments in Israel. Should circumstances change, including any changes in the manner in which the United States imposes income tax upon the income of United States investments in Israel, our Government would be prepared to re-open the discussions on provisions which would minimize the conflicts between the United States tax system and the incentives proposed by the Israeli Government to foreign investors and which would be consistent with the income tax policies of the United States, including treaty policies, with respect to other developing countries.

"I have the honor to propose that this note and your Excellency's reply confirming the above points of understanding on behalf of your Government shall be regarded as constituting an agreement between our two Governments concerning this matter, which will enter into force on the date of the entry into force of the Convention between the Government of the United States of America and the Government of the State of Israel with respect to taxes on income, signed at Washington November 20,1975.

"Accept, Excellency, the renewed assurances of my highest consideration."

I confirm these understandings on behalf of the Government of Israel. These understandings constitute an agreement between our two Governments on this matter, which will enter into force on the date of entry into force of the Convention between the Government of the State of Israel and the Government of the United States of America with Respect to Taxes on Income signed at Washington on November 20, 1975.

Accept, Excellency, the renewed assurances of my highest consideration.

EPHRAIM EVRON,
Ambassador.

MAY 30, 1980.

HIS EXCELLENCY
EPHRAIM EVRON,

Ambassador of Israel.

EXCELLENCY: I have the honor to refer to the Convention between the Government of the United States of America and the Government of the State of Israel with respect to taxes on income, signed at Washington November 20, 1975 and amended by a Protocol which was signed today, and to confirm on behalf of the Government of the United States of America, the following understanding reached between the two Governments.

The competent authorities of each of the Contracting States shall review the procedures and requirements for an organization of the other Contracting State to establish its status as an eligible recipient of the charitable contributions described in Article 15-A with a view to avoiding duplicate application by such organizations to the administering agencies of both Contracting States. If a Contracting State determines that the other Contracting State maintains procedures to determine such status and rules for qualification that are compatible with such procedures and rules of the first-mentioned Contracting State, it is contemplated that such Contracting State shall accept the certification of the administering agency of the other State as to such status for the purpose of determining the deductibility or creditability of such charitable contributions.

I have the honor to propose that this note and your Excellency's reply confirming the above points of understanding on behalf of your Government shall be regarded as constituting an agreement between our two Governments concerning this matter, which will enter into force on the date of the entry into force of the Convention between the Government of the United States of America and the Government of the State of Israel with respect to taxes on income, signed at Washington November 20, 1975.

Accept, Excellency, the renewed assurances of my highest consideration.

For the Secretary of State:

(s) HAROLD H. SAUNDERS.

EMBASSY OF ISRAEL
Washington, D.C., June 2, 1980.

THE SECRETARY OF STATE,
The Department of State,
Washington, D.C.

EXCELLENCY: I have the honor to acknowledge your note of May 30, 1980, which reads as follows:

"EXCELLENCY: I have the honor to refer to the Convention between the Government of the United States of America and the Government of the State of Israel with respect to taxes on income,

signed at Washington on November 20, 1975 and amended by a Protocol which was signed today, and to confirm on behalf of the Government of the United States of America, the following understanding reached between the two Governments.

"The competent authorities of each of the Contracting States shall review the procedures and requirements for an organization of the other Contracting State to establish its status as an eligible recipient of the charitable contributions described in Article 15-A with a view to avoiding duplicate application by such organizations to the administering agencies of both Contracting States. If a Contracting State determines that the other Contracting State maintains procedures to determine such status and rules for qualification that are compatible with such procedures and rules of the first-mentioned Contracting State, it is contemplated that such Contracting State shall accept the certification of the administering agency of the other State as to such status for the purpose of determining the deductibility or creditability of such charitable contributions.

"I have the honor to propose that this note and your Excellency's reply confirming the above points of understanding on behalf of your Government shall be regarded as constituting an agreement between our two Governments concerning this matter, which will enter into force on the date of the entry into force of the Convention between the Government of the United States of America and the Government of the State of Israel with respect to taxes on income, signed at Washington November 20, 1975.

"Accept, Excellency, the renewed assurances of my highest consideration."

I confirm these understandings on behalf of the Government of Israel. These understandings constitute an agreement between our two Governments on this matter, which will enter into force on the date of entry into force of the Convention between the Government of the State of Israel and the Government of the United States of America with Respect to Taxes on Income signed at Washington on November 20, 1975.

Accept, Excellency, the renewed assurances of my highest consideration.

EPHRAIM EVRON,
Ambassador.

MAY 30, 1980.

HIS EXCELLENCY
EPHRAIM EVRON,
Ambassador of Israel.

EXCELLENCY: I have the honor to refer to the Convention between the Government of the United States of America and the Government of the State of Israel with respect to taxes on income, signed at Washington on November 20, 1975 and amended by a Protocol which was signed today, and

to confirm, on behalf of the Government of the United States of America, the following understanding reached between the two Governments.

The Government of the United States and the Government of Israel agree that exchange of information shall be made in accordance with Article 29 (Exchange of Information) of the Convention.

It is understood, however, that due to a lack of technical capability, and to a severe manpower shortage in revenue administration in Israel, it is impractical, at this time, for the Government of Israel to exchange information on a routine basis with respect to receipts from Israel of dividends, interest and royalties by residents of the United States as well as any information not existing in the Finance Minister's files. However, as soon as the above deficiencies are remedied, the Government of Israel will provide information made available by advances in its capability of acquiring and compiling tax information.

I have the honor to propose that this note and your Excellency's reply confirming the above points of understanding on behalf of your Government shall he regarded as constituting an agreement between our two Governments concerning this matter, which will enter into force on the date of the entry into force of the Convention between the Government of the United States of America and the Government of the State of Israel with respect to taxes on income, signed at Washington November 20, 1975.

Accept, Excellency, the renewed assurances of my highest consideration.

For the Secretary of State:

(s) Harold H. Saunders

EMBASSY OF ISRAEL,
Washington, D.C., May 30, 1980.

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THE SECRETARY OF STATE,
The Department of State,
Washington, D.C.

EXCELLENCY: I have the honor to acknowledge your note of May 30, 1980, which reads as follows:

"EXCELLENCY: I have the honor to refer to the Convention between the Government of the United States of America and the Government of the State of Israel with respect to taxes on income, signed at Washington on November 20, 1975 and amended by a protocol which was signed today, and to confirm, on behalf of the Government of the United States of America, the following understandings reached between the two governments.

"The Government of the United States and the Government of Israel agree that exchange of information shall be made in accordance with Article 29 (Exchange of Information) of the Convention.

"It is understood, however, that due to a lack of technical capability, and to a severe manpower shortage in revenue administration in Israel, it is impractical, at this time, for the Government of Israel to exchange information on a routine basis with respect to receipts from Israel of dividends, interest and royalties by residents of the United States as well as any information not existing in the Finance Minister's files. However, as soon as the above deficiencies are remedied, the Government of Israel will provide information made available by advances in its capability of acquiring and compiling tax information.

"I have the honor to propose that this note and your Excellency's reply confirming the above points of understanding on behalf of your Government shall be regarded as constituting an agreement between our two Governments concerning this matter, which will enter into force on the date of the entry into force of the Convention between the Government of the United States of America and the Government of the State of Israel with respect to taxes on income, signed at Washington November 20, 1975.

"Accept, Excellency, the renewed assurances of my highest consideration.

I confirm these understandings on behalf of the Government of Israel. These understandings constitute an agreement between our two Governments on this matter, which will enter into force on the date of entry into force of the Convention between the Government of the State of Israel and the Government of the United States of America with Respect to Taxes on Income signed at Washington on November 20, 1975.

Accept, Excellency, the renewed assurances of my highest consideration.

Sincerely,

EPHRAIM EVRON,
Ambassador.

PROTOCOL 2

SECOND PROTOCOL AMENDING THE 1975 TAX CONVENTION WITH ISRAEL

MESSAGE

FROM

THE PRESIDENT OF THE UNITED STATES

TRANSMITTING

THE SECOND PROTOCOL AMENDING THE 1975 CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE STATE OF ISRAEL WITH
RESPECT TO TAXES ON INCOME (AS AMENDED BY THE PROTOCOL SIGNED ON MAY 30, 1980), SIGNED AT JERUSALEM ON JANUARY 26, 1993

LETTER OF SUBMITTAL (PROTOCOL 2)

DEPARTMENT OF STATE
Washington, June 17, 1993.

The PRESIDENT,
The White House

THE PRESIDENT: I have the honor to submit to you, with a view to its transmission to the Senate for advice and consent to ratification, the Second Protocol Amending the 1975 Convention Between the Government of the United States of America and the Government of the State of Israel with Respect to Taxes on Income (as amended by the Protocol signed on May 30, 1980) signed at Jerusalem on January 26, 1993. An associated exchange of notes is submitted for the information of the Senate.

On November 18, 1981, the Senate gave its advice and consent to ratification of the 1975 Convention, as amended, subject to an understanding providing for Congressional access to information exchanged under the Convention. The understanding proved to be unacceptable to Israel and the Convention, as amended, did not enter into force. The Second Protocol further amends the 1975 Convention, as amended by the 1980 Protocol, in large measure to accommodate certain post-1980 provisions of United States tax law and treaty policy. The new Protocol also reflects changes in Israeli law and makes certain technical corrections to the Convention which are necessary because of the passage of time.

The Second Protocol replaces the language on the exchange of information appearing in the Convention and First Protocol with language used in 12 tax treaties to which the Senate has given advice and consent since 1981. In incorporating that formula in the Second Protocol, both Governments understood and agreed that the Convention, as amended, will permit General Accounting Office and Congressional tax-writing committees' access to confidential information exchanged under the Convention in connection with their performance of oversight functions. Thus, the Senate should not find it necessary to repeat the understanding in its 1981 resolution of advice and consent to the Convention and First Protocol.

It is hoped and expected that the Convention, as amended, will be an important impetus to Israel's economy by encouraging and facilitating greater United States private sector investment in Israel. The

Convention will establish a framework which we hope will contribute to the further expansion of economic relations between the two countries on a broader and reciprocal basis.

Associated with the Protocol, but not forming an integral part of it, is an exchange of notes containing a number of understandings reached during the negotiation of the Protocol regarding its interpretation and application.

Many of the changes effected by the Protocol are minor amendments or clarifications, and are not discussed in this report. Among the more significant amendments to the Convention is a provision to assure that dividends paid by non-taxable conduit entities, such as U.S. regulated investment companies and real estate investment trusts, will not receive unjustified treaty benefits. Likewise, the Protocol will amend the interest provisions of the Convention to deny treaty benefits to so-called "excess inclusions" with respect to a residual interest in a real estate mortgage investment conduit.

The Convention will be amended to permit the application of branch taxes, which were introduced into U.S. law by the Tax Reform Act of 1986. Although Israel does not now impose such taxes, it has preserved the right in the Protocol to do so. Also consistent with the Tax Reform Act of 1986, the Convention will be amended to make clear that any income earned by a permanent establishment, the receipt of which is deferred until after the permanent establishment has ceased to exist, will be attributable to the permanent establishment.

The Protocol will replace the limited anti-treaty-shopping rules in the Convention with modern, comprehensive rules to ensure that the benefits of the Convention are limited to residents of the two countries meeting certain standards designed to prevent residents of third countries from inappropriately using the Convention. Similar standards are found in other recent United States income tax conventions.

The Convention will be amended to assure that the full U.S. taxing rights under the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) are preserved. The amended language also assures that Israel will be able, under the Convention, to exercise the same taxing rights in respect of real property gains as the United States.

The Convention allows relatively high withholding taxes at source on interest payments. The new Protocol, however, provides an election for the interest recipient to be taxed on interest income by the source country on a net basis. In addition, the Contracting States agree to consult to determine whether it would be appropriate to amend the Convention in response to changes in tax laws or treaty policies of one of the States and to endeavor to make the necessary amendments to the Convention.

The new Protocol contains a number of minor amendments and clarifications including the following: the coverage of the non-discrimination protection will be broadened to include state and local taxes as well as national taxes; the residence rules will be modified, consistent with recent U.S. treaties, to clarify the residence, for purposes of the Convention, of U.S. citizens and green card holders who reside in third countries; and the "saving clause", under which the United States reserves its statutory taxation rights with respect to its citizens and residents, will be extended to include former citizens who have

expatriated for tax avoidance purposes. The Protocol will also clarify the relationships between statutory source rules and those in the Convention for determining the foreign tax credit under the Convention.

The Convention and the two amending Protocols will enter into force after the expiration of 30 days following the date on which instruments of ratification have been exchanged. The provisions concerning taxes on dividends, interest and royalties will take effect on the first day of the second month following the exchange of instruments of ratification, and provisions concerning other taxes will take effect retroactively to the beginning of the year in which it enters into force if the entry into force takes place within the first half of the year. If entry into force occurs during the second half of the year, the Convention, as amended, will have effect for taxable years beginning on or after January 1 following the exchange of instruments of ratification.

A technical memorandum explaining in detail the provisions of the Second Protocol will be prepared by the Department of the Treasury and will be submitted separately to the Senate Committee on Foreign Relations.

The Department of the Treasury and the Department of State cooperated in the negotiation of the Second Protocol. It has the full approval of both Departments.

Respectfully submitted,

WARREN CHRISTOPHER.

Enclosures: As stated.

LETTER OF TRANSMITTAL (PROTOCOL 2)

THE WHITE HOUSE, *October 19, 1993.*

To the Senate of the United States:

I transmit herewith for the advice and consent of the Senate to ratification the Second Protocol Amending the Convention Between the Government of the United States of America and the Government of the State of Israel with Respect to Taxes on Income, signed at Washington on November 20, 1975, as amended by the Protocol signed May 30, 1980. The Second Protocol was signed at Jerusalem on January 26, 1993. Also transmitted for the information of the Senate is an exchange of notes and the report of the Department of State with respect to the Protocol.

The Second Protocol further amends the 1975 Convention, as amended by the 1980 Protocol, in large measure to accommodate certain post-1980 provisions of U.S. tax law and treaty policy. The new Protocol also reflects changes in Israeli law and makes certain technical corrections to the Convention that are necessary because of the passage of time. It will modernize tax relations between the two countries and will facilitate greater private sector U.S. investment in Israel.

I recommend that the Senate give early and favorable consideration to the Protocol and give its advice and consent to ratification.

WILLIAM J. CLINTON

SECOND PROTOCOL AMENDING THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE STATE OF ISRAEL WITH RESPECT TO TAXES ON INCOME SIGNED ON NOVEMBER 20, 1975, AS AMENDED BY THE PROTOCOL SIGNED ON MAY 30, 1980

The Government of the United States of America and the Government of the State of Israel, desiring to conclude a second Protocol to amend the Convention with respect to taxes on income signed on November 20, 1975, as amended by the Protocol signed on May 30, 1980 (hereinafter referred to as the "Convention") have agreed as follows:

ARTICLE I

1. In subparagraph (a) of paragraph (1) of Article 1 (Taxes Covered) of the Convention, the words "Internal Revenue Code" shall be deleted and replaced by the following: "Internal Revenue Code of 1986 (but excluding social security taxes)".

2. Subparagraph (b) of paragraph (l) of Article 1 (Taxes Covered) of the Convention shall be deleted and replaced by the following:

> "(b) In the case of Israel, taxes imposed by the Israeli Income Tax Ordinance, by the Land Appreciation Tax Law, by the Income Tax Law (Adjustments for Inflation), and other taxes on income administered by the Government of Israel (including, but not limited to, the profit tax on banking institutions and insurance companies and the income tax component of a compulsory loan)."

3. Paragraph (3) of Article 1 (Taxes Covered) of the Convention shall be deleted and replaced by the following:

"(3) For the purposes of Article 27 (Nondiscrimination), this Convention shall apply to taxes of every kind imposed by a Contracting State, or a state or a political subdivision thereof."

ARTICLE II

1. A new subparagraph (c) shall be added to paragraph (1) of Article 3 (Fiscal Residence) of the Convention, as follows:

"(c) For purposes of subparagraph (b), a United States citizen or an alien admitted to the United States for permanent residence (a green card holder) who is not a resident of Israel under subparagraph (a), is a resident of the United States only if the individual has a substantial presence, permanent home or habitual abode in the United States. If such individual is a resident of Israel under subparagraph (a), he shall be considered a resident of both Contracting States and his residence for purposes of the Convention shall be determined under paragraph (2)."

2. In subparagraph (a) of paragraph (2) of Article 3 (Fiscal Residence) of the Convention, the phrase (as defined in section 9 (16) of the Israeli Income Tax Ordinance), his center of vital interests shall be deemed to be in Israel." shall be deleted and replaced by the following: "(as defined in section 35 of the Israeli Income Tax Ordinance), his center of vital interests shall be deemed to be in Israel;".

3. Paragraph (3) of Article 3 (Fiscal Residence) of the Convention shall be deleted and replaced by the following:

"(3) Where, by reason of the provisions of paragraph (1), a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavor to settle the question by mutual agreement and determine the mode of application of the Convention to such person. Until the competent authorities make such a determination, the person shall not be treated as a resident of either Contracting State except for purposes of Article 26 (Relief from Double Taxation), Article 27 (Nondiscrimination) and Article 31 (Entry Into Force) and for purposes of payments by such person covered by paragraph (2) of Article 12 (Dividends), paragraphs (2) and (3) of Article 13 (Interest) and paragraph (1)(b) of Article 14 (Royalties).'

ARTICLE III

1. The last sentence of paragraph (6) of Article 4 (Source of Income) of the Convention shall be deleted and replaced by the following:

"Notwithstanding the preceding sentence, gains derived by a resident of one Contracting State from the sale, exchange or other disposition of Stock in a corporation of the other Contracting State to which paragraph (l)(e) of Article 15 (Capital Gains) applies shall be deemed to arise in that other State."

2. The last Sentence of paragraph (7) of Article 4 (Source of Income) of the Convention shall be deleted and replaced by the following:

"Notwithstanding the preceding provisions of this paragraph, remuneration described in Article 22 (Governmental Functions) and payments described in Article 21 (Social Security Payments) paid:

(a) from the public funds of a Contracting State or a political subdivision or local authority thereof,

(b) by a corporation wholly owned by a Contracting State or a political subdivision or local authority thereof, which performs functions of a governmental nature, or

(c) by any other body which is treated for tax purposes in the same manner as the Contracting State, a political subdivision or local authority thereof, pursuant to the laws of that State, which performs functions of a governmental nature, shall be treated as income from sources within that Contracting State only."

ARTICLE IV

In paragraph (5) of Article 5 (Permanent Establishment) of the Convention, the portion of the last sentence beginning with the words " unless the exercise" shall be deleted and replaced by the following:

"unless the activities of such person are limited to those mentioned in paragraph (3), which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph."

ARTICLE V

1. The following sentence shall be added at the end of paragraph (3) of Article 6 (General Rules of Taxation) of the Convention:

"for this purpose, the term "citizen" shall include a former citizen whose loss of citizenship had as one of its principal purposes the avoidance of tax, but only for a period of 10 years following such loss. For the application of this provision to a resident of a Contracting State, the competent authorities shall consult together on the purposes of such loss of citizenship."

2. In subparagraph (a) of paragraph (4) of Article 6 (General Rules of Taxation) of the Convention, after the words "15-A (Charitable Contributions)," the following words shall be added: "paragraphs (2) and (3) of 20 (Private Pensions and Annuities) ,".

3. At the end of paragraph (6) of Article 6 (General Rules of Taxation) of the Convention, the following words shall be added: "or during the first three months of the following year."

4. Paragraph (7) of Article 6 (General Rules of Taxation) of the Convention shall be renumbered as paragraph (9), and the following paragraphs shall be inserted:

"(7) In applying paragraph (8) of Article 4 (Source of Income), paragraphs (1) and (2) of Article 8 (Business Profits), paragraph (5) of Article 12 (Dividends), paragraph (5) of Article 13 (Interest), paragraph (3) of Article 14 (Royalties) and subparagraph (c) of paragraph (1) of Article 15 (Capital Gains) of the Convention, any income or gain attributable to a permanent establishment during its existence is taxable in the Contracting State where such permanent establishment is situated even if the receipt of the payments is deferred until such permanent establishment has ceased to exist.

(8) The appropriate authority of either Contracting State may request consultations with the appropriate authority of the other Contracting State to determine whether an amendment to the Convention is appropriate to respond to changes in the law or policy of either Contracting State. If these consultations determine that the effect of the Convention or its application have been unilaterally changed by reason of domestic legislation enacted by a Contracting State such that the balance of benefits provided by the Convention has been significantly altered, the authorities shall promptly endeavor to amend the Convention to restore an appropriate balance of benefits. In addition, if there are changes in treaty policy or the domestic law of a Contracting State which make it appropriate to amend the Convention, the authorities shall promptly consult to consider such amendments."

ARTICLE VI

Paragraph (3) of Article 7 (Income from Real Property) of the Convention shall be deleted and replaced by the following:

"(3) (a) Gains derived by a resident of Israel from the alienation of a United States real property interest, or from the alienation of an interest in a partnership, trust or estate, to the extent attributable to a United States real property interest, may be taxed by the United States.

(b) Gains derived by a resident of the United States from the alienation of a comparable interest in real property in Israel may be taxed by Israel. For this purpose, a 'comparable interest in real property in Israel' includes rights in a legal entity, the disposition of which, under Israeli domestic law, is taxed as a disposition of rights in real property; rights in any other legal entity 50 percent or more of the market value of the assets of which consist directly or indirectly of immovable property situated in Israel; and rights in a partnership, trust or estate, to the extent that the gains from the disposition thereof are attributable to real property situated in Israel or to a comparable interest in real property in Israel."

ARTICLE VII

1. In subparagraph (b) of paragraph (2) of Article 12 (Dividends) of the Convention, the words "of either Contracting State" shall be inserted after "When a corporation".

2. Paragraphs (3) and (4) of Article 12 (Dividends) of the Convention shall be renumbered as paragraphs (4) and (5), and the following shall be inserted as paragraph (3):

"(3) (a) In the United States, subparagraph (b) of paragraph (2) shall not apply in the case of dividends paid by a United States Regulated Investment Company or Real Estate Investment Trust. Subparagraph (a) shall apply in the case of dividends paid by a Regulated Investment Company. In the case of dividends paid by a Real Estate Investment Trust, subparagraph (a) of paragraph (2) shall apply if the beneficial owner of the dividends is an individual holding a less than 10 percent interest in the Real Estate Investment Trust; otherwise the rate of tax applicable under United States domestic law shall apply.

(b) In Israel, paragraph (2) shall not apply to dividends paid by corporations the income of which is taxed in the manner described in sections 64 and 64A of the Israeli Income Tax Ordinance, or in a substantially similar manner. In such cases, the income shall be treated as if it were business profits from a permanent establishment taxable according to the rules of Article 8 (Business Profits)."

ARTICLE VIII

1. Paragraph (2) of Article 13 (Interest) of the Convention, shall be renumbered as subparagraph (a) of paragraph (2), and the following subparagraph shall be inserted:

"(b) A resident of a Contracting State may elect, in lieu of the tax that would be imposed under subparagraph (a), to be taxed on its interest income as if that income were industrial and commercial profits and were taxable under Article 8 (Business Profits). The competent authorities of each Contracting State may adopt reasonable rules for the determination and reporting of taxable income. Each competent authority may also adopt procedures to ensure that a person deriving interest income provides such books and records as are necessary to determine the proper amount of the tax."

2. A new paragraph (8) shall be added to Article 13 (Interest) of the Convention as follows:

"(8) The provisions of paragraphs (2) and (3) shall not apply to an excess inclusion with respect to a residual interest in a real estate mortgage investment conduit."

ARTICLE IX

The following new Article shall be added as Article 14-A (Branch Tax) of the Convention:

"ARTICLE 14-A
Branch Tax

(1) A corporation which is a resident of a Contracting State may be subject in the other Contracting State to a tax in addition to the tax allowable under the other provisions of this Convention.

(2) (a) In the case of the United States, such tax may be imposed only on:

(i) the "dividend equivalent amount" of the profits of the corporation which are effectively connected (or treated as effectively connected) with the conduct of a trade or business in the United States and which are either attributable to a permanent establishment in the United States or are subject to tax in the United States under Article 7 (Income from Real Property) or Article 15 (Capital Gains) of this Convention; and

(ii) the excess, if any, of interest deductible in the United States in computing the profits of the corporation that are subject to tax in the United States and are either

attributable to a permanent establishment in the United States or are subject to tax in the United States under Article 7 (Income from Real Property) or Article 15 (Capital Gains) of this Convention, over the interest paid by or from the permanent establishment or trade or business in the United States.

(b) In the case of Israel such tax nay be imposed only on amounts sufficient to provide that a branch in Israel of a United States corporation (or a corporation of the United States otherwise taxable on net income in Israel) is taxed in a manner comparable to a similarly situated Israeli corporation and its United States shareholder.

(3) (a) The taxes described in subparagraph (a) (i) of paragraph (2) shall not be imposed at a rate in excess of 12.5 percent.

(b) The taxes described in subparagraph (a) (ii) of paragraph (2) shall not be imposed at a rate in excess of 5 percent.

(c) The taxes described in subparagraph (b) of paragraph (2) shall not be imposed at rates in excess of the comparable rates imposed by the United States under subparagraphs (a) and (b) of this paragraph."

ARTICLE X

1. Subparagraph (a) of paragraph (1) of Article 15 (Capital Gains) of the Convention shall be deleted and replaced by the following:

"(a) The gain is subject to tax by that other Contracting State under the provisions of Article 7 (Income from Real Property),".

2. Subparagraph (e) of paragraph (1) of Article 15 (Capital Gains). of the Convention shall be deleted and replaced with the following:

"(e) The gain is derived by a resident of a Contracting State from the sale, exchange or other disposition of stock in a corporation of the other Contracting State, but only if the resident of the first-mentioned Contracting State owned either directly or indirectly at any time within the 12- month period preceding such sale, exchange or other disposition, stock possessing 10 percent or more of the voting power of the corporation.

3. The existing paragraph (2) of Article 15 (Capital Gains) of the Convention shall be renumbered as paragraph (3) and a new paragraph (2) shall be added as follows:

"(2) For the purpose of subparagraph (e) of paragraph (1), if--

(a) The transferor and the transferee are companies resident in the same Contracting State;

(b) The transferor or the transferee owns, directly or indirectly, 80 percent or more of the voting rights and value of the other, or a company resident in the same Contracting State owns, directly or indirectly (through companies resident in the same Contracting State), 80 percent or more of the voting rights and value of both; and

(c) The transferee's basis in the asset (for purposes of determining gain on any subsequent disposition in the State in which it is resident) is determined, in whole or in part, by reference to the transferor's basis, then the amount of the gain taxable in that other Contracting State shall be limited to the value of cash or other property received by the transferor (not including stock in the transferee or another company resident in the first-mentioned Contracting State that owns directly or indirectly 80 percent or more of the voting rights and value of the transferee). This limitation on the amount of gain that may be taxed shall not apply if the Contracting State in which the transferor is resident subjects to tax a greater amount of gain; in such a case, the other Contracting State may tax the gain in accordance with its domestic law (applied consistently with this Convention). In all events, the other Contracting State may tax the gain in accordance with its domestic law (applied consistently with this Convention) at the time of any sale, exchange or other disposition not subject to the limitations of this paragraph (2)".

ARTICLE XI

The text of Article 22 (Governmental Functions) of the Convention shall be designated as paragraph (1) of Article 22 and new paragraphs (2) and (3) shall be added as follows:

"(2) For the purposes of this Article, the term public funds of one of the Contracting States shall be deemed to mean the funds of:

(a) a Contracting State or a political subdivision or local authority thereof,

(b) a corporation wholly owned by a Contracting State or a political subdivision or local authority thereof, which performs functions of a governmental nature, or

(c) any other body which is treated for tax purposes in the same manner as the Contracting State, a political subdivision or local authority thereof, pursuant to the laws of that State, which performs functions of a governmental nature.

(3) For the purposes of this Article, employment by a Contracting State shall be deemed to include employment by any entity enumerated in subparagraphs (a), (b) or (c) of paragraph (2)."

ARTICLE XII

Article 25 (Investment or Holding Companies) of the Convention shall be deleted and replaced with the following:

"ARTICLE 25
Limitation on Benefits

1. A person that is a resident of a Contracting State and derives income from sources within the other Contracting State shall not be entitled, in that other Contracting State, to the benefits of this Convention if:

(a) 50 percent or more of the beneficial interest in such person (or in the case of a company, 50 percent or more of the voting power or value of the company's stock) is owned, directly or indirectly, by any combination of one or more individuals who are not residents of a Contracting State and who are not citizens of a Contracting State taxable in that Contracting State on income derived outside that Contracting State; or

(b) 50 percent or more of the gross income of such person is used in substantial part, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons who are residents of a State other than a Contracting State, and who are not citizens of a Contracting State taxable in that Contracting State on income derived outside that Contracting State.

2. If a company is a resident of a Contracting State and there is outstanding a class of stock of that company or of another company that controls that company, and that class of stock entitles its holders, by a dividend distribution or by any other means, to a disproportionately high share of the income derived in the other Contracting State from certain assets that are located in that other Contracting State or from activities that are performed there, and 50 percent or more of the shares of that class of stock are owned, directly or indirectly, by any individual or combination of individuals who are neither residents of a Contracting State nor citizens of a Contracting State who are subject to tax in that Contracting State on income derived outside that Contracting State, then the benefits of this Convention will not apply with respect to any income that is attributable to those assets or activities.

3. The provisions of paragraphs (1) and (2) shall not apply if the person deriving the income is one of the following:

(a) an individual;

(b) an entity described in subparagraphs (a), (b) or (c) of paragraph (2) of Article 22 (Governmental Functions);

(c) engaged in the active conduct of a trade or business in the first-mentioned Contracting State (other than the business of making or managing investments, unless these activities are banking or insurance activities carried on by a bank or insurance company), and the income derived from the other Contracting State is derived in connection with, or is incidental to, that trade or business;

(d) a company in whose principal class of shares there is substantial and regular trading on a recognized stock exchange; or

(e) an entity that is a not-for-profit organization and that, by virtue of that status, is generally exempt from income taxation in its Contracting State of residence, provided that more than half of the beneficiaries, members or participants, if any, in such organization are persons that are entitled, under this Article, to the benefits of this Convention.

4. (a) A person that is not entitled to the benefits of the Convention pursuant to the preceding provisions of this Article may, nevertheless, be granted the benefits of the Convention if the competent authority of the State in which the income in question arises so determines.

(b) If one of the Contracting States proposes to deny benefits to a resident of the other Contracting State by reason of this Article, the competent authorities of the Contracting States shall, upon request of a competent authority, consult each other.

(c) The competent authorities of the Contracting States shall consult together with a view to developing a commonly agreed application of the provisions of this Article.

5. For purposes of subparagraph (d) of paragraph (2), the term "recognized stock exchange" means:

(a) the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for purposes of the Securities Exchange Act of 1934;

(b) the Tel Aviv Stock Exchange and any other Israeli exchange that may be approved by the Minister of Finance; and

(c) any other stock exchange agreed upon by the competent authorities of the Contracting States."

ARTICLE XIII

1. Paragraph (2) of Article 26 (Relief from Double Taxation) of the Convention shall be deleted and replaced by the following:

"(2) Where a United States citizen is a resident of Israel--

(a) with respect to items of income that are exempt from United States tax, or that are subject to a reduced rate of United States tax when derived by a resident of Israel who is not a United States citizen, Israel shall allow as a credit against Israeli tax, subject to the provisions of Israeli tax law regarding credit for foreign tax, only the tax paid, if any, that the United States may impose under the provisions of this Convention, other than taxes that may be imposed solely by reason of citizenship under paragraph (3) of
Article 6 (General Rules of Taxation);

(b) for purposes of computing United States tax, the United States shall allow as a credit against United States tax the income tax paid to Israel after the credit referred to in subparagraph (a); the credit so allowed shall not reduce that portion of the United States tax that is creditable against Israeli tax in accordance with subparagraph (a);

(c) for the exclusive purpose of relieving double taxation in the United States under subparagraph (b), items of income referred to in subparagraph (a) shall be deemed to arise in Israel to the extent necessary to avoid double taxation of such income under subparagraph (b)."

2. In paragraph (3) of Article 26 (Relief from Double Taxation) of the Convention, the phrase "Israel shall allow" shall be deleted and replaced by the following: " in accordance with the provisions and subject to the limitations of the law of Israel (as it may be amended from time to time without changing the general principle hereof), Israel shall allow."

3. A new paragraph (4) shall be added to Article 26 (Relief from Double Taxation) of the Convention as follows:

"(4) Notwithstanding any other provision of this Convention, the source rule for income derived from the sale, exchange or other disposition of stock or of interests in an intangible set forth in Article 4 (Source of Income) shall apply for purposes of this Article. The other source rules set forth in Article 4 also shall apply for purposes of this Article to the extent not prohibited by the domestic law of the Contracting State that is providing relief from double taxation."

ARTICLE XIV

1. Paragraph (1) of Article 27 (Nondiscrimination) of the Convention shall be deleted and replaced by the following:

"(1) Citizens of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which citizens of that other State in the same circumstances are or may be subjected. This provision shall also apply to persons who are not residents of one or both of the Contracting States. However, for the purposes of United States tax, a United States citizen who is not a resident of the United States and an Israeli citizen who is not a resident of the United States are not in the same circumstances."

2. A new paragraph (4) shall be added to Article 27 (Nondiscrimination) of the Convention as follows:

"(4) Nothing in this Article shall be construed as preventing either Contracting State from imposing the tax described in Article 14A (Branch Tax)."

ARTICLE XV

Paragraph (1) of Article 29 (Exchange of Information) of the Convention shall be deleted and replaced by the following:

"(1) The competent authorities of the Contracting States shall exchange such information as is pertinent to carrying out the provisions of this Convention or preventing fraud or fiscal evasion in relation to the taxes which are the subject of this Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any persons or authorities other than those concerned with the assessment (including judicial determination), collection, or administration of the taxes which are the subject of the Convention."

ARTICLE XVI

Subparagraph (b) of Article 31 (Entry Into Force) of the Convention shall be deleted and replaced by the following:

"(b) As respects other Taxes:

(i) to taxable years beginning on or after January 1 of the year in which this Convention enters into force, if the Convention enters into force prior to July 1 of any calendar year; or

(ii) to taxable years beginning on or after January 1 of the year following the date on which this Convention enters into force, if the Convention enters into force after June 30 of any calendar year."

ARTICLE XVII

This protocol shall be ratified and instruments of ratification shall be exchanged as soon as possible. The Protocol shall enter into force 30 days after the date of the exchange of instruments of ratification, and shall have effect in accordance with Article 31 (Entry Into Force) of the Convention. Notwithstanding the second sentence of Article 31, for purposes only of applying Article 26 (Relief from Double Taxation) to years specified in subparagraph (b) of Article 31, the Convention shall be applied as if the penultimate sentence of paragraph (1) of Article 26 had entered into force on May 30, 1980.

IN WITNESS WHEREOF, the undersigned, duly authorized thereto by their respective Governments have signed this Protocol.

Done at Jerusalem, in duplicate, in the English and Hebrew languages, the two texts having equal authenticity, this *26* day of *January* 199*3*.

FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:	FOR THE GOVERNMENT OF THE STATE OF ISRAEL
(s) William C. Harrop	(s) Shimon Peres

NOTES OF EXCHANGE (PROTOCOL 2)

Minister of Foreign Affairs
Jerusalem, 26 January, 1993

His Excellency
Mr. William C. Harrop
Ambassador of the
United States of America in Israel

Excellency, I have the honour to refer to your Note of 26 January 1993 confirming the understandings stated in the Note and reached between our two governments. relating to the

Convention between the Government of the United States of America and the Government of the State of Israel with Respect to Taxes on Income, and the First and Second Protocols thereto, and to inform you of the Agreement of my Government to these understandings.

These understandings constitute an agreement between our two Governments on this matter, which shall enter into force on the day of entry into force of the Convention between the Government of the United States of America and the Government of the State of Israel with respect to Taxes on Income and the First and Second Protocols thereto.

Accept, Excellency, the renewed assurances of my highest consideration.

(s) Shimon Peres

EMBASSY OF THE
UNITED STATES OF AMERICA
Tel Aviv January 26, 1993

His Excellency
Shimon Peres,
Minister of Foreign Affairs
of the State of Israel, Jerusalem.

No. 020

Excellency: I have the honor to refer to the Convention between the Government of the United States of America and the Government of the State of Israel with Respect to Taxes on Income, and the First and Second Protocols thereto, and to confirm certain understandings reached between the two Governments:

1. In subparagraph (b) of paragraph (1) of Article 1 (Taxes Covered), the phrase "other taxes on income administered by the Government of Israel" is understood to include only taxes imposed solely under Israeli law.

2. In paragraph (3) of Article 1 (Taxes Covered), the phrase "political subdivision thereof" is understood to include local authorities.

3. In subparagraph (a)(ii) of paragraph (1) of. Article 3 (Fiscal Residence), the term "person... resident in Israel" is understood to include persons on whom taxes are imposed by Israel pursuant to the Income Tax Ordinance on income from sources outside of Israel by virtue of their being Israeli citizens.

4. In paragraph (3) of Article 3 (Fiscal Residence), it is understood that when one of the provisions of the Convention cited in the paragraph is operative, all other provision of the Convention necessary to apply the cited provision in the manner intended also will be operative. For instance, if a dual resident makes a dividend payment subject to paragraph (2) of Article 12 (Dividends), other articles of the Convention, such as Article 4 (Source of Income), will apply to the extent necessary to ensure proper treatment according to this Convention.

5. In applying the last sentence of paragraph (6) of Article 4 (Source of Income), it is understood that section 865(h) of the United States Internal Revenue Code may apply to require a taxpayer to determine the foreign tax credit separately with respect to the United States tax on gain from the sale of stock in an Israeli corporation to which the source rule in that sentence applies.

6. It is agreed that if the United States hereafter alters its policy regarding the provision of a tax sparing credit, or if the United States reaches agreement on the provision of a tax sparing credit with any other country, the Convention shall be promptly amended to incorporate such a provision.

7. Paragraph (8) of Article 6 (General Rules of Taxation) recognizes that future changes in the law or domestic policy of either Contracting State may make it appropriate to amend the Convention. Examples of changes that may justify amendment are understood to include, but are not limited to, the following:

(i) the decision by one Contracting State to extend favorable treaty benefits to a third country (such as a liberalization of the double taxation relief provided by foreign tax credits) so that the other Contracting State would be justified in requesting similar benefits under this Convention; and

(ii) changes in the domestic law of one Contracting State (such as integration of corporate and individual taxation) so that either that Contracting State or the other Contracting State could reasonably be requested to extend benefits under this Convention similar to benefits granted under treaties of that Contracting State with other countries.

It also is understood that the parties will consult about possible amendments to the Convention in the event that one Contracting State adopts domestic rules that treat expenses incurred within that Contracting State more favorably than expenses incurred in the other Contracting State, so long as the Free Trade Area Agreement between the United States and Israel is in force.

8. In paragraph (2) of Article 10 (Grants), it is understood that a grant shall not be considered to be "taxed by Israel" solely by reason of the fact that the grant is not included for Israeli income tax purposes in the basis of stock or assets.

9. In subparagraph (b) of paragraph (3) of Article 12 (Dividends), it is understood that there are several different ways in which an Israeli corporation may be taxable in a "pass-through" manner such that its income would be included within the scope of the subparagraph. For instance, the corporation may be exempt from tax, the shareholders may be taxable on their pro rata shares of the corporation's

income, or the corporation may be entitled to deduct from its taxable income dividends paid to shareholders.

10. It is understood that paragraph (8) of Article 13 (Interest) has been added at the request of the United States to address a problem of domestic tax avoidance arising under the internal laws of the United States. The United States intends to include similar provisions in all of its future treaties. Israel understands that if the United States were to revise its internal laws in the future to address this problem in a manner other than by imposing tax on the recipient of the excess inclusion, excess inclusions under the revised laws would be treated as ordinary interest income in the hands of nonresident recipients and would be eligible for the exemptions from tax applicable to interest income under the laws of the United States. It is further understood that, should the United States fail to include a provision similar to paragraph (8) of Article 13 in its treaties signed subsequent to the entry into force of this Convention, without having revised its internal laws as aforestated, such a change in U.S. treaty policy would make it appropriate to amend the Convention on this matter, pursuant to paragraph (8) of Article 6 of the Convention

11. In paragraph (2) of Article 14-A (Branch Tax), it is understood that if Israel imposes its tax under subparagraph (b) of paragraph (2) in circumstances in which the United States will not impose its taxes under subparagraph (a), the competent authorities will consult with a view to conforming the rules under the Convention. It is further understood that a resident of a Contracting State that qualifies for benefits under the Convention shall not be subject to a branch tax imposed by the other Contracting State except in accordance with the Convention.

12. In paragraphs (1) and (2) of Article 15 (Capital Gains), it is understood that ownership “directly or indirectly” includes constructive ownership through related persons.

13. In Paragraph (3) of Article 25 (Limitation on Benefits), it is understood that the competent authority of a Contracting State may be expected to grant benefits under this Convention to a resident of the other Contracting State that fails to qualify under subparagraph (b) of paragraph (1) solely by reason of a bona-fide loan from a financial institution not resident in either of the Contracting States.

14. The competent authorities of the Contracting States will develop an agreed Memorandum of Understanding intended to give guidance both to taxpayers and tax authorities of our two countries in interpreting Article 25 (Limitation on Benefits). As experience is gained in administering the Convention, as amended by the Protocols, and particularly Article 25, the competent authorities may develop and publish further understandings and interpretations.

15. In paragraph (4) of Article 26 (Relief from Double Taxation) it is understood that, for purposes of providing relief from double taxation in the United States, the terms "stock" and "intangibles" are limited to those interests for which an election relating to foreign tax credit relief is provided under United States law.

16. It is understood that any reference in the Convention to a currency of a Contracting States shall be deemed to refer to the legal tender of that Contracting State as renamed or replaced from time to time.

I confirm these understandings on behalf of the Government of the United States of America. Upon confirmation by your Government, these understandings shall constitute an agreement between our two Governments on this matter, which will enter into force on the day of entry into force of the Convention between the Government of the United States of America and the Government of the State of Israel with Respect to Taxes on Income and the First and Second Protocols thereto.

I would be grateful if you would confirm that these understandings are shared by your Government.

Accept, Excellency, the renewed assurances of my highest consideration.

(s) William C. Harrop

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