

SECOND PROTOCOL AMENDING 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 ON NOVEMBER 20, 1975, AS AMENDED
BY THE PROTOCOL SIGNED ON MAY 30, 1980

The Government of the State of Israel and the
Government of the United States of America, 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 (1) 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 (1)(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,

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 (1)(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 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 14A (Branch Tax) of the Convention:

"ARTICLE 14A

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 may 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

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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."

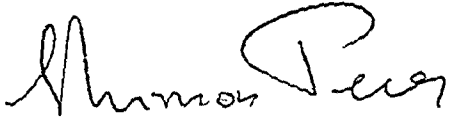
ARTICLE XVII

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.

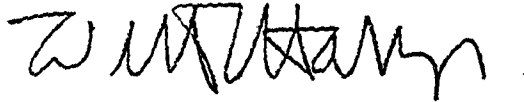
IN WITNESS WHEREOF, the undersigned, duly authorized thereto by their respective Governments, have signed this Protocol.

Done at Jerusalem, in duplicate, in the English and Hebrew languages, the two texts having equal authenticity, this 26th day of January, 1993.

FOR THE GOVERNMENT OF
THE STATE OF ISRAEL:



FOR THE GOVERNMENT OF THE
UNITED STATES OF AMERICA:



Treaties Department - Ministry Of Foreign Affairs - Israel