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EXPLANATION OF PROPOSED INCOME TAX TREATY BETWEEN THE UNITED STATES AND EGYPT

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INTRODUCTION

This pamphlet describes the proposed income tax treaty between the United States and the Arab Republic of Egypt ("Egypt"). The proposed treaty was signed August 24, 1980. There presently exists no tax treaty in force between the United States and Egypt.

The proposed treaty will replace the proposed treaty with Egypt which was signed on October 28, 1975, but never brought into force. That treaty was withdrawn from the Senate. The proposed treaty has been scheduled for a public hearing on September 24, 1981, by the Senate Committee on Foreign Relations.

The first part of the pamphlet is a summary of the provisions of the proposed treaty that differ from the model tax treaty. The second part provides an overview of U.S. tax rules relating to international trade and investment and U.S. tax treaties in general. This is followed by a detailed, article-by-article explanation of the proposed treaty.

I. SUMMARY

In General

The purpose of the proposed treaty between the United States and Egypt is to reduce or eliminate double taxation of income earned by citizens or residents of either country from sources within the other country and to establish procedures for exchanging information, help prevent accordance or evasion of taxes, and assisting in collection and other administrative matters between the two countries. The proposed treaty is intended to promote closer economic cooperation between the two countries and to eliminate possible barriers to trade caused by overlapping taxing jurisdictions of the two countries.

This proposed treaty is substantially similar to other recent U.S. income tax treaties and to the model tax treaty of the Organization for Economic Cooperation and Development (OECD). It also reflects the influence of the United Nations model for income tax treaties between developed and developing countries.

As in other United States tax treaties, these objectives are principally achieved by each country agreeing to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other. There are, however, several provisions which vary from the basic model.

(1) The proposed treaty provides (Article 11) that the United States is to reduce its withholding tax to 15 percent on dividends paid to Egyptian portfolio investors and five percent of dividends paid to direct investors. However, the treaty does not provide for a parallel reduction in Egyptian taxes. Under its laws, Egypt allows a deduction to corporations equal to the amount of any dividends paid out of current earnings. The treaty consequently does not limit the Egyptian tax imposed under Egyptian law on U.S. corporate shareholders. However, the treaty does limit the general income tax which Egypt would otherwise impose on U.S. individuals receiving dividends from Egyptian corporations to an average of 20 percent of the net dividend.

(2) Income from personal services (Articles 15 through 18) is treated in a slightly different manner than in many other U.S. treaties. Individuals performing personal services are to be subject to tax in the country where the services are performed if the individual is present in that country for 90 days within the tax year, instead of the longer period generally provided in U.S. treaties. An exception is provided for entertainers and athletes, whose services may be taxed in the country where performed if the gross income from the service exceeds $400 per day that the individual is performs services in that country.

(3) The treaty generally provides for a 15-percent limit on the withholding rates of each country applicable to interest (Article 12), and royalties (Article 13).

(4) The treaty (Article 9) provides for an exemption of shipping income which is slightly broader than the exemption found in many U.S. tax treaties. Under the treaty, income from international shipping of a resident of one country is to be exempt in the other country. Most existing U.S. treaties limit the exemption to ships or aircraft registered in the country of the owner's residence, but this provision follows newer treaties and the current U.S. model.

Issues

(1) Egypt grants a tax exemption to certain businesses that make investments in Egypt. The exemption is generally applicable if the Egyptian corporation is controlled by a foreign corporation. The tax exemption is not applicable if the Egyptian corporation is controlled by foreign individuals who are residents of a country which will tax the income when the shareholders receive it as dividends. The United States does tax the dividends and therefore it would appear that Egyptian companies owned by individuals who are U.S. residents will be discriminated against when compared to residents of other countries. This is a relatively minor issue as few individuals own Egyptian companies.

(2) The proposed treaty contains some concessions to source basis taxation to reflect Egypt's status as a developing country. The issue is whether these concessions to source basis taxation for a developing country are appropriate U.S. treaty policy, and if so, whether Egypt is an appropriate recipient of these concessions.

II. OVERVIEW OF UNITED STATES TAXATION OF INTERNATIONAL TRADE AND INVESTMENT AND TAX TREATIES

A. United States Tax Rules

The United States taxes U.S. citizens and residents and U.S. corporations on their worldwide income. The United States generally taxes nonresident alien individuals and foreign corporations only on their U.S. source income.

Income of a nonresident alien or foreign corporation which is effectively connected with the conduct of a trade or business in the United States is subject to tax at the normal graduated rates on the basis of net taxable income. Deductions are allowed in computing effectively connected taxable income, but only if and to the extent they are connected with income which is effectively connected.

U.S. source fixed or determinable, annual or periodical income (e.g. interest, dividends, rents, salaries, wages, premiums, annuities) which is not effectively connected with a U.S. trade or business is subject to tax at a rate of 30 percent of the gross amount paid to the nonresident alien or foreign corporation. This gross tax on fixed or determinable income is often reduced or eliminated in the case of payments to residents of countries with which the U.S. has an income tax treaty. The 30-percent (or lower treaty rate) tax imposed on U.S. source noneffectively connected income paid to foreign persons is collected by means of withholding (hence they are often called withholding taxes).

Certain exemptions from the gross tax are provided. Bank account interest is defined as foreign source interest and, therefore, is exempt. Exemptions are also provided for certain original issue discount and for income of a foreign government from investments in U.S. securities. Our treaties also provide for exemption from tax in certain cases.

Net U.S. source capital gains are also subject to the 30 percent tax but only in the case of a nonresident alien who is present in the United States for at least 183 days during the taxable year. Otherwise foreign corporations and nonresident aliens are only subject to U.S. taxation (at the graduated rates) on those capital gains that are effectively connected with the conduct of a trade or business in the United States.

Prior to June 18, 1980, noneffectively connected capital gains from the sale of U.S. real estate were subject to U.S. taxation only if received by a nonresident alien who was present in the United States for at least 183 days. However, in the Omnibus Reconciliation Act of 1980 a provision was added to the Internal Revenue Code that the sale, exchange or disposition of U.S. real estate by a foreign corporation or a nonresident alien would be taxed as effectively connected income.

Also taxable under this legislation are dispositions by foreign investors of their interests in certain U.S. corporations and other entities whose assets include U.S. real property and associated personal property.

The source of income received by nonresident aliens and foreign corporations is determined under special rules contained in the Internal Revenue Code. Under these rules interest and dividends paid by a U.S. citizen or resident or by a U.S. corporation are considered U.S. source income. However, if the U.S. corporation derives more than 80 percent of its gross income from foreign sources, then dividends and interest paid by such corporation will be foreign source rather than U.S. source. Conversely, dividends and interest paid by a foreign corporation, which has at least 50 percent of its income as effectively connected income, are U.S. source to the extent of the ratio of its effectively connected income to total income.

Rents and royalties paid for the use of property in the United States is considered U.S. source income. The property use can be either tangible property or intangible property (e.g., patents, secret processes and formulas, franchises and other like property).

Since it taxes U.S. persons on their worldwide income, double taxation of income can arise because income earned abroad by a U.S. person will be taxed by the country in which the income is earned and also by the United States. The United States seeks to mitigate this double taxation by allowing U.S. taxpayers to credit their foreign income taxes against the U.S. tax imposed on their foreign source income. A fundamental premise of the foreign tax credit is that it may not offset the U.S. tax on U.S. source income. Therefore, the foreign tax credit provisions contain a limitation that insures that the foreign tax credit only offset the U.S. tax on foreign source income. This limitation is computed on a world-wide consolidated basis. Hence, all income taxes paid to all foreign countries are combined to offset U.S. taxes on all foreign income. Separate limitations on the foreign tax credit are provided for certain interest, DISC dividends, and oil income.

A U.S. corporation that owns 10 percent or more of the stock of a foreign corporation may credit foreign income taxes paid or deemed paid by that foreign corporation on earnings that are received as dividends. These deemed paid taxes are included in total foreign taxes paid for the year the dividend is received and go into the general pool of taxes to be credited.

B. United States Tax Treaties—In General

The traditional objectives of U.S. tax treaties have been the avoidance of international double taxation and the prevention of tax avoidance and evasion. To a large extent, the treaty provisions designed to carry out these objectives supplement Code provisions having the same objectives, modifying the generally applicable statutory rules with provisions which take into account the particular tax system of the treaty country. Given the diversity of tax systems in the world, it would be virtually impossible to develop in the Code rules which unilaterally would achieve these objectives for all countries.

Notwithstanding the unilateral relief measures of the United States and our treaty partners, double taxation might arise because of differences in source rules between the United States and the other country. Likewise, if both countries consider the same deduction allocable to foreign sources, double taxation can result. Significant problems arise in the determination of whether a foreign tax qualifies for the U.S. foreign tax credit. Also, double taxation may arise in those limited situations where a corporation or individual may be treated as a resident of both countries and be taxed on a worldwide basis by both.

In addition, there may be significant problems involving "excess" taxation—situations where either country taxes income received by nonresidents at rates which exceed the rates imposed on residents. This is most likely to occur in the case of income taxed at a flat rate on a gross income basis. (Most countries, like the United States, generally tax domestic source income on a gross income basis when it is received by nonresidents who are not engaged in business in the country.) In many situations the gross income tax is imposed at a rate which exceeds the tax which would have been paid under the net income tax system applicable to residents.

Another related objective of U.S. tax treaties is the removal of barriers to trade, capital flows, and commercial travel caused by overlapping tax jurisdictions and the burdens of complying with the tax laws of a jurisdiction where the contacts with, and income derived from, that jurisdiction are minimal.

The objective of limiting double taxation is generally accomplished in treaties by the agreement of each country to limit, in certain specified situations, its right to tax income earned from its territory by residents of the other country. For the most part, the various rate reductions and exemptions by the source country provided in the treaties are premised on the assumption that the country of residence will tax the income in any event at levels comparable to those imposed by the source country on its residents. The treaties also provide for the elimination of double taxation by requiring the residence country to allow a credit for taxes which the source country retains the right to impose under the treaty. In some cases, the treaties may provide for exemption by the residence country of income taxed by the source country pursuant to the treaty.

Treaties first seek to eliminate double taxation by defining the term "resident" so that an individual or corporation generally will not be subject to a tax as a resident by each of the two countries. The treaty also provides that neither country will tax business income derived from sources within it by residents of the other country unless the business activities in the taxing jurisdiction are subsantital enough to constitute a branch or other permanent establishment or fixed base. The treaties contain commercial visitation exemptions under which individual residents of one country performing personal services in the other will not be required to file tax returns and pay tax in that other country unless their contacts exceed certain specified minimums. For example, presence for a set number of days or earnings of over a certain fixed dollar amount.

The treaties deal with passive income such as dividends, interest, or royalties, or capital gains, from sources within one country derived

by residents of the other country by either providing that they are taxed only in the country of residence or by providing that the withholding tax generally imposed on those payments is reduced. As described above, the U.S. generally imposes a 30-percent tax and seeks to reduce this tax in some cases on some income to zero in its tax treaties.

In its treaties, the United States, as a matter of policy, retains the right to tax its citizens and residents on their worldwide income as if the treaty had not come into effect, and provides this in the treaties in the so-called "saving clause." Double taxation can therefore still arise. Double taxation can also still arise because most countries will not exempt passive income from tax at source.

This double taxation is further mitigated either by granting a credit for income taxes paid to the other country, or, in the case of some of our treaty partners, by providing that income will be exempt from tax in the country of residence. The United States provides in its treaties that it will allow a credit against United States tax for income taxes paid to the treaty partners, subject to the limitations of U.S. law. An important function of the treaty is to define the taxes to which it applies to provide that they will be considered creditable income taxes for purposes of the treaty.

The treaties also provide for administrative cooperation between the countries. This cooperation includes a competent authority mechanism to resolve double taxation problems arising in individual cases, or more generally, by consultation between tax officials of the two governments.

Administrative cooperation also includes provision for an exchange of tax-related information to help the United States and its treaty partners administer their tax laws. The treaties generally provide for the exchange of information between the tax authorities of the two countries where such information is necessary for carrying out the provisions of the treaty or of their domestic tax laws. The obligation to exchange information under the treaties typically does not require either country to carry out measures contrary to its laws or administrative practices or to supply information not obtainable under its laws or in the normal course of its administration, or to supply information which would disclose trade secrets or other information the disclosure of which would be contrary to public policy.

The provisions generally result in an exchange of routine information, such as the names of U.S. residents receiving investment income. The IRS (and the treaty partner's tax authorities) also can request specific tax information from a treaty partner. This can include information to be used in a criminal investigation or prosecution.

III. EXPLANATION OF PROPOSED TAX TREATY

A detailed, article-by-article explanation of the proposed tax treaty between the United States and Egypt is presented below.

Article 1. Taxes Covered

The proposed treaty applies to taxes on income that are imposed by either country. In the case of the United States, it applies to the Federal income taxes imposed under the Internal Revenue Code but excluding the personal holding company tax or the accumulated earning tax. Thus, the right of the United States to impose these taxes is preserved.

The treaty also applies to the following taxes of Egypt: the tax on income derived from immovable property, the tax on income from movable capital, the tax on commercial and industrial profits, the tax on wages, salaries, indemnities, and pensions, the tax on profitts from noncommercial professions, the General income tax, the Defense tax, the National security tax, the War tax, and any supplementary taxes imposed as a percentage of any of the above taxes. Under Article 25 these taxes are designated as income taxes for purposes of the U.S. foreign tax credit.

The proposed treaty contains a provision generally found in U.S. income tax treaties which applies the treaty to substantially similar taxes which either country may impose after the date on which the treaty was signed. The countries are obligated to notify the other of any changes is their respective tax laws and of the adoption of any new taxes.

Additionally, the nondiscrimination provision (Article 26) of the treaty applies to all taxes imposed at the national, state, or local level by the United States or Egypt. The exchange of information provisions (Article 28) of the proposed treaty will apply to taxes of every kind imposed by the two countries at the national level.

Article 2. General Definitions

Most of the standard definitions found in U.S. income tax treaties are contained in the proposed treaty. The definition of the term "United States", means the United States of America, but does not include Puerto Rico, the Virgin Islands, Guam or any other possession. Accordingly, as in the case of all other tax treaties, they are not covered. When used in the geographical sense, the United States includes the territorial sea of the United States and the continental shelf of the United States insofar as the exploration and exploitation of natural resources on the continental shelf is concerned. This definition follows section 638 of the Internal Revenue Code.

The term "Egypt" means the Arab Republic of Egypt and, in certain situations relating to the exploration for natural resources, the seabed and subsoil of the submarine areas adjacent to Egypt (in general, the continental shelf).

The proposed treaty defines the term international traffic to include all voyages of a ship or aircraft operated by a resident of one of the countries unless the voyage is solely within places in one country.

The terms U.S. or Egyptian corporation is defined as a corporation created or organized under the laws of the respective country. Accordingly, a corporation cannot be a dual resident.

The proposed treaty also contains the standard provision that undefined terms are to have the meaning which they have under the applicable tax laws of the country applying the treaty. Where a term is defined in a different manner by the two countries or where its meaning under the laws of either country is not readily determinable, the competent authorities of the two countries may establish a common meaning for the term in order to prevent double taxation or to further any other purpose of the treaty.

Article 3. Fiscal Residence

The benefits of the proposed treaty generally are available only to residents of one of the countries. The proposed treaty defines "resident of Egypt" and "resident of the United States," and in addition provides a set of rules to determine residence in the case of an individual with dual residence. This provision of the proposed treaty is based on the fiscal domicile article of the OECD model tax treaty and is similar to the provisions found in other U.S. tax treaties.

Under the treaty, a person (either an individual or an entity such as a partnership, estate or trust) is considered to be a resident of either country if, under the laws of that country, the person is resident for tax purposes. A partnership, estate, or trust will be considered to be a resident of either country only to the extent that the income it derives is subject to tax, either in its hands or the hands of its partners or beneficiaries, as the income of a resident of the country. A citizen of the United States is not automatically a resident of the United States under this definition and accordingly may not be entitled to the benefits of the treaty. For example, a citizen of the United States resident in a third country would not be entitled to reduced rates of tax on Egypt source income.

An individual whom both countries consider to be a resident according to their general rules for determining residence will be deemed for all purposes of the treaty to be a resident of the country in which he has his permanent home (where an individual dwells with his family), his center of vital interests (his closest economic and personal relations), his habitual abode, or his citizenship. If the residence of an individual cannot be determined by these tests, applied in the order stated, the competent authorities of the countries will settle the question by mutual agreement.

Article 4. Source of Income

The source of income rules establish the framework for the basic provisions of the treaty that one country may tax residents and corporations of the other country only on income from sources within the taxing country (provided, with certain exceptions, that the resident is not a citizen of the taxing country). The rules are also important because the U.S. foreign tax credit is limited to the U.S. tax on income from sources outside the United States. Several of the

source rules contained in the proposed treaty differ in some degree from the source rules provided in the Internal Revenue Code. Since the general rules of taxation contained in the proposed treaty (Article 6) provide that it will not be applied to increase a person's tax, a taxpayer is not bound to apply the rules described below where the treaty rules would increase his U.S. tax liability.

The proposed treaty provides that dividends will be treated as income from sources within a country if paid by a corporation of that country. However, the treaty provides two exceptions to this general rule. First, dividends paid by U.S. corporations whose activities take place solely or mainly in Egypt are to be treated as Egyptian source income and accordingly, the dividends may be taxed by Egypt under Article 11. This rule is similar to exceptions provided in the Internal Revenue Code for foreign corporations doing business in the United States. Second, dividends paid by an Egyptian corporation are to be treated as U.S. source income if for the prior three years at least 50 percent of that corporation's gross income was industrial or commercial profits attributable to a permanent establishment of the corporation in the United States. This rule differs from the comparable Internal Revenue Code provision (section 861(a)(2)(B)) in that if the test is met all of the dividend is treated as U.S. source income rather than the pro rata portion of gross income.

Interest will be treated as income from sources within a country only if paid by that country, a political subdivision or a local authority thereof, or by a resident of that country. However, interest paid on an indebtedness incurred in connection with a permanent establishment will be sourced in the country where the permanent establishment is situated. This exception permits one country, under the proper circumstances, to tax interest paid by a permanent establishment maintained in that country by a resident of the other country or by a resident of a third country. For example, if a resident of France has a permanent establishment in Egypt which borrows money from a resident of the United States, the interest paid by the Egyptian permanent establishment will be deemed to be from Egyptian sources and Egypt may therefore tax the interest payments. The United States will not under the Code (sec. 861(a)(1)(C) and (D)) impose its withholding tax on interest paid to nonresident alien individuals or foreign corporations by a foreign corporation having a trade or business in the United States unless the majority of the foreign corporation's gross income from all sources for the 3-year period preceding the payment of the interest was effectively connected with the conduct of a U.S. trade or business.

In addition, the source rule for interest paid by permanent establishments will operate to exempt interest from tax in the country of the payor's residence if the interest is paid to a resident of the other country by a permanent establishment situated in a third country (and the indebtedness was incurred in connection with the third country permanent establishment). This results from the restriction in Article 6 (General rules of taxation) that a resident of one country who is not a citizen of the other country may be taxed by the other country only on income from sources within that other country.

The proposed treaty provides that royalties for the use of, or the rights to use, property or rights to which the royalty article (Article 13) applies will be treated as income from sources within a country only to the extent that such royalties are for the use of, or the right to use, the property or rights within that country.

Income (including mineral royalties) to which the provision relating to income from real property (Article 7) applies will be treated as income from sources within a country only if the real property (or, in the case of a mineral royalty, the underlying real property) is situated in that country.

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

Income from the purchase and sale, exchange, or other disposition of intangible or tangible personal property (other than contingent gains to which the royalty article applies) will be treated as income from sources within a country only if such sale, exchange, or other disposition is within that country.

Income received by an individual for his performance of labor or personal services, whether as an employee or in an independent capacity, will be treated as income from sources within a country only to the extent that the services are performed in that country. Income from personal services performed aboard ships or aircraft operated by a resident of one country in international traffic will be treated as income from sources within that country if performed by a member of the regular complement of the ship or aircraft. However, compensation described in Article 21 (Government Functions) and social security payments (Article 20) will be treated as income from sources within the country making the payments.

Notwithstanding the rules described above, industrial or commercial profits attributable to a permanent establishment will be considered to be from sources within the country in which the permanent establishment is located. This rule also applies to passive income of the types described above in situations where the passive income is treated as industrial and commercial profits because it is effectively connected with the permanent establishment.

The source of any item of income not specified in this article will be determined by each country in accordance with its own law. However, if the source of any item of income under the laws of one country is different from its source under the laws of the other country, or if its source is not readily determinable under the laws of either, the competent authorities of the two countries may, in order to prevent double taxation or further any other purpose of the proposed treaty, establish a common source of the item of income for purposes of the proposed treaty.

Article 5. Definition of Permanent Establishment

The proposed treaty contains a definition of permanent establishment which generally follows the pattern of other recent U.S. income tax treaties and the OECD model tax treaty. The permanent establishment concept is one of the basic devices used in income tax treaties to avoid double taxation. Generally, a resident of one country is not taxable on its business profits by the other country unless those profits

are attributable to a permanent establishment of the resident in the other country. In addition, the permanent establishment concept is used to determine whether the reduced rates of, or exemptions from, tax provided for dividends, interest, and royalties are applicable, or whether those amounts will be taxed as business profits.

The proposed treaty provides that in general, a permanent establishment is a fixed place of business through which a resident of one country engages in industrial or commercial activities in the other country. The proposed treaty specifies that a permanent establishment may be a seat of management; a branch; an office; a factory; a workshop; a mine or quarry, or other place of extraction of natural resources; and the maintenance of any building site or construction or assembly project only if it solely exists for more than six months. This six-month period is shorter than the 12-month period provided in many treaties and in the U.S. model. It reflects Egypt's status as a developing country.

This general rule is modified to provide that a fixed place of business which is used solely for any or all of a number of specified activities will not constitute a permanent establishment. These activities include the use of facilities for storing, displaying, or delivering merchandise belonging to the resident; the maintenance of a stock of goods belonging to the resident for purposes of storage, display, delivery, or processing by another person, and the purchase of goods, collection of information, advertising, scientific research, or other auxiliary activities, for the resident. A resident of one country shall not be deemed to have a permanent establishment in the other country merely because the resident sells goods which were displayed at trade fairs or conventions in that other country. The trade fair exception is not intended to apply with respect to goods in the resident's inventory.

A resident of one country will be deemed to have a permanent establishment in the other country if it maintains an agent in the other country who has, and habitually exercises, a general contracting authority in that other country. This rule does not apply if the agent's authority is limited to the purchase of goods for his principle. The proposed treaty contains the usual provision that the agency rule will not apply if the agent is a broker, general commission agent or other agent of independent status acting in the ordinary course of its business.

The determination of whether a resident of one country has a permanent establishment in the other country is to be made without regard to the fact that the resident may be related to a resident of the other country or to a person who engages in business in that other country.

The article is to be applied to determine, where relevant, whether a resident of a third country has a permanent establishment in the U.S. or Egypt, or whether a resident of the United States or Egypt has a permanent establishment in a third country. This provision is relevant to determine the source of certain interest income. It does not extend the benefits of the treaty to third country residents.

Article 6. General Rules of Taxation

The proposed treaty contains the basic general rules of taxation which are found in most of our other tax treaties. In many treaties, however, these rules are not found in a separate article.

A resident of one country may be taxed by the other country only on income from sources within that other country (which includes business profits only to the extent they are attributable to a permanent establishment in that other country). For this purpose, the source rules of Article 4 are to be applied.

The proposed treaty also contains the customary rule that it may not be applied to restrict any benefits under domestic tax rules. This reflects the general rule that a treaty does not work to increase the tax burden of residents of either country beyond what it would be in the absence of the treaty—that is, the treaty only applies where it benefits taxpayers. (See, for example, the discussion under Article 4 of the source of certain dividend income.)

The proposed treaty contains the usual "saving clause" by which the United States (or Egypt) reserves the right to tax its citizens and residents as if the treaty had not come into effect. However, this savings clause does not apply in several cases where its application would nullify specific policies contained in the proposed treaty which are designed to benefit residents and citizens. The principal exceptions involve social security payments, the foreign tax credit, the nondiscrimination provision and the mutual agreement procedure. The savings clause also does not affect the benefits provided to resident aliens under the provisions relating to diplomatic or consular officers or other governmental employees, teachers, and students, and trainees, provided they are not citizens of or do not have immigrant status in the country imposing the tax.

The treaty also authorizes the competent authorities to promulgate regulations to carry out the treaty. This power is also provided by U.S. law (sec. 7805).

Article 7. Income from Real Property

The United States generally taxes U.S. source income from real property earned by a foreign person not engaged in trade or business in the United States at 30 percent of the gross amount of the income. Gains on the sale or exchange of U.S. real property and certain interests in U.S. real property are taxed by the U.S. as business profits effectively connected with a U.S. business (sec. 897).

The proposed treaty retains the right of the United States and Egypt to tax income from real property by providing that income from real property may be taxed in the country where the real property is located. Income from real property includes income from the direct use or renting of the property and gains on the sale, exchange, or other disposition of the property. It also includes royalties and other payments in respect of the exploitation of natural resources (e.g., oil wells) and gains on the sale, exchange or other disposition of the royalty rights on the underlying natural resource. Mortgage interest is treated as income from real property under the proposed treaty.

The proposed treaty also provides that gains from the disposition of shares of a corporation or an interest in a partnership, estate, or trust is treated as real property income if the property of the entity consists principally of real property located in the United States or Egypt. This generally permits the United States to tax dispositions according to section 897 of the Code.

Article 8. Business Profits

U.S. code rules—The United States taxes U.S. citizens, residents and corporations on their worldwide income. The United States taxes nonresident alien individuals and foreign corporations on their U.S. source income which is not effectively connected with the conduct of a trade or business in the United States. They are also taxed on their income which is effectively connected with the conduct of a trade or business in the United States whether that income is U.S. source or foreign source.

The taxation of income differs depending on whether it is effectively connected or not. Income which is effectively connected with the conduct of a trade or business in the United States is subjected to tax at the normal graduated rates on a net basis. Deductions are allowed in computing effectively connected taxable income, but only if and to the extent they are connected with income which is effectively connected.

Foreign source income is effectively connected income only if the foreign person has an office or other fixed place of business in the United States and the income is attributable to that place of business. Only three types of foreign source income can be effectively connected income; rents and royalties derived from the active conduct of a licensing business; dividends, interest, or gain from stock or debt derived in the active conduct of a banking, financing or similar business in the United States; and certain sales income attributable to a United States sales office.

Except in the case of a dealer, the trading in stocks, securities or commodities in the United States for one's own account does not constitute a trade or business in the United States and accordingly from those activities is not taxed by the U.S. as business income. This concept includes trading through a U.S. based employee, a resident broker, commission agent, custodian or other agent or trading by a foreign person physically present in the United States.

Proposed treaty rules.—The treaty contains rules for the taxation of business profits that are similar to U.S. internal rules. Under the proposed treaty industrial and commercial profits of a resident of one country are taxable in the other country only to the extent they are attributable to a permanent establishment which the resident has in the other country. This provision is one of basic limitations on a source country's right to tax income of a nonresident.

In computing the taxable industrial and commercial profits, the deduction of expenses, wherever incurred, which are reasonably connected with the business profits are allowed. Deductible expenses include executive and general administrative expenses, interest, research and development expenses, and other expenses wherever incurred. Thus, for example, a U.S. company that has a branch in Egypt but has its head office in the United States will, in computing its Egyptian tax liability of the branch, be entitled to deduct a portion of the executive and general administrative expenses incurred in the United States by the head office for purposes of administering the Egyptian branch. However, in determining the amount of the deduction for head office expenses, the deduction may be limited to the expenses actually incurred by the head office without including a profit element.

The profits of a permanent establishment are determined on an arm's-length basis. Thus, there is to be attributed to it the industrial and commercial profits which would reasonably be expected to have been derived if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing at arm's-length with the resident of which it is a permanent establishment. (See Code sec. 864(c).)

Industrial and commercial profits will not be attributed to a permanent establishment merely by reason of the purchase of merchandise by the permanent establishment (or by the resident of which it is a permanent establishment) for the account of that resident. Thus, where a permanent establishment purchases goods for its head office, the industrial and commercial profits attributed to the permanent establishment with respect to its other activities will not be increased by any profit element on its purchasing activities.

For purposes of the proposed treaty, the term "industrial or commercial profits" includes 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 and the rental or licensing of motion picture films or films or tapes used for radio or television broadcasting. The term does not include income from the performance of personal services derived by an individual either as an employee or in an independent capacity. The proposed treaty follows the approach of our other recent tax treaties and the Internal Revenue Code by including within "industrial and commercial profits" investment income (income from dividends, interest, certain royalties, capital gains, and income derived from property and natural resources) where the income is effectively connected with a permanent establishment. (See Code sec. 864(c).)

The proposed treaty also contains criteria for determining whether income is effectively connected with a permanent establishment. Factors to be taken into account 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 a permanent establishment and whether the activities carried on through such permanent establishment are a material factor in the realization of the income. The effectively connected concept in this paragraph is substantially similar to the effectively connected concept applied by the United States to all taxpayers under the Code (sec. 864(c)).

Where business profits include items of income which are dealt with in other articles, those other articles will govern the taxation of those items of income.

Article 9. Shipping and Air Transport

The proposed treaty exempts from tax in one country income which is derived by a resident of the other country from the operation of ships and aircraft in international traffic. Gains which are derived from the sale, exchange or other disposition of such ships or aircraft are covered by Article 14 (Capital Gains) and thus are generally exempt from tax by the nonresidence country. This exemption is somewhat broader than that previously provided in most U.S. tax treaties under which shipping and air transport income of a resident of one country is exempt by the other only if the ships or aircraft are reg-

istered in the first country. It conforms to the most recent treaties and to the current U.S. model.

Income from the operation in international traffic of ships or aircraft includes the rental income of ships or aircraft operated in international traffic if the rental income is incidental to income of the resident from the actual operation of ships or aircraft which would qualify for the exemption. For example, this rule permits an airline which is a resident of one country and which has excess equipment during certain periods to lease that excess equipment during those periods to an airline which is a resident of the other country.

The proposed treaty also makes clear that income derived from the use, maintenance, and lease of containers, trailers for the inland transport of containers, and other related container equipment in connection with the operation in international traffic of ships or aircraft is to be included within the scope of the shipping and air transport provision.

The proposed treaty makes clear that dividends from a corporation engaged in the operation of ships or aircraft are not covered by this article. Those dividends would be covered by the dividend article (Article 11).

The treaty also provides that the Decree of the Egyptian Council of Ministers (of November 23, 1955), which provides a limited exemption for U.S. air transport enterprises, is to cease to have effect upon entry into force of this convention, since the treaty contains a broader exemption provision.

Article 10. Related Persons

The proposed treaty, like most other U.S. tax treaties, contains a provision similar to section 482 of the Internal Revenue Code which recognizes the right of each country to make an allocation of income in the case of transactions between related persons, if an allocation is necessary to reflect the conditions and arrangements which would have been made between unrelated persons.

It is anticipated that when a redetermination has been made by one country with respect to the income of a related person, the other country will attempt to reach an agreement with the first country in connection with the redetermination and, if it agrees with the redetermination, it will make a corresponding adjustment to the income of the other person.

Article 11. Dividends

The United States imposes a 30-percent tax (sometimes called a "withholding tax") on the gross amount of dividends paid to nonresident alien individuals and foreign corporations. The 30-percent tax does not apply if the recipient is engaged in a trade or business in the United States and the dividend is effectively connected with that trade or business.

The proposed treaty limits the rate of withholding tax imposed by the United States to 15 percent on dividends paid to Egyptian residents generally and to 5 percent on dividends paid to Egyptian corporations which have at least a 10-percent ownership interest in the paying corporation. The 5-percent withholding rate is not to apply (but the 15-percent rate will apply) where more than 25 percent of the paying corporation's gross income consists of interest and dividends

other than interest derived in the conduct of a financial business or dividends or interest from a 50-percent or greater subsidiary (i.e., where the corporation is an investment company).

The proposed treaty contains no comparable reduction of Egyptian tax on dividends paid by Egyptian corporations to residents of the United States. Under the proposed treaty, dividends are subject to the tax on movable capital plus the defense tax, the national security tax, the war tax, the supplementary tax on any of the above taxes and any substantially similar taxes enacted after the treaty enters into force. To the extent dividends are paid out of current earnings, the paying corporation must be allowed a deduction from taxable income equal to the amount of the dividends. No deduction is required with respect to distributions out of accumulated earnings. These treaty provisions thus do not alter the rules of Egyptian law which would be applied in the absence of a treaty.

In the case of dividends paid by Egyptian corporations to individuals, Egypt levies the taxes described in the paragraph above with the same deduction rule. In addition, the treaty provides that the general income tax imposed under Egyptian law may be levied, but the average amount of general income tax imposed cannot exceed 20 percent of the net dividend payable for any year. Dividends paid to a U.S. corporation are subject to all of the taxes described above, but not the general income tax.

In accordance with the usual treaty rules, dividends which constitute industrial or commercial profits of a resident in one country attributable to a permanent establishment in the other country are to be treated as business profits (and taxed under Article 8) rather than as dividends. If the recipient of the dividend is a citizen of the first country, that country would also tax the dividends under the saving clause.

The treaty contains special rules for branches of U.S. corporations which constitute permanent establishments in Egypt and for U.S. corporations which operate solely or mainly in Egypt. Under the treaty, dividends paid by these U.S. corporations and dividends deemed to be paid (under Egyptian law) by branches of U.S. corporations are also to be fully subject to the Egyptian taxes described above in connection with dividends paid to Egyptian corporations. These rules are also to apply only if an Egyptian corporate tax deduction is allowed to the U.S. corporation or branch for the amount of the dividend or deemed dividend paid. Thus, the same deduction rules that apply to a resident corporation apply to a branch. These rules reflect Egyptian law which taxes foreign corporations that earn most of their income in Egypt as Egyptian corporations. The U.S. has similar rules with respect to dividends paid by certain foreign corporations. (See sec. 861(a)(3)(B) and (C).)

The term "dividend" is defined as including income from certain shares that are not debt claims. It includes income on corporate rights that is subject to the same tax treatment as income from shares in the distributing corporation's country of residence.

Article 12. Interest

The United States imposes a 30-percent tax on U.S. source interest paid to foreign persons under the same rules that are applicable to

dividends. U.S. source interest generally is interest paid on debt obligations of U.S. persons, but not interest on deposits in U.S. banks.

The proposed treaty generally limits the withholding tax in the source country on interest derived by a resident of one country from sources within the other country to 15 percent of the gross amount of interest paid.

The reduced rates of withholding tax on interest will apply unless the recipient has a permanent establishment in the source country and the interest is effectively connected with the permanent establishment. If the interest is industrial or commercial profits attributable to a permanent establishment then it will be taxed under the business profits provisions (Article 8) of the proposed treaty. This treatment generally conforms to that provided by other recent U.S. tax treaties and the U.S. and OECD model tax treaties.

Interest paid by a resident of one country to a person other than a resident of the other country (and, in the case of interest paid by a resident of Egypt, to a person other than a U.S. citizen) will be exempt from tax by the other country. However, this rule is inapplicable (1) if the interest is treated as income from sources within the other country under the proposed treaty's source of income rules or (2) if the recipient of the interest has a permanent establishment in the other country and the interest is effectively connected with the permanent establishment.

The proposed treaty also provides that interest derived beneficially by either country, or by a tax-exempt instrumentality of either country, will be exempt from tax by the other country. Under this rule income derived by the Export-Import Bank of the United States and the Overseas Private Investment Corporation (OPIC) on loans made to Egyptian residents will be exempt from tax by Egypt. This exemption also applies where a resident of one country receives interest income on debt obligations guaranteed or insured by that country or an instrumentality of that country.

The proposed treaty defines the term interest in broad terms as income from money lent and any other income which the tax laws of the source country treat as income from money lent. Real estate mortgage interest and any other income treated as income from real estate under Article 7 is not interest. It is understood that this provision permits the United States to apply its rules for distinguishing between debt and equity (section 385) with the competent authorities settling disputes if conflicts between United States and Egyptian rules cause double taxation.

The proposed treaty deals with the question of non-arm's length interest payments in situations where the payor and recipient are related, by providing that the interest provision of the proposed treaty only applies to the amount of interest which would have been paid had the parties not been related. The excess might, for example, be treated as dividends subject to the provisions of Article 11.

Article 13. Royalties

Under the same system that applies to dividends and interest, the United States imposes a 30-percent tax on all U.S. source royalties paid to foreigners. Royalties are from U.S. sources if they are from property located in the United States including royalties for the use of or the right to use intangibles in the United States.

The proposed treaty provides for a reduction of source basis taxation at royalities derived by a resident of one country. Royalties derived by a resident of one country from sources within the other may be taxed by both countries, but the tax by the country of source is limited to 15 percent of the gross amount of the royalty. The source of a royalty is the country where the rights are used.

Royalties are defined in the proposed treaty as payments of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works, and payments of any kind made as consideration for the use of, or the right to use, patents, designs, models, plans, secret processes or formulas, trademarks, or other like property or rights. Payments made on copyrights of motion picture films or films or tapes used for radio or television broadcasting are not treated as royalties. Instead, they are commercial and industrial profits under Article 8. Royalties include gains derived from the sale, exchange, or other disposition of such property or rights to the extent the amounts received are contingent on the productivity use, or disposition of the property or rights. If the amounts realized are not contingent, the provisions of Article 14 (Capital Gains) may apply.

The reduced withholding rates do not apply where the recipient has a permanent establishment in the source country and the royalties are effectively connected with the permanent establishment. If the royalty is effectively connected with a permanent establishment, then it will be considered business profits of the permanent establishment subject to the rules of the business profits provisions (Article 8).

As in the case of the interest provision, the royalty provision does not apply to that part of a royalty paid to a related person which is considered excessive. In addition, the provision does not apply to dividends on stock issued under Egyptian law as consideration for royalty rights.

Article 14. Capital Gains

The United States generally exempts foreign persons from tax on their U.S. source capital gains. Gains from the disposition of U.S. real property and U.S. real property interests are taxed. (See discussion of Article 7.) The proposed treaty generally continues this treatment by providing that capital gains derived by a resident of one country will be exempt from tax by the other country. The exemption does not apply where an individual resident of one country is present in the source country for 183 days or more during the taxable year. Tax would also be imposed under the code in such a case. In addition, this provision does not apply to gains which are subject to the provisions relating to business profits (Article 8), income from real property (Article 7), and royalties (Article 13). In those cases, the gain may be taxed by the country in which the property is located.

Article 15. Independent Personal Services

Under U.S. law, the income of a nonresident alien from the performance of personal services is not taxed if the individual is not in the U.S. for at least 90 days, the compensation does not exceed $3,000, and the services are performed as an employee of a foreign person not engaged in a trade or business in the U.S. or they are performed for a foreign

permanent establishment of a U.S. person. The United States taxes the income of a nonresident alien at regular rates if the income is effectively connected with the conduct of a trade or business in the United States by the individual. (See discussion of U.S. taxation of business profits under Article 8 (Business Profits).) The performance of personal services in the United States can be a trade or business within the United States (section 864(b)).

This article, and Article 16, limit a country's right to tax income earned by a resident of the other country from the performance of personal services.

Under the proposed treaty, income from the performance of independent personal services (i.e., services performed as an independent contractor, not as an employee) in one country by a resident of the other country is exempt from tax in the country where the services are performed, unless the person performing the personal service is present in the source country for 90 or more days during the taxable year. This provision is modified in the case of income derived by public entertainers (theater, motion picture, radio and television artists, musicians, and athletes) by Articles 17 and 18.

Article 16. Dependent Personal Services

Under the proposed treaty, income from services performed as an employee in one country (the source country) by a resident of the other country will not be taxable in the source country if four requirements are met: (1) the individual is present in the source country for less than 90 days during the taxable year; (2) the individual is an employee of a resident of, or a permanent establishment in, his country of residence; (3) the compensation is not borne by a permanent establishment of the employer in the source country; and (4) the income is subject to tax in the country of residence. Income of a U.S. citizen which is excluded from income under the section 911 exclusion for income earned abroad thus does not qualify for the exemption from Egyptian tax.

Special rules are provided in Articles 21, 22 and 23 for government employees, teachers and students and trainees which, where applicable, take precedence over the general rules in this article.

Compensation derived by an employee aboard a ship or aircraft operated by a resident of one country in international traffic is exempt from tax by the other country, provided that the employee is a member of the regular complement of the ship or aircraft.

Article 17. Public Entertainers

The proposed treaty provides a special set of rules that apply to public entertainers and athletes. This proposed treaty provides that, notwithstanding other provisions of the treaty dealing with personal services (Article 15, Independent Personal Services and Article 16, Dependent Personal Services), income derived by an individual resident of one country from his performance of personal services in the other country 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 country, but only if the gross amount of such income exceeds $400 for each day the individual is present in the other country for the purpose of performing such services therein. If the individual

receives a lump sum payment for services performed on a number of days, the amount received will be prorated over the number of days on which the services are performed.

Article 18. Amounts Received for Furnishing Personal Services of Others

The proposed treaty contains a provision that allows the country where personal services are performed to tax income from the furnishing of the services under situations which have been viewed as an abuse of tax treaties. The purpose of this provision is to prevent individuals (generally residents of a third country) from using an entity of one country (for example, a corporation) to furnish services in the other country and thereby avoid payment of tax in either country.

Under the proposed treaty, amounts received by a resident of one country for furnishing in the other country the services of one or more individuals may be taxed by the country where the services are performed where the resident directly or indirectly compensates the person or persons who actually performed the services. This provision is to apply if the person for whom the services were rendered had the right (whether or not legally enforceable) to designate the person or persons who would render the services, or did in fact designate the person or persons, and the person performing the services is not a resident of either country who is subject to tax on the compensation. This provision is not to apply if it is established to the satisfaction of the competent authority of the source country that the organization furnishing the services was neither formed nor used in a manner which results in a substantial reduction on the income taxes from the furnishing of the services.

This provision does not apply to a resident of one country if the person furnishing the services of others is resident in a third country. Accordingly, unlike some other U.S. treaties, it does not deal with certain abusive cases involving the use of tax haven entities by entertainers. In that case, the rules of Articles 15, 16, or 17 would apply to the person performing the services. The treaty does not deal with the third country supplier of the services.

Article 19. Private Pensions and Annuities

Under the proposed treaty, private pensions and other similar remuneration, alimony, and annuities derived from one country by residents of the other country are taxable only in the country of residence of the individual. Child support payments made by a resident of one country to a resident of the other are exempt in the recipient's country. Pensions generally include payments for past services, but not social security, which is covered by Article 20, or governmental pensions which are covered by Article 21.

Article 20. Social Security Payments

Under the proposed treaty, social security payments and other public pensions, including railroad retirement benefits, paid by one country to a resident of the other are to be taxed only in the country of residence. The article relating to termination of the treaty contains a special provision (Article 32(2)) allowing this Article to be termi-

nated by either country at any time after the proposed treaty enters into force.

Article 21. Governmental Functions

Under the proposed treaty, wages, including pensions or similar benefits, paid by one country to an individual for labor or personal services performed for that country in the discharge of governmental functions is exempt from tax by the other country. This exemption does not apply if the individual performing the services is a citizen of, or acquires immigrant status in, the country where the services are performed. It applies only to amounts paid by the national government, and thus, in the case of the United States, does not apply to amounts paid by the States.

Any services performed in connection with a trade or business carried on by one of the countries are to be treated the same as services provided for private employers (for which Articles 16 and 19 apply).

Article 22. Teachers

The proposed treaty provides that a teacher or researcher who is a resident of one country will be exempt from tax in the other country on income from teaching or engaging in research in the host country if he is present in that country for a period not expected to exceed two years. The exemption only applies if the individual comes to the other country primarily for the purpose of teaching or engaging in research pursuant to an invitation of the host country or a recognized educational institution of the host country. It is not to apply with respect to income from research which is undertaken primarily for the benefit of a specific person or persons. If the teacher or researcher remains in the other country for a period exceeding two years, the exemption only applies to income earned during the 2-year period.

Article 23. Students and Trainees

Under the proposed treaty, residents of one country who become students in the other country will be exempt from tax in the host country on gifts from abroad used for maintenance or study and on any grant, allowance or award. In addition, a $3,000 annual exemption from tax by the host country is provided for personal service income (such as income from a part-time job) derived from sources within the country in which the individual is studying.

These exemptions and the visiting teachers' exemption (Article 22) may only be utilized for a period of 5 years plus any additional period of time necessary to complete educational requirements as a candidate for a post-graduate or professional degree from a recognized institution. In addition, the benefits under the teacher's article are not available to an individual if, during the immediately preceding period, the individual received the benefit of the student provision.

In addition to the exemption regarding students, the proposed treaty follows the approach of other recent U.S. tax treaties and provides a limited exemption for personal service income of residents of one country who are employees of a resident of that country and who are temporarily present in the other country to study at an educational institution or to acquire technical, professional, or business

experience. This exemption is available for a period of 12 consecutive months and is limited to $7,500. The proposed treaty also provides an exemption for income from personal services performed in connection with training, research, or study by residents of one country who are temporarily present in the other country as participants in Government-sponsored training programs. This exemption is limited to $10,000.

If an individual qualifies for the benefits of more than one of the provisions of this article and Article 22 (the visting teachers exemption), the individual may choose the most favorable provision but may not claim the benefits of more than one provision in any taxable year. This provision does not apply to students or trainees who are citizens of, or who have acquired immigrant status in, the host country.

Article 24. Investment or Holding Companies

The proposed treaty contains a provision which denies the benefits of the dividends, interest, royalties, and capital gains articles to a corporation which is entitled in its country of residence to special tax benefits resulting in a substantially lower tax on those types of income than the tax generally imposed on corporate profits by that country. This provision only applies if more than 25 percent of the capital of the corporation is owned by nonresidents of that country. Thus, a dual test must be met in order for the provision to come into effect. A similar provision is contained in several recent U.S. tax treaties. The U.S. capital gain rates do not constitute special tax benefits.

This provision is intended to have broad application. Accordingly, the term capital should be broadly construed. It includes, for example, common and preferred stock, and convertible debt. It also applies if nonresidents have effective control over the requisite percentage of the capital of the company.

The purpose of this provision is to prevent residents of third countries from using a corporation in one treaty country, which is preferentially taxed in that country, to obtain the tax benefits in the other treaty country which the proposed treaty provides for dividends, interest, royalties, and capital gains derived from that other country. Without this provision, residents of third countries could form an investment or holding company in one of the countries to take advantage of any special rates of tax for holding companies. This accords with the purpose of an income tax treaty between two countries to lessen or eliminate the amount of double taxation of income derived from sources within one country by a resident of the other country.

Article 25. Relief from Double Taxation

Under the proposed treaty, each country agrees to provide its citizens and residents with a foreign tax credit for the appropriate amount of income taxes paid to the other country. The credit allowed for U.S. tax purposes under this provision is subject to the provisions of U.S. law applicable to the year in question. Thus, the United States is not obligated to maintain a particular type of foreign tax credit. (The U.S. presently has an "overall" or worldwide foreign tax credit limitation.) The credit allowed by Egypt is limited to the amount of

Egyptian tax attributable to income from sources within the United States.

The proposed treaty also provides that a deemed-paid foreign tax credit will be made available to a United States corporation with respect to dividends from an Egyptian corporation in which it has at least a 10-percent ownership interest. In this case, a credit will be allowed for the Egyptian corporate tax paid by the Egyptian corporation on the earnings out of which the dividend is paid. A deemed-paid foreign tax credit satisfying the treaty requirements is presently provided under the Internal Revenue Code. Similarly, the proposed treaty provides that Egypt is to provide a deemed-paid foreign tax credit for U.S. tax attributable to dividends received by Egyptian corporations from U.S. corporations in which they are 10-percent shareholders.

For the purpose of applying the U.S. foreign tax credit under the treaty in relation to taxes paid to Egypt, the rules set forth under Article 4 will be applied to determine the source of income.

The provision provides that the taxes designated in Article 1 as covered by the treaty will be creditable for U.S. purposes. Accordingly, Treasury regulations dealing with foreign taxes would no longer be relevant to the designated taxes, to the extent that they deal with whether the taxes paid are income taxes and thus creditable. However, since, under Article 6, a U.S. person's taxes cannot be increased by reason of the treaty a person or taxpayer may choose the Code foreign tax credit. In that case, the regulation would apply.

Article 26. Nondiscrimination

The proposed treaty contains a comprehensive nondiscrimination provision relating to taxes imposed at all levels of government similar to provisions which have been embodied in other recent U.S. income tax treaties. One country cannot discriminate by imposing more burdensome taxes on its residents who are citizens of the other country, or on permanent establishments of residents of the other country, than it imposes on comparable taxpayers. This provision does not, however, require either country to grant to residents of the other country the personal allowances, reliefs, or deductions for taxation purposes on account of personal status or family responsibilities which it grants to its own residents. The nondiscrimination provision also applies to corporations of one country which are owned by residents of the other country.

The treaty contains two specific exceptions that reflect Egyptian tax laws. Egypt is not required to give to U.S. corporations the exemptions from Egyptian tax provided under Egyptian law for income earned outside of Egypt as insurance reserves of an Egyptian corporation and with respect to certain exempt distributions from Egyptian investment corporations (necessary to avoid double taxation within that country). In addition, an exception is provided for the provisions of Article 11 allowing Egypt to tax dividends from U.S. corporations operating solely or mainly in Egypt and to tax deemed dividends from Egyptian permanent establishments of U.S. corporations.

Egypt grants a tax exemption to certain businesses that make investments in Egypt. The exemption is generally applicable if the

Egyptian corporation is controlled by a foreign corporation. The tax exemption is not applicable if the Egyptian corporation is controlled by individuals and the country in which these individuals are located taxes the income when distributed. The United States does tax the dividends and therefore it appears that Egyptian companies owned by individuals who are U.S. residents will be discriminated against when compared to residents of other countries.

Article 27. Mutual Agreement Procedure

The proposed treaty contains the standard mutual agreement provision which authorizes the competent authorities of Egypt and the United States to consult together to attempt to alleviate individual cases of double taxation or cases of taxation not in accordance with the proposed treaty.

Under the proposed article, a resident or citizen of one country who considers that the action of the countries or any one of them will cause him to pay a tax not in accordance with the convention may present his case to the competent authority of the country of which he is a resident or citizen. The competent authority then makes a determination as to whether or not the claim has merit. If the claim does have merit, that competent authority endeavors to come to an agreement with the competent authority of the other country to limit the taxation which is not in accordance with the provisions of the treaty.

A second provision directs the competent authorities to resolve any difficulties or doubts arising as to the application of the convention. Specifically, they are authorized to agree to the attribution of profits to a resident of one country and its permanent establishment in another country, the allocation of income, deductions or credits, the determination as to source of income, and the characterization of items of income.

The treaty authorizes the competent authorities to communicate with each other directly for purposes of reaching an agreement in the sense of the mutual agreement provision. It also authorizes them to meet together for an oral exchange of opinions. These provisions make clear that it is not necessary to go through normal diplomatic channels in order to discuss problems arising by the application of the convention and also removes any doubt as to problems which might arise by reason of the confidentiality rules of the United States or Egypt.

Finally, the provision provides for the waiver of the statute of limitations of either country so as to permit the issuance of a refund or credit. The provision, however, does not authorize the imposition of additional taxes after the statute of limitations has run.

Article 28. Exchange of Information

This article forms the basis for cooperation between the two states to attempt to deal with avoidance or evasion of their respective taxes and to enable them to obtain information so that they can properly administer the convention. The proposed treaty provides for the exchange of information which is necessary to carry out the provisions of the proposed treaty or for the prevention of fraud or for the administration of statutory provisions concerning taxes to which the

convention applies. The exchange is limited, however, to information that could be obtained under the laws and administrative practices of each of the countries with respect to its own taxes.

It is understood that a requested country will use its subpoena or summons powers or any other powers that it has under its own laws to collect information requested by the other country, even though it itself does not need that information for its own purposes. It is intended that the requested country may use those powers even if the requesting country could not under its own laws. Thus, it is not intended that provision be strictly reciprocal. For example, once the U.S. Internal Revenue Service has referred a case to the Justice Department for possible criminal prosecution, the United States investigators can no longer use an administrative summons to obtain information. If, however, Egypt could still use administrative process to obtain requested information, it would be expected to do so even though the U.S. cannot. The United States could not, however, tell Egypt which of its procedures to use.

Under the provision dealing with taxes covered, the exchange of information article applies to all taxes imposed at the national level even though those taxes are not otherwise covered by the proposed treaty. The information may apply to tax compliance generally and not merely to avoidance or evasion of tax.

Information exchanged is to be treated as secret except that it may be disclosed to any person concerned with, or made a part of a public record with respect to, the assessment, collection, or enforcement of, or litigation concerning, the taxes to which the treaty applies. Serious questions have arisen under this language as to the right of the Congress, in the exercise of its oversight responsibilities, to obtain this information.

However, no information may be exchanged if the exchange would be contrary to public policy. Where specifically requested, the information must be provided in authenticated form including the form of deposition of witnesses and copies of unedited original documents (including books, papers, statements, records, accounts or writings), to the extent that such authenticated documents can be obtained under the laws of and administrative practices of the two countries. The provision specifically overrides any doctrine of law under which international judicial assistance is not accorded in tax matters. The provision is made for an exchange of information on a routine basis as well as with reference to particular cases.

Article 29. Assistance in Collection

The provision requires that each country aid in collecting the taxes of the other country to the extent necessary to insure that treaty benefits are not enjoyed by persons not entitled to their benefit. A country is not obligated to carry out measures contrary to its laws or administrative procedures.

Article 30. Diplomatic and Consular Officials

The proposed treaty contains the rule found in other U.S. tax treaties that its provisions are not to affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or the provisions of special agreements.

Article 31. Entry into Force

The proposed treaty will enter into force 30 days following the exchange of the instruments of ratification. It will become effective with respect to withholding tax rates on the first day of the second month following the date on which the proposed treaty enters into force. With respect to all other taxes, it will become effective for taxable years beginning on or after January 1st of the year following the date on which the proposed treaty comes into force.

Article 32. Termination

The proposed treaty will continue in force indefinitely, but either country may terminate it at any time after 5 years from its entry into force by giving at least 6 months' prior notice through diplomatic channels. If terminated, the termination will be effective with respect to income of taxable years beginning (or, in the case of withholding taxes, payments made) on or after January 1 next following the expiration of the 6-month period. The provisions of Article 20 (social security payments) may be terminated by either country at any time after the proposed treaty enters into force by prior notice given through diplomatic channels.

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