2 November 1976

INCOME TAX PRACTICES MAINTAINED BY THE NETHERLANDS

Report of the Panel presented to the Council of Representatives on 12 November 1976
(L/4425 - 23S/137)

1. The Panel's terms of reference were established by the Council on 30 Jul 1973 (C/M/89 paragraph 7):

"To examine the matter referred by the United States to tpi1 11 Tf(the) TjETBT1 0 0 1 485.76 563.28 T

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8. The Netherlands system of levying

enterprises" and (d) "The exemption in respect of exported goods of … taxes, other than … indirect taxes levied at one or several stages on the same goods if sold for internal consumption …"

Effects of the Netherlands' tax practices for taxation of foreign profits

14. The representative of the United States pointed out that the Netherlands, at least in practice, followed the territoriality principle of taxation and

tax if such income was subject to tax in the host country where the permanent establishment of the enterprise or the subsidiary was established and that was introduced to ensure that if a tax haven did not levy any tax on the income of such a branch the income was fully subject to Dutch tax. He stated that the "subject to tax" requirement had been introduced to prevent the use of tax havens. He further stated that many developing countries attempted to create an attractive climate for foreign investment by means of tax holidays or reduced tax rates and that the territoriality principle prevented the sacrifices which the developing countries made in the fiscal sphere from being nullified by higher taxation in the investor's home country. If the "subject to tax" requirement were to be replaced by a stricter criterion, for example, by a requirement that tax was actually to be paid on profits made abroad, serious harm would be done to the interests of the developing countries. Although the "subject to tax" requirement did

deny the suppositions and presumptions of the United States offhand since they were made without supporting details. No government could in his opinion give assurances that mistakes were never made

in the application of the arm's-length principle, whether caused by false information given by the taxpayer or by wrong estimation of a situation by the tax authorities themselves. He stated, however, that such cases could never be invoked as a proof that the principles underlying the Dutch tax system were not in fact observed.

Effects of the Netherlands tax practices for taxation of foreign dividends

25. The representative of the United States noted that the profits of a foreign subsidiary were not consolidated with the profits of its Dutch parent and no Dutch tax was directly imposed on the subsidiary's profits. He also noted that there was not a mere deferral of Dutch tax until profits were repatriated in the form of dividends, since in most cases, there was exemption from tax on those earnings because the dividends were fully tax exempt, thereby resulting in remission of Dutch tax on the subsidiary's profits from Dutch exports. He also stated that Dutch companies were exempt from Dutch taxes on all "benefits" connected with qualifying shareholding including dividends in cash and kind, bonus shares, "hidden" profit distribution and capital gains, providing certain conditions were met. The exemption was also applicable to dividends from a domestic company, but there was no similarity of tax treatment because a domestic subsidiary was subject to Dutch tax, whereas the foreign subsidiary was not.

26. The representative of the Netherlands replied that the Dutch system made no distinction relating

29. The representative of the Netherlands went on to argue that if the mere fact that the Netherlands applied the territoriality principle were sufficient evidence of failure to meet obligations under Article XVI:4, the consequence could then be inter alia that any country imposing less tax on sales income than the United States was failing to meet its obligations to the United States under the GATT, even if the former country taxed export sales income in the same manner as other profits. Such consequences which emerged logically from the United States conception were not in any way covered by Article XVI:4.

30. Commenting on this last point, the representative of the United States said that he rather contended that if the DISC legislation violated the GATT, then any system which taxed export profits at a differentially lower rate than profits on domestic sales was in violation of the GATT.

Bi-level pricing

31. Referring to the provision in Article XVI:4 relating to the sale of products for export "at a price lower than the comparable price charged for the like product to buyers in the domestic market", the representative of the United States argued that, if the Panel on DISC found that when the CONTRACTING PARTIES agreed that exemption of direct taxes in respect of exported goods was generally to be considered a subsidy within the meaning of Article XVI:4 they intended to create a presumption that such tax practices resulted in lower export prices in relation to domestic prices, and if the DISC Panel went on to find that the deferral of taxes on export sales income provided by DISC resulted in lower export prices, then the Panel on Dutch Tax Practices had likewise to find that the tax practices of the Netherlands, providing for the total or partial exemption of export sales income of exporters located within the Netherlands, were more likely to result in lower export prices and, therefore, were even more clearly prohibited by Article XVI:4.

B. Article XXIII:2 nullification or impairment of benefits

32. The representative of the United States argued that a prima facie case of nullification or impairment was established where it was determined that the measure complained against violated the General Agreement and that, since the tax practices of the Netherlands constituted prohibited subsidies within the meaning of Article XVI:4, they had resulted in the prima facie nullification or impairment of benefits accruing to the United States under the General Agreement.

33. The Dutch position was that its practices were not in contravention of the GATT and that there was not, therefore, a prima facie case of nullification or impairment.

for the internal market. The Panel also considered that the fact that the practices might also act as an incentive to investment abroad was not relevant in this context.

36. The Panel also noted that the tax treatment of dividends from abroad ensured that the benefits referred to above were fully preserved.

37. In circumstances where different tax treatment in different countries resulted in a smaller total tax bill in aggregate being paid on exports than on sales in the home market, the Panel concluded that there was a partial exemption from direct taxes. This resulted from the fact that, even though it followed the world-wide taxation principle, the Netherlands did not levy a tax on profits from export sales by foreign branches or subsidiaries when these were subject to tax abroad irrespective of whether these tax rights were exercised. The Panel

44. The Panel was of the view that, given the size and breadth of the export subsidy, it was likely that it had led to an increase in the Netherlands' exports in some sectors and, although the possibility could not be ruled out that the tax arrangements would encourage production abroad and a decrease in exports in other sectors, nonetheless concluded that it was also covered by the notification obligation of Article XVI:1.

45. In the light of the above, and bearing in mind the precedent set by the Uruguayan case (BISD, 11 Suppl. p.100), the Panel found that there was a prima facie case of nullification or impairment of benefits which other contracting parties were entitled to expect under the General Agreement.