

GENERAL AGREEMENT ON
TARIFFS AND TRADE

RESTRICTED

C/99

15 March 1977

Limited Distribution

COUNCIL
2 March 1977

Original: English

INCOME TAX PRACTICES MAINTAINED BY THE NETHERLANDS

Statement by the Representative of the Netherlands

At the meeting of the Council of 12 November 1976, this delegation limited itself to the observation that the report on certain tax practices maintained by the Netherlands (L/4425) would be carefully studied and that we would revert to the matter at a subsequent Council meeting.

The promised study has meanwhile been completed and in the light thereof our authorities have concluded that the Panel reached conclusions which are based on too wide an interpretation of the term "export activities" and which may also give rise to serious misunderstandings from a fiscal point of view. Much as we appreciate the painstaking manner in which the Panel went into this matter and gave the Netherlands delegation an opportunity of putting forward its point of view before the Panel's conclusions were drafted, the Netherlands authorities cannot share those conclusions and therefore must fully reserve their position in this matter.

My authorities also feel that the fact that the Panel has allowed itself to be drawn into making comparisons between two basically different principles of tax-legislation may give rise to unfounded doubts on the validity of the territoriality principle, which lies at the base of the Netherlands income tax and company tax legislation.

They further regret that - perhaps misled by the way the territoriality principle is formulated in Netherlands law - the Panel erroneously describes our system (paragraph 34) as a "particular application of the world-wide principle."

I mention these points because they illustrate a certain amount of confusion, which may have resulted from the fact that the same Panel members were invited to deal more or less simultaneously with four different tax legislations.

Our most serious difficulty with the Panel's conclusions stems however from the fact that it obviously started from an interpretation of the term "export activities" which, without being clearly defined, is in our view far too wide. We have the impression that the Panel did not fully realize that the DISC legislation and the tax practices of the Netherlands differ so fundamentally in their purpose and effect that they cannot possibly be viewed from the same angle. Whilst the export activities of a DISC are clearly circumscribed by the DISC legislation itself, this concept requires a very careful approach when dealing with the Netherlands tax system. Whereas the DISC legislation relates to the taxation of profits made by American companies in the United States or elsewhere in respect of activities directed specifically to the export of goods, the "tax practices of the Netherlands", on the other hand, relate to the taxation of profits (and other income) gained abroad, regardless of the nature of those profits.

In paragraph 34 of its report the Panel states, without giving reasons, "that the particular application of the world-wide principle by the Netherlands, in conjunction with the qualified exemption in respect of foreign income, allowed some part of export activities belonging to an economic process originating in the country to be outside the scope of the Netherlands taxes." In stating this the Panel has obviously placed under the term "export activities" all activities that take place within the framework of an enterprise or concern in respect of the sale to, and in, foreign countries of goods manufactured in the Netherlands. My authorities hold the view, however, that the meaning of the term "export activities" is more restricted and that the interpretation which we consider to be correct would remove the premise from which the Panel's conclusion springs. Indeed, it is noticeable that the Panel indicates in its conclusion where export activities begin, but not where the term ceases to be relevant. Since it is essential that the term "export activities" be correctly interpreted when judging this matter, we feel obliged to underline this point.

Export activities are part of an economic process that begins with the producer and ends with the user or consumer. In its broadest form this process contains the following links: producer - exporter - importer - wholesaler - retailer - consumer. We regard this as a chain in which the final stage of the export activities is reached at the point the foreign importer has the power to dispose of the goods. Any profits accruing from transactions belonging to subsequent links of the chain cannot be ascribed to export activities and therefore fall outside the scope of the relevant GATT obligations. Accordingly, to our knowledge, not a single country taxes profits made in another country on the resale transactions of an independent importer established there, or of an independent person who represents a later link in the chain of transactions. The question now - and it is a decisive one - is whether a different standpoint should be adopted if the importer or the person who represents a later link in the

chain is not independent of, but dependent on, the exporter. We have in mind in particular foreign permanent establishments (branches) and foreign subsidiaries of the exporter.

In the view of my authorities the answer is "No". They consider that also in such cases, any profits made after importation into another country, i.e. in the subsequent links of the chain, should not be regarded as part of the profits from export activities. This would only be otherwise if, and in so far as, the dependent importer were to be charged prices lower than those charged to an independent importer. In such a contingency any profits which, in the "exporter-importer" link, should be attributed directly to the exporter as such, would be hidden in the profits made by the importer-dependent-on-the-exporter, i.e. in a later link in the chain of activities. There is, however, no question of this if the exporter's profits are calculated with due regard to the "at arm's length principle", i.e. on the basis of prices which are not lower than those charged to an independent importer. Attention is drawn in this connexion to paragraph 18 of the Panel's report, which says that the Netherlands delegation expressly stated "that the tax base was always the same, irrespective of whether the sale was effected by the exporter to an independent third party, to its subsidiary or to a branch abroad, the relations between the Dutch company and its branch or subsidiary having to be those that would have existed with an independent third party". This being so, the only conclusion that can be reached is that, contrary to what the Panel has assumed, profits accruing from export activities are taken into account by the Netherlands, not partly but fully when levying tax. Accordingly, there are no grounds for the Panel's conclusion "that the Netherlands has foregone revenue from this source and created a possibility of a pecuniary benefit".

It may be useful in this connexion to go into the Panel's remarks on the application of the "at arm's length principle" by the Netherlands. Although the Netherlands expressly stated that according to Dutch theory, jurisprudence and practice the application of this principle is covered by the notion "sound business practice", which is the criterion according to which the profits of an enterprise should be calculated (as stated in paragraph 24 of the report), the Panel has ventured to evince some doubt about this (paragraph 41 of the report: "The rule of sound business practice ... might not always coincide with arm's length pricing"). In the Netherlands view the expression of such a doubt, for which indeed no grounds are indicated, is beside the point, since it does not prove any failure on the part of the Netherlands to apply the "at arm's length principle". This is borne out by the fact that no evidence of this whatever has been presented by the United States, which has merely voiced the assumption (in paragraph 23 of the report), that "Dutch tax authorities could be willing, in some cases, to allow favourable pricing on export sales". Although maintaining our statement, that the application of the "at arm's length principle" is covered by

its fiscal law, we are aware of the fact, that the application of this principle could give rise to difficulties in practice. My authorities are therefore willing, if a country is of the opinion that in a given case the application of this principle is not fully observed in fact, to investigate such a case under the mutual agreement procedure provided for in the conventions for the avoidance of double taxation concluded by the Netherlands and, if the objection appears to be justified, to take the necessary measures.

Finally, I may touch upon the procedural aspects of this case: if I am well informed it is the first time in the history of GATT conciliation procedures that a panel has not discussed the gist of its conclusions with the parties concerned before circulating them in the form of an official document. Our delegation was in fact given an opportunity to comment upon the descriptive part of the report but we had no indication whatsoever regarding the contents of the conclusions contained in paragraphs 34 through 45. From what I have said before it is clear that a great deal of misunderstanding could have been cleared up if we had been given an opportunity to ask the Panel to expand on its interpretation in the context of the General Agreement of the term "export activities", on which hinge all the conclusions that follow.

As things stand now this particular question is before the Council and we are ready to co-operate in the search for a procedure which should provide a reply to the fundamental question we have raised without causing further delay and unnecessary complications. I may add that in our view the clarification of the concept of "export activities" does not require the assistance of fiscal experts as has been suggested. It would be a strange situation if the GATT Council could not determine the correct meaning of "export activities" in terms of the General Agreement. In the meantime there is no doubt in the mind of the Netherlands delegation that our more limited interpretation of this concept will be confirmed and that therefore the United States complaint against the Netherlands was unjustified.