

# GENERAL AGREEMENT ON TARIFFS AND TRADE

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## INCOME TAX PRACTICES MAINTAINED BY THE NETHERLANDS

### Communication by the Netherlands

1. In May 1973 the United States brought a complaint under Article XXIII:2 inter alia against the Netherlands, stating that income tax practices in respect of foreign sales subsidiaries (of Netherlands companies) constituted a continuing exemption from direct taxes in favour of exported products as compared to products sold for the domestic market and as such were not consistent with the commitments of the Netherlands under the General Agreement in respect of subsidies (document L/3860). On 30 July 1973 the Council agreed to set up a panel to examine this matter and to make such findings as would assist the CONTRACTING PARTIES in making recommendations or rulings provided for in paragraph 2 of Article XXIII.

2. The report of the panel is contained in document L/4425 of 2 November 1976. The panel, having examined the effects of Netherlands tax practices "in economic terms", noted that the application of the Netherlands tax system "allowed some part of export activities belonging to an economic process originating in the country, to be outside the scope of the Netherlands taxes". Although the concept of "export activities" was not defined by the panel it became clear from the further conclusions of the panel that this term was used so as to include activities taking place after the foreign importer has obtained the power to dispose of the goods. It was and is the Netherlands view that the latter activities (which are often carried out by importers independent of the producer or exporter) should not be subject to taxation by the exporting country and are not to be considered as export activities in terms of the General Agreement.

3. On the basis of the above-mentioned examination in economic terms the panel developed further considerations which - though couched in prudent language - led to the conclusion that the Netherlands tax practices "in some cases had effects which were not in accordance with Dutch obligations under Article XVI:4".

In a statement circulated as document C/99 of 15 March 1977 the Netherlands view was set out that this conclusion was based on a rather wide concept of export activities which may be valid in economic terms but which goes well beyond the more limited interpretation that should be given to this term in defining obligations under the General Agreement. During subsequent Council meetings this view received support from a number of other delegations and was not challenged by third countries.

4. At the last Council meeting during which this matter was discussed (14 March 1978, document C/M/124) the representative of the United States stated that his authorities had developed certain ideas in respect of inter alia

Netherlands tax practices which were being discussed both bilaterally and in multilateral fora. He expressed the hope that these ideas would lead to a constructive solution and considered that more time should be given to this process. During further consultations in the course of 1978 it was recognized by the United States authorities that the origin country should tax all the economic activity associated with a product measured on an arms-length basis up to the point of export.

In fact the remaining dispute centred on the question of the Netherlands application for tax purposes of the arms-length pricing standard in transactions between exporting enterprises and foreign buyers under their or under the same control.

5. Apart from the detailed and explicit assurances that the Netherlands authorities were able to give bilaterally in this respect, an occasion was found during the negotiations on the MTN subsidy-code to reaffirm the arms-length principle and to establish a procedure for any difficulties that may arise concerning the application of this principle (e.g. footnote 2 to the illustrative list annexed to the code, which entered into force between the two parties on 1 January 1980).

6. In view of the above it is the understanding of the Netherlands authorities that the original dispute has found a satisfactory solution. Under these circumstances they feel that the panel report in accordance with customary practice should be adopted by the Council but that such adoption should take place on the understanding that economic processes involving the exported goods but located in another country need not be subject to taxation by the exporting country and should not be regarded as part of export activities in terms of the General Agreement.

The Council is requested to proceed with this matter before the end of 1980.