Editorial

A Remarkable Treaty

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The recently signed US-Netherlands tax treaty may, without exaggeration, be considered a milestone not only for the fiscal relations between the two countries concerned, but also for the development of international tax treaty law. It has taken more than ten years of negotiations before a treaty could be concluded between two countries with fundamentally different views on the taxation of direct investments. On the one hand, there is the Netherlands, although relatively small, it remains the home country of some sizeable multinationals and, perhaps as a result of that, a country which imposes few impediments on international capital flows. The taxation of foreign investments made by Netherlands companies is based on the capital import neutrality principle. As a result, the well-known participation privilege unilaterally exempts dividends received on outbound investments. Inbound investments are not subject to significant taxes at source. Interest and royalty payments are not subject to any tax at all. Dividend payments are, in principle, subject to tax at source against a statutory rate of 25 per cent. It is, however, official policy to reduce the rate to nil under the treaties concluded by the Netherlands. These characteristics of the Netherlands tax system have undeniably resulted in a significant flow of investment through the Netherlands into third countries, not the least of which is the United States.

The international tax system of the United States is based on almost contrary principles which no doubt find their origin not only in history, but also in that country's enormous national economy. Taxation of outbound investments, as demonstrated by the Foreign Tax Credit System, is based on the concept of capital export neutrality. Inbound investments are subject to high withholding taxes and are only reduced by a treaty network, which is relatively small.

In addition to these basic differences in the international tax systems there exist in both countries very different views on issues such as transfer pricing methods or, even more basic, the status of treaties *vis-à-vis* domestic law. The Netherlands, gradually, is realizing that it no longer has complete freedom to conclude tax treaties, but has to take into account the fact that it is part of a federation of States called the European Community.

The result of this long awaited treaty is, therefore, of the utmost interest not only because of the significant flows of capital involved, but also since some of the provisions included in this treaty will most likely reappear in treaties concluded by other countries. The United States has already indicated that the Limitation on Benefits provision in Article 26 may very well serve as a model for similar provisions in the renegotiated treaties with other EC Member States.

It is for these reasons that the Editorial Board of this journal decided to publish a special issue exclusively focusing on the new treaty. Next to the text of the treaty and the accompanying Memorandum of Understanding, you will find an extensive commentary on the articles of the treaty. In addition, we have included an account of a conference organised by the Federation of Netherlands Industry ('VNO') and the Washington and Amsterdam offices of Baker & McKenzie on 4 February 1993 in The Hague. Among the speakers at the Conference were the Netherlands head negotiator, Mr. Schoemaker, and the respective US head negotiators, Ms. Bennett and Mr. Morrison. Their comments on various aspects of the treaty, especially the labyrinth Article 26 (Limitation on Benefits) offer a unique inside view of the meaning and background of this remarkable treaty.