The U.S.-Netherlands Income Tax Treaty: Closing the Doors on the Treaty Shoppers

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Abstract

This Comment examines the fruition of the U.S. Treasury Department’s efforts to forestall third-country residents’ avoidance of U.S. taxation on transatlantic investments through intermediary companies. Part I sets forth multinational corporations’ penchant for interposing entities in the Netherlands and the multifarious endeavors implemented to curb abusive treaty practices. Part I also discusses the unilateral legislative provisions that expedited, and the bilateral tax treaty provision that shaped, the U.S.-Dutch negotiations. Part II describes the detailed requirements enumerated in the extensive limitation on benefits provision of the U.S.-Netherlands Treaty. Part III argues that Article 26 strengthens the international community’s commitment to effecting tax treaties and serves to rightfully compel treaty shoppers to relinquish propitious tax treatment, while ensuring treaty benefits to bona fide residents of the Netherlands. Part III also contends that the Convention escapes contravention of European unification and provides U.S. negotiators with an opportunity to forge an authoritative tax treaty policy. This Comment concludes that the revolutionary bilateral accord effectuates future U.S. tax conventions, sustains the U.S. tax base, and severely hinders the use of Dutch holding companies as investment vehicles for the procurement of benefits under the U.S.-Netherlands Treaty.
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INTRODUCTION

The post-World War II community has witnessed a marked proliferation in financial activity that traverses every nation’s borders.¹ Multinational corporations, with profits exceeding the gross domestic products of several countries,² continue to expand, distributing capital and resources through ensconced channels of global subsidiaries.³ The emergence of intricate transnational investments poses formidable policy issues for the world’s many independent taxing jurisdictions.⁴

These sovereignies, seeking international economic growth and the reduction of double taxation⁵ on their citizens, have entered into numerous income tax treaties.⁶ The tax conventions

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2. JANET LOWE, THE SECRET EMPIRE: HOW 25 MULTINATIONALS RULE THE WORLD 5 (1992). The United States, Japan, U.S.S.R. (former), France, Germany, Italy, the United Kingdom, and Canada are the only nations, out of a total of 213, that report gross domestic products larger than the assets of the world’s leading banks. Id.


4. See GUSTAFSON & PUGH, supra note 1, at 11 (discussing complications in taxation that have arisen due to operations of multinational enterprises); H. David Rosenbloom, Tax Treaty Abuse: Policies and Issues, 15 LAW & POL’Y INT’L BUS. 763, 764 (1983) (noting that policymakers must delicately balance long-term tax policy goals with acceptable practices in international trade and commerce).

5. ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, COMM. ON FISCAL AFFAIRS, MODEL DOUBLE TAXATION CONVENTION ON INCOME AND ON CAPITAL 7 (1977) [hereinafter 1977 OECD MODEL] (containing text of model with commentary). Double taxation is "the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods . . . ." Id.

6. See Robert J. Rolfe & Timothy S. Doupnik, The United States Attempts to Crack Down on Treaty Shopping, 38 TAX EXECUTIVE 325, 325 (1986). The principle goal of tax treaties is the removal of the negative effects of double taxation on the international movement of goods, services, capital, and people. See 1977 OECD MODEL, supra note 5, at 7; Extract of the Report of the Financial Committee to the Council of the League of Nations, League of Nations, Doc. C.368 M.115 1925 II A, at 1 (1925) (urging future drafters of tax conventions to consider "the disadvantage of placing any obstacles in the way of the
govern when, and to what extent, a resident of one country is subject to taxation in another country. Although the bilateral agreements explicitly prescribe the parties entitled to treaty benefits, third-country residents have secured favorable tax treatment via treaty shopping.

The United States, through unilateral and bilateral actions, has manifested its appetency for eradicating premeditated efforts that take advantage of the international tax network. In international circulation of capital, which is one of the conditions of public prosperity and world economic reconstruction*). Income tax treaties have been most effective at affording taxpayers mutuality of relief. See Vincent P. Belotsky, Jr., The Prevention of Tax Havens Via Income Tax Treaties, 17 CAL. W. INT'L L.J. 45, 62 (1987) (discussing history, use, and importance of income tax treaties). A tax treaty is also a productive medium for resolution of disputes, prevention of fiscal evasion, accommodation of differing tax systems, avoidance of excessive taxation, exchange of information, and advancement of a country's economic and foreign policy. Id. But see David S. Foster, The Importance of Tax Treaties, 5 HASTINGS INT'L & COMP. L. REV. 565 (1982) (noting lack of unanimity in support of tax treaties). Opponents contend that scarce governmental resources are wasted on negotiating and maintaining a treaty network that is continually outdated, thereby opening loopholes that invite treaty abuse. Id. at 565.

7. See Rosenbloom, supra note 4, at 770 (describing tax treaties as jurisdictional documents). Tax treaties originated as an integral role in the commerce between nations. Belotsky, supra note 6, at 62.

8. See, e.g., Treasury Department's Model Income Tax Treaty, June 16, 1981, art. 1, ¶ 1, reprinted in 1 Tax Treaties (CCH) ¶ 211, at 10,573 [hereinafter 1981 U.S. Model Treaty]. The 1981 U.S. Model Treaty explicitly states that "[t]his Convention shall apply to persons who are residents of one or both of the Contracting States, except as otherwise provided in the Convention." Id. The addition of "except as otherwise provided" in tax conventions is significant. Mary C. Bennett & Philip D. Morrison et al., A Commentary to the United States Netherlands Tax Convention, in THE 1992 UNITED STATES-NETHERLANDS TAX CONVENTION 3, 4 (Baker & McKenzie, Kluwer Law & Taxation 1993). For example, information exchange provisions affect entities who are not residents of one of the treaty nations, while limitation on benefits articles frustrate residents' entitlement to benefits. Id.

9. Rosenbloom, supra note 4, at 766. Third-country resident refers to an entity that is not a citizen of one of the treaty signatories. Id.

10. See Rolfe & Doupnik, supra note 6, at 925 (defining treaty shopping as process of creating corporations in particular countries strictly to take advantage of favorable tax treaty system). Treaty shopping generally refers to "the use by a national of a country with which the United States does not have an income tax treaty of an entity formed under the laws of a U.S. treaty partner to reduce or eliminate source-country (U.S.) taxes." Leslie J. Schreyer & Sean Mitts, Limitations on Treaty Shopping With Respect to Dividends and Non-Portfolio Interest, in FOREIGN INVESTMENT IN THE UNITED STATES 1988, 405, 405 (PLI Tax Law and Estate Planning Course Handbook Series No. J4-3618, 1988).

11. But see Schreyer & Mitts, supra note 10, at 405 (discussing theory that treaty shopping reduces U.S. effective tax rate for third-country residents, thereby giving U.S. businesses advantage in attracting capital).

12. See One Treaty at a Time, Says International Tax Counsel, 1 J. INT'L TAX'N 40, 41
furtherance of this goal, the U.S. Treasury Department has embarked on an aggressive campaign to renegotiate those treaties that permit third-country residents to successfully avoid all tax on U.S. income. U.S. negotiators mandate that U.S. tax treaties include a limitation on benefits provision that requires a company to establish a sufficient nexus with the residence-country before obtaining reduced withholding tax rates from the source-country.14

The 1948 United States-Netherlands Convention with respect to Taxes on Income and Certain Other Taxes (the "1948 Treaty")15 represented one of the last, and probably the most notorious, U.S. tax treaties that accorded third-country residents
a permissible tax avoidance configuration when structuring U.S. investments. The absence of a limitation on benefits clause in the 1948 Treaty triggered exhaustive negotiations that culminated in the long-awaited United States-Netherlands Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (the "U.S.-Netherlands Treaty" or "Convention"). The successful

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16. See Morrison & Bennett, supra note 15, at 331 (ascribing presence of tax avoidance activities in Netherlands to absence of anti-treaty shopping provision in 1948 Treaty). The primary function of tax conventions is to promote the exchange of goods and services and the movement of capital and persons. See supra note 6 (discussing ability of tax treaty to alleviate negative effects of double taxation); Gild, supra note 1, at 559 (adding that second major objective is to combat international tax evasion and avoidance schemes). Tax avoidance, in contrast to the willful and deliberate violation of the law essential for tax evasion, pertains to "persons [who] arrange their affairs in such a way as to take advantage of weaknesses or ambiguities in the law to reduce the tax payable below what it would otherwise be, without actually breaking the law." U.N. DEP'T OF INT'L ECONOMY & SOCIAL AFFAIRS, MANUAL FOR THE NEGOTIATION OF BILATERAL TAX TREATIES BETWEEN DEVELOPED AND DEVELOPING COUNTRIES at 22, U.N. Doc. ST/ESA/94, U.N. Sales No. E.79.XVI.3 (1979) [hereinafter U.N. MANUAL]. But see Belotsky, supra note 6, at 50 (noting that definitions of tax evasion and avoidance can cause unclear distinctions); see also Richard A. Gordon, Tax Havens and Their Use By United States Taxpayers - An Overview 60-61 (1981) (abandoning use of these two terms and creating four categories that range from "completely legal" to "fraud"). This Comment focuses on tax avoidance rather than tax evasion.

17. Fred C. de Hosson, Introduction, in The 1992 United States-Netherlands Tax Convention, supra note 8, at 1, 1. The U.S.-Netherlands Treaty is the result of more than twenty years of negotiations. Id. The first round of substantive talks began in September 1988. Bell & Shoemaker, supra note 13, at 85 n.30. For a discussion of issues facing drafters of tax treaties, see generally Rosenbloom, supra note 4 (surveying history of U.S. tax treaties and U.S. model conventions to identify most troublesome theoretical and technical problems of treaty drafting); Stanley S. Surrey, International Tax Conventions: How They Operate and What They Accomplish, 23 J. TAX'N 364 (1965) (discussing impulses behind tax treaty negotiations).

denouement on December 18, 1992, engendered an intricate limitation on benefits provision, provided in Article 26,19 which is reflective of the increasing detail contained in international tax conventions.20

This Comment examines the fruition of the U.S. Treasury Department’s efforts to forestall third-country residents’ avoidance of U.S. taxation on transatlantic investments through intermediary companies. Part I sets forth multinational corporations’ penchant for interposing entities in the Netherlands and the multifarious endeavors implemented to curb abusive treaty practices. Part I also discusses the unilateral legislative provisions that expedited, and the bilateral tax treaty provision that shaped, the U.S.-Dutch negotiations. Part II describes the detailed requirements enumerated in the extensive limitation on benefits provision of the U.S.-Netherlands Treaty. Part III argues that Article 26 strengthens the international community’s commitment to effecting tax treaties and serves to rightfully compel treaty shoppers to relinquish propitious tax treatment, while ensuring treaty benefits to bona fide residents of the Netherlands. Part III also contends that the Convention escapes contravention of European unification and provides U.S. negotiators with an opportunity to forge an authoritative tax treaty policy. This Comment concludes that the revolutionary bilateral accord effectuates future U.S. tax conventions, sustains the U.S. tax base, and severely hinders the use of Dutch holding companies as investment vehicles for the procurement of benefits under the U.S.-Netherlands Treaty.

I. THE DEVELOPMENT OF EFFORTS TO LIMIT ABUSIVE TREATY PRACTICES

International tax avoidance is not a recent phenomenon.21

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19. See U.S.-Neth. Treaty, supra note 18, art. 26, S. TREATY Doc. No. 6, at 59, 32 I.L.M. at 486; Bennett & Morrison, supra note 8, at 68 (concluding that Article 26 has “flexibility and relative predictability of application” to accord benefits of Convention to bona fide residents).


Treaty shopping, though a contemporary expression, was practiced long before the term's conception. The 1945 U.S. bilateral accord with the United Kingdom (the "U.S.-U.K. Treaty") was the first U.S. tax convention to incorporate anti-treaty shopping language. The conspicuous omission of a limitation on benefits clause in the 1948 Treaty, in connection with Dutch tax law and the extensive network of Dutch tax accords, invited treaty abuse by third-country multinationals. The implementation of Article 26, in the U.S.-Netherlands Treaty, reflects the aftermath of the continual development of anti-treaty shopping provisions in U.S. legislation, the U.S. tax treaty net-

In 1721, the American colonies shifted their trade to Latin America in order to avoid paying duties imposed by England. The tax morality which developed from this avoidance of English duties has been described as follows: 'The fact that the colonists were constantly evading the navigation acts, and made no pretense of paying the duties imposed by England must have had a demoralizing effect, and taught them to evade duties imposed by their own lawmakers...'

Id. (citation omitted).

22. See Helmut Becker & Felix J. Wurm, Survey, in Treaty Shopping: An Emerging Tax Issue and its Present Status in Various Countries 1, 2 (1988) (discussing derivation of treaty shopping). The pejorative nature of treaty shopping is analogous to the negative connotation attached to the U.S. civil procedure term, forum shopping. Id. Forum shopping occurs "when a party attempts to have his action tried in a particular court or jurisdiction where he feels he will receive the most favorable judgment or verdict." Black's Law Dictionary 655 (6th ed. 1990).

23. Becker & Wurm, supra note 22, at 2. The term, treaty shopping, originates from the Congressional Hearings on Offshore Tax Havens, held in April 1971. Id.

24. See id. (stating that "problem dates back some time before 1971); supra note 21 (discussing international tax avoidance practices in American colonies).


27. See Kral & Serota, supra note 26, at 442 (discussing attractiveness of Netherlands as location for holding companies of third-country multinational corporations); U.S.-NETH. REPORT, supra note 13, at 18 (explaining susceptibility of Netherlands to treaty abuse).
work, and the various model tax conventions.28

A. Treaty Shopping Under the 1948 Treaty

Treaty shopping generally occurs when third-country residents generate income in the source-country, obtain treaty benefits in the residence-country, and ultimately receive the income at a low overall tax cost.29 This practice contravenes the intentions of the treaty signatories (the “Contracting States”).30 The 1948 Treaty did not address abuse by treaty shoppers,31 and consequently, was transformed from a bilateral treaty into a multilateral treaty, offering benefits to citizens throughout the world.32


29. See Rosenbloom, supra note 4, at 766 (describing repatriation of income to third-country investor, through residence-country, as “prototype situation”). The third-country resident, the ultimate owner of the income, does not reside in the source-country or the residence-country. Id. There are three basic structures that enable companies to engage in treaty shopping: direct conduit companies, stepping stone companies, and bilateral relations. Becker & Wurm, supra note 22, at 4-5. Successful treaty shopping generally entails the presence of three factors: (1) a reduction of source-country taxation; (2) a low or zero effective rate of tax in the residence-country; and (3) a low or zero rate of tax on payments from the residence-country to the taxpayer. See Gordon, supra note 16, at 158.


31. See supra note 26 and accompanying text (discussing absence of anti-treaty shopping provision in 1948 Treaty).

1. Treaty Shoppers Find Refuge in the Netherlands

Third-country investors' predilection for the Netherlands can be ascribed to their unremitting pursuit of tax abatements. Financial planners worldwide, coveting U.S. tax advantages, availed themselves of the 1948 Treaty and situated holdings, headquarters, and financing companies in the Netherlands. Hence, the Netherlands functioned as an international investment switching center, proffering multinationals a prudent site from which to establish a U.S. subsidiary and then receive ensuing distributions.

The popularity of the Netherlands in international tax planning schemes was not due exclusively to the 1948 Treaty. Holland, with a solid financial position, maintains an expansive network that extends tax benefits globally. In addition, the Dutch tax authorities issue advanced tax rulings, enabling com-

33. See ERIC TOMSETT, TAX PLANNING FOR MULTINATIONAL COMPANIES 34 (1989) (discussing that Netherlands is prime location for conduit finance companies).
34. See Lori Ioannou, Tax Havens of Europe, Int'l Bus., Aug. 1992, at 50. Companies are interested in moving money expeditiously without heavy taxation. Id. (quoting Vice President of Intel Corporation, in charge of taxation issues). This is achieved by interposing intermediate entities, located in the residence-country, between the ultimate investor and their investment in the source-country. See Joseph C. Amico, Planning Under Article 26 of the 1992 U.S.-Netherlands Tax Treaty, 6 TAX NOTES INT'L 1333, 1333-34 (1993) (providing example of this scenario).
35. See Ioannou, supra note 34, at 50 (discussing reduction in corporate income taxes by placing corporate entity in Netherlands). The Netherlands has over 5,000 finance and holding company subsidiaries. Id.
36. See GORDON, supra note 16, at 152-57 (describing third-country residents' use of foreign borrowing, finance companies, holding companies, active business, real estate investment, and personal service companies).
37. See generally Boudewijn Barre, The Use of a Dutch Intermediary Company to Help Manage and Control an Organisation's Worldwide Tax Liabilities (June 5, 1993) (unpublished manuscript, on file with TAX NOTES INT'L) (discussing position of Netherlands in international tax planning).
38. See Morrison & Bennett, supra note 15, at 331 (describing Netherlands as sensible location for holding companies).
39. See Ioannou, supra note 34, at 50 (discussing other fiscal advantages of Netherlands).
40. CENTRAL INTELLIGENCE AGENCY, THE WORLD FACTBOOK 1992 244 (1992) (describing Dutch economy as "highly developed and affluent"). Id.
41. See Ioannou, supra note 34, at 50 (discussing that Dutch are currently entered into 50 tax treaties with other countries). The Dutch treaties afford favorable withholding tax rates on dividend, royalty, and interest payments to the Netherlands. TOMSETT, supra note 33, at 34 (discussing potential reduction "on interest received by Dutch company to nil"). Selection of the Netherlands is cost effective for companies interested in mergers or joint ventures. See Rolfe & Doupnik, supra note 6, at 327 (discussing formation of jointly-owned holding company between Clark Equipment and Volvo). The
panies to predetermine their tax position and profits with certainty.\textsuperscript{42}

2. Avoidance of U.S. Taxation Through Dutch Holding Companies

Companies that were located in countries lacking a U.S. double taxation avoidance treaty oftentimes invested in the United States through a Dutch holding company.\textsuperscript{43} This company operated as a conduit through which passive income payments\textsuperscript{44} were transferred from a U.S. subsidiary, to a Dutch holding company, and then distributed to a third-country parent company.\textsuperscript{45} Conventionally labeled the Dutch sandwich, the Netherlands constituted the meat located in the middle of the United States and the investing country.\textsuperscript{46}

Under the 1948 Treaty, the passive income distributions were subject to a reduced U.S. withholding tax rate.\textsuperscript{47} Further-

\begin{itemize}
\item Dutch tax treaty network facilitates transfers of capital among global operations at significant tax savings. \textit{Id.}
\item See Tomsett, supra note 33, at 34 (stating that Dutch tax authorities regularly give firm and binding rulings).
\item See Gordon, supra note 16, at 155 (discussing use of holding companies). A holding company is defined as an entity that "usually confines its activities to owning stock in, and supervising management of, other companies." \textit{Black's Law Dictionary} 731 (6th ed. 1990). A non-U.S. entity licensing a patent, for use in the United States, could use a Dutch holding company for "back-to-back" royalties. Gordon, supra note 16, at 154. The non-U.S. entity avoided the 30% U.S. withholding tax, for royalties received, by licensing its patent to a Dutch corporation, and then, licensing the patent back to U.S. licensees. \textit{Id.}; 1948 Treaty, supra note 15, art. 9, 62 Stat. at 1262, T.I.A.S. No. 1855 at 7 (exempting payments of royalties from U.S. withholding tax). Canadian corporations avoided withholding taxes on dividends by establishing an intermediary company in the Netherlands. See Kingson, supra note 14, at 1276 (noting absence of Dutch taxation on dividends paid out of profits not derived in Netherlands). Canadian Pacific Limited used a Netherlands holding corporation for a U.S.$200,000,000 tender offer. \textit{Id.}
\item See I.R.C. § 1362(d)(3)(D)(ii). Passive investment income, in part, includes receipts derived from royalties, rents, dividends, and interest. \textit{Id.}
\item See Gordon, supra note 16, at 155.
\item See 1948 Treaty, supra note 15, arts. 7, 9, 11, 12, 62 Stat. at 1761-62, T.I.A.S. No. 1855 at 6-8. If an investor controlled more than 25% of a subsidiary, the 30% U.S. withholding tax was reduced to 5% for dividends received. \textit{Id.} Furthermore, the tax was reduced to nil for royalties and interest payments received. \textit{Id.} Under the U.S.-Netherlands Treaty, a lower 5% levy applies with holdings of more than 10%. U.S.-Neth. Treaty, supra note 18, art. 10, S. Treaty Doc. No. 6, at 20, 32 I.L.M. at 469. Dutch intermediary companies will no longer be able to repatriate interest income and royalties, generated in the United States, at a nominal tax cost. See Protocol Amending the
more, Dutch domestic laws include a participation exemption which exempts a company's income from Dutch corporate income tax when it is realized by a Dutch resident or non-resident corporate taxpayer. Both the participation exemption and the provisions, or lack thereof, of the 1948 Treaty presented third-country nationals with a viable route to escape U.S. and Dutch taxation.


The United States, since 1939, has actively sought to negotiate tax conventions with trading partners to minimize the bur-


49. See Stef van Weeghel, Netherlands Draft Bill Attempts Crackdown on Tax Haven Transactions, 4 J. Int'l Tax'n 422 (1993) (discussing proposed draft legislation in Netherlands that would amend Corporate Income Tax Act of 1969); Mariëtte Turkenburg & Jos Teeuwen, New Anti-Tax Haven Measures for the Netherlands, Int'l Tax Rev., Oct. 1993, at 23 (discussing revised subject-to-tax test for participation exemption and describing proposed legislation as “radical”). Generally, income derived from the source-country is exempt from Dutch income tax if certain requirements are met. See van Weeghel, supra, at 424 n.9. One exception, under the 1948 Treaty, was that the profit of the permanent establishment had to be subject to tax in another jurisdiction before qualifying for liberation from the Dutch income tax. Id. at 424. However, this provision's effectiveness was dubious because no minimum tax rate was stipulated. Id.

50. See Gordon, supra note 16, at 155 (noting that proper planning eliminated Dutch corporate tax).

51. See Rolfe & Doupnik, supra note 6, at 326. As of January 1, 1994, the United States had treaties in force with the following countries: Australia, Austria, Barbados, Belgium, Bermuda, Canada, People's Republic of China, Cyprus, Czech Republic, Denmark, Egypt, Finland, France, Germany, Greece, Hungary, Iceland, India, Indonesia, Ireland, Italy, Jamaica, Japan, Korea, Luxembourg, Malta, Mexico, Morocco, Netherlands, Netherlands Antilles, New Zealand, Norway, Pakistan, Philippines, Poland, Romania, Russia, Slovak Republic, Spain, Sweden, Switzerland, Trinidad & Tobago, Tu-
den of double taxation. However, the compromise reached between the Contracting States is vitiated when tax avoidance practices assist unintended beneficiaries and erode the U.S. tax base. Treaty shoppers' use of U.S. tax conventions permits the provisions of these bilateral agreements to supersede U.S. domestic law. In addition, the U.S. ability to negotiatet tax treaties is frustrated when third-country investors attain commensurate benefits through existing accords. Consequently, the value of U.S. withholding taxes as a bargaining chip during tax treaty negotiations, United Kingdom, and U.S.S.R. (former). Telephone interview with Office of International Tax Counsel, U.S. Department of the Treasury (Feb. 7, 1994).

52. Schreyer & Mitts, supra note 10, at 406. The United States enters into tax conventions in order to reduce the taxation levied upon U.S. investors and to gain access to relevant tax information. See id. (noting that tax treaties generally provide rules for exchange of information to secure enforcement of each country's domestic revenue laws); Bruce Zagaris, *The U.S.-Netherlands Income Tax Treaty: Tax Collection Assistance and Evidence-Gathering*, 47 *BULL. FOR INT'L FISCAL DOCUMENTATION* 342 (1993) (discussing collection assistance provisions in U.S.-Netherlands Treaty).

53. See Rolfe & Doupnik, supra note 6, at 325. The United States has manifested its opposition to treaty shopping through court decisions and administrative rulings. Id. at 330-35. The holdings indicate the intention of the United States to deny treaty benefits to intermediary entities with limited local ties to their country of residence by looking at the substance, rather than the form, of a transaction. See, e.g., Frank Lyon Co. v. United States, 435 U.S. 561 (1978) (holding sham transaction); Moline Properties, Inc. v. Commissioner, 319 U.S. 456 (1943) (finding sham corporation); Johansson v. United States, 336 F.2d 809 (5th Cir. 1964) (denying treaty benefits to U.S. boxer who, as Swedish heavyweight boxing champion, attempted to take advantage of exemption clause in U.S.-Swiss Treaty); Aiken Indus., Inc. v. Commissioner, 56 T.C. 925 (1971) (holding that Honduran corporation was not true recipient of interest, and therefore, not entitled to treaty exemption). In 1984, the Internal Revenue Service (the "I.R.S.") issued two revenue rulings, representing its most direct attack against treaty shopping. See Rev. Rul. 84-152, 1984-2 C.B. 381 (denying 30% withholding tax on interest paid on loan from Swiss corporation through its Netherlands Antilles subsidiary); Rev. Rul. 84-153, 1984-2 C.B. 383 (holding that financing through Antilles was subject to 30% tax).

54. See Gild, supra note 1, at 581 (discussing lower revenues to Contracting States due to treaty shopping); Rosenbloom, supra note 4, at 812 (noting that source-country has legitimate interest in ensuring that income accorded treaty benefits will be subject to tax in residence-country); Rosenbloom & Langbein, supra note 25, at 396 (stating that treaty shopping practices cause unintended revenue loss not envisioned by Contracting States).

55. See Gild, supra note 1, at 582 (noting override of Internal Revenue Code because treaty shopping, contrary to intent of U.S. Congress, repeals U.S. taxes on income repatriated to third-country that has not entered into tax convention with United States).

56. See Schreyer & Mitts, supra note 10, at 406 (noting treaty shoppers' disinterest in persuading their countries of residence to negotiate U.S. tax conventions); Gild, supra note 1, at 581 (adding that this contradicts U.S. objective of concluding tax treaties with its major trading partners).
The international efforts addressing the quandaries of international double taxation date back to the League of Nations. The United Nations and regional forums, most notably the Organisation for Economic Co-operation and Development (the "OECD"), continue to examine these issues. The bodies, comprising worldwide representation, document their efforts in a series of model bilateral tax conventions. These treaties, coupled with the U.S. and Dutch model treaties and the acumen imparted through preceding U.S. bilateral treaties, facilitated U.S.-Dutch negotiations regarding Article 26 of the U.S.-Netherlands Treaty.

57. Schreyer & Mitts, supra note 10, at 406. The extensive U.S. tax treaty network adversely affects U.S. citizens. See Gild, supra note 1, at 582-83 (alleging discrimination against U.S. residents because they are unable to treaty shop).

58. U.N. Manual, supra note 16, at 16 (stating that "international efforts to deal with the problems of international double taxation were begun by the League of Nations . . . "). The "Report on Double Taxation," issued by the League of Nations in 1923, is the "intellectual base" from which modern treaties developed. See Honey L. Goldberg, Conventions For the Elimination of International Double Taxation: Toward a Developing Country Model, 15 LAW & POL'Y INT'L BUS. 833, 851-52 (1983).

59. See Jacques Sasseville, The OECD Model Tax Convention is Revised, 4 J. INT'L TAX'N 129 (1993) (noting that OECD was created after World War II to administer Marshall Plan). The OECD establishes committees that cover numerous areas, including financial markets, economic policy, and taxation. Id. In 1971, the OECD's Committee on Fiscal Affairs revised the extant Draft Double Taxation Convention on Income and on Capital, accounting for "the changes in systems of taxation and the increase in international fiscal relations on the one hand and, on the other, the development of new sectors of business activity and the increasingly complex forms of organization adopted by enterprises for their international activities." Gild, supra note 1, at 565.

60. See generally Goldberg, supra note 58, at 835-39 (examining OECD and U.N. models that serve as basis for many bilateral treaties currently in force).

61. See Report to the Council on the Fifth Session of the Committee, League of Nations Doc. C.252 M.124 1935 IIA, at 4 (1935). The Fiscal Committee of the League of Nations gave the following rationale for the elaboration of model tax conventions: "The existence of model draft treaties . . . has proved of real use . . . in helping to solve many of the technical difficulties which arise in [the negotiation of tax treaties]." Id.; see Rosenbloom & Langbein, supra note 25, at 360 (stating that model treaties, produced through international cooperation, are "major achievements").

62. Bennett & Morrison, supra note 8, at 3.
1. The Inception of Anti-Treaty Shopping Language in U.S. Tax Treaties

The earliest anti-treaty shopping language appeared in Article 6 of the 1945 U.S.-U.K. Treaty. The arranged-or-maintained test, inaugurated in this tax convention, attempted to ensure that legitimate corporate structures were the sole beneficiaries of lower dividend rates. The test, confined to several words, had a narrow application due to its subjective focus and its inadequate interpretive guidelines.

The metamorphosis of the anti-treaty shopping language into its own provision occurred in the 1962 U.S.-Luxembourg Treaty. Article 15 of this tax accord explicitly proscribes granting treaty benefits to income entitled to special treatment under Luxembourg laws. Third-country residents' infrequent use of

64. Id. art. 6, ¶ 1, 60 Stat. at 1381, T.I.A.S. No. 1546 at 6 (stating that dividends paid by corporation in source-country to controlling corporation in residence-country were subject to 5% tax rate, rather than 30% U.S. withholding rate or 15% U.S.-U.K. Treaty rate). The reduced rate was raised to 15% if "the relationship of the two corporations ha[d] been arranged or [was] maintained primarily with the intention of securing such reduced rate." Id. The arranged-or-maintained language appeared in several subsequent U.S. income tax treaties. See, e.g., Convention for the Avoidance of Double Taxation with respect to Income, Oct. 25, 1956, U.S.-Aus., art. 6, 8 U.S.T. 1699, 1704, T.I.A.S. No. 3923 at 6; Convention for the Avoidance of Double Taxation with respect to Income, May 6, 1948, U.S.-Den., art. 6, 62 Stat. 1730, 1734, T.I.A.S. No. 1854 at 5; Convention for the Avoidance of Double Taxation with respect to Income, Sept. 13, 1949, U.S.-Ir., art. 6, 2 U.S.T. 2303, 2310, T.I.A.S. No. 2356 at 9; 1948 Treaty, supra note 15, art. 7, 62 Stat. 1757, 1767, T.I.A.S. No. 1855 at 6; Convention for the Avoidance of Double Taxation with respect to Income, May 24, 1951, U.S.-Switz., art. 6, 2 U.S.T. 1751, 1756-57, T.I.A.S. No. 2316 at 6.
65. See Rosenbloom, supra note 4, at 780-81 (discussing absence of concrete guidance for interpreting arranged-or-maintained test). The arranged-or-maintained test's principal obstacle was enforceability because it concentrated on the subjective intent of the individuals who had organized the corporate structure while offering tax authorities virtually no guidance. Id.; Priv. Ltr. Rul. 82-300-91 (Apr. 28, 1982); Priv. Ltr. Rul. 81-240-38 (Mar. 17, 1981). Moreover, this test failed to preclude arrangements to secure the 15% rate. See Rev. Rul. 79-65, 1979-1 C.B. 458.
67. Id. art. 15, 15 U.S.T. at 2364, T.I.A.S. No. 5726 at 10. The nonreciprocal provision provides:

The present Convention shall not apply to the income of any holding company entitled to any special tax benefit under Luxembourg Law of July 31, 1929, and Decree Law of December 27, 1937, or under any similar law subsequently enacted, or to any income derived from such companies by any shareholder thereof.

Id.
Luxembourg, as an intermediary base for transferring investments into and out of the United States, reflects the effectiveness of Article 15.68

2. Further Refinement

A 1970 U.S. tax convention with Finland (the "U.S.-Finland Treaty") embodied an even more efficient and sophisticated U.S. attempt to challenge third-country abuse of U.S. treaty benefits.69 Article 27 of the U.S.-Finland Treaty, entitled "Investment or Holding Companies," enhanced the Luxembourg approach by denying benefits based on a special measures test and a foreign ownership test.70 The special measures test provided that treaty benefits would not be granted if the domestic laws taxed income at lower rates than business profits generally.71 The foreign ownership test similarly denied benefits where non-

68. Rosenbloom, supra note 4, at 781 (stating that simple rule of U.S.-Luxembourg Treaty accomplished purpose).


70. 1970 U.S.-Finland Treaty, supra note 69, art. 27, 22 U.S.T. at 72-73, T.I.A.S. No. 7042 at 32-33. Article 27 states:

A corporation of one of the Contracting States deriving dividends, interest, or royalties from sources within the other Contracting State shall not be entitled to the benefits . . .

(a) by reason of special measures granting tax benefits to investment or holding companies the tax imposed on such corporation by the former Contracting State with respect to such dividends, interest, or royalties is substantially less than the tax generally imposed by such Contracting State on corporate profits, and

(b) 25 percent or more of the capital of such corporation is held of record or is otherwise determined, after consultation between the competent authorities of the Contracting States, to be owned directly or indirectly, by one or more persons who are not individual residents of the former Contracting State (or, in the case of a Finnish corporation, who are citizens of the United States).

Id. This provision only applied to corporations with respect to dividends, interest, and royalty payments. See Rosenbloom, supra note 4, at 786 (discussing narrowness of this provision). Similar provisions appeared in several U.S. treaties ratified in the 1970's. See, e.g., Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital, May 7, 1975, U.S.-Ic., art. 27, 26 U.S.T. 2004, 2100, T.I.A.S. No. 8151 at 98 (adding capital gains to list of income items possibly denied and omitting reference to investment or holding companies in text); Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains, Dec. 31, 1975, U.S.-U.K., art. 16, 31 U.S.T. 5668, 5683, T.I.A.S. No. 9682 at 16 (departing from basic two-part test espoused in U.S.-Finland Treaty).

71. See supra note 70 (delineating special measures test in paragraph (a)).
residents owned a substantial percentage of the interests in an entity. This two-part rule, incorporated into most bilateral treaties negotiated in the 1970's, had a significant impact on the drafting of the first U.S. Model Treaty.

In 1977, the United States promulgated a Model Treaty (the "1977 Model") to function as a coherent guide for future treaty negotiations. Article 16 of the 1977 Model contained a streamlined "Investment or Holding Companies" provision, which mirrored the two-part rule in the U.S.-Finland Treaty. Article 16, though ineffective, highlighted flaws in the practical application of these tests and facilitated the progression towards a more stringent provision.

The next revision, in December of 1981, significantly altered the previous requirements. The 1981 U.S. Model Treaty...
extended coverage to all taxpayers and for all treaty benefits.\textsuperscript{80} Entities were required to meet both the foreign ownership standard and a revised special measures test.\textsuperscript{81} A safe harbor was added to the foreign ownership rule by presuming resident ownership if a company's stock was traded on an approved stock exchange.\textsuperscript{82}

The revised special measures test,\textsuperscript{83} otherwise labeled a conduit rule,\textsuperscript{84} was more effective than its predecessor, which enabled non-residents to escape taxation by comparing two tax bases that could both be depleted.\textsuperscript{85} In contrast, the 1981 U.S. Model test examined the substantiality of payments made to

\begin{quote}
1. A person (other than an individual) which is a resident of a Contracting State shall not be entitled under this Convention to relief from taxation in the other Contracting State unless

\hspace{1cm} (a) more than 75% of the beneficial interest in such person is owned, directly or indirectly, by one or more individual residents of the first-mentioned Contracting State; and

\hspace{1cm} (b) the income of such person is not used in substantial part, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons who are residents of a State other than a Contracting State and who are not citizens of the United States.

For the purposes of subparagraph (a), a company that has substantial trading in its stock on a recognized exchange in a Contracting State is presumed to be owned by individual residents of that Contracting State.

2. Paragraph 1 shall not apply if it is determined that the acquisition or maintenance of such person and the conduct of its operations did not have as a principal purpose obtaining benefits under the Convention.

3. Any relief from tax provided by a Contracting State to a resident of the other Contracting State under the Convention shall be inapplicable to the extent that, under the law in force in that other State, the income to which the relief relates bears significantly lower tax than similar income arising within that other State derived by residents of that other State.
\end{quote}

\textit{Id.}

80. \textit{Id.} (expanding scope of provision to cover all benefits). \textit{But see supra} note 75 (limiting reach of 1977 U.S. Model provision to only passive income items).

81. \textit{See supra} note 79 (noting placement of "and" between paragraphs 1(a) and 1(b) of 1981 U.S. Model Treaty).

82. \textit{Id.} (focusing on sentence following paragraphs 1(a) and 1(b)).

83. \textit{Id.} (omitting term "special measures" from text of provision).

84. \textit{See Schreyer & Mitts, supra} note 10, at 272 (describing conduit rule as base erosion provision).

85. \textit{See Rosenbloom, supra} note 4, at 798 (stating that purpose of revised special measures test was to fill "perceived deficiency" of previous rule). The prior test permitted third-country residents to avoid taxation when the laws of the residence-country and the third-country both sufficiently depleted the tax base. \textit{Id.}
non-treaty residents, thereby mitigating a notable defect.\textsuperscript{86} In addition, a potential defense was afforded to those taxpayers who could demonstrate that the principal purpose of their operations was not the procurement of treaty benefits.\textsuperscript{87} Despite these improvements, the continued dependence on presumptive tests, with limited interpretive guidelines, frustrated the adoption of the 1981 U.S. Model Treaty as a comprehensive anti-treaty shopping provision.\textsuperscript{88}

3. International Efforts: OECD Model Tax Treaties

In 1956, the OECD assembled a Fiscal Committee to examine a potential uniform multilateral treaty for the avoidance of double taxation.\textsuperscript{89} The international taxing principles embraced in subsequent OECD model conventions influenced the negotiations of several hundred bilateral income tax treaties signed throughout the world.\textsuperscript{90} The adoption of the 1992 OECD Model Treaty\textsuperscript{91} replaced the existing 1977 version.\textsuperscript{92} Although the 1992 version does not contain a limitation on benefits provision, U.S. persistence\textsuperscript{93} in this area necessitated a lengthy discussion of its merits in the 1992 Commentary attached to the 1992 Model.\textsuperscript{94} The 1992 Commentary dismissed earlier attempts to limit treaty shopping\textsuperscript{95} and endorsed recent U.S. treaty and statutory developments.\textsuperscript{96}

\textsuperscript{86} Id. (discussing advantage of analyzing substantiality of payments rather than comparing tax bases).

\textsuperscript{87} See supra note 79 (stating test in paragraph 2 for bypass of paragraph 1).


\textsuperscript{89} See supra note 59 (discussing function of OECD); Rosenbloom & Langbein, supra note 25, at 367-68 (providing history of OECD efforts).


\textsuperscript{91} See 1992 OECD Model, supra note 28, 1 Tax Treaties (CCH) ¶ 191, at 10,503. For further discussion of the 1992 OECD Model Treaty, see Sasseville, supra note 59.

\textsuperscript{92} See Andersen, supra note 90, at 46 (discussing changes in 1992 OECD Model).

\textsuperscript{93} U.S. adamancy is not shared by all OECD delegations. Id. at 48. Opponents contend that most offensive treaty abuse situations can be neutralized by existing principles of \textit{frais legis}, substance-over-form, and beneficial ownership. Id. Furthermore, less egregious treaty abuse situations are not worth serious concern. Id.

\textsuperscript{94} Id. at 47-48.

\textsuperscript{95} See id. at 47 (describing prior methods as unsatisfactory).

\textsuperscript{96} See id. at 47-48 (recognizing significant U.S. impact on OECD's view of treaty shopping).
C. Unilateral Override: Alternative to Bilateral Tax Treaties

In the United States, a conflict exists between the power of the U.S. Congress to override treaty obligations through unilateral legislation and the obligation of the U.S. government to adhere to negotiated agreements with its trade partners.97 The U.S. Supreme Court has interpreted the U.S. Constitution98 to mean that equivalent weight should be given to the legal authority of tax treaties and federal statutes.99 If a conflict arises between a statute and a treaty provision, accepted cannons of construction defer to the one passed most recently.100 The willingness of the U.S. Congress to resolve the treaty shopping predicament through unilateral legislation influenced the Dutch government's decision to engage in meaningful negotiations with the United States.101

1. Congress Adopts a "Qualified Resident" Requirement

The U.S. Tax Reform Act of 1986 (the "TRA '86")102

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97. See Belotsky, supra note 6, at 64-65 (surveying treaty process in United States). Senator Robert Dole voiced concern with this inherent conflict when he commented that "as the United States tax treaty network grows and as tax treaties become more detailed and complex, this concern regarding the possible conflicts between the tax legislative process and the tax treaty process can only increase." Dole Comments on Pending Tax Treaties, 13 Tax Notes 1005 (1981).

98. See U.S. Const. art. VI, § 2. Section 2 of the U.S. Constitution states that the "[i]laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land ... ." Id.

99. See, e.g., Reid v. Covert, 354 U.S. 1, 18 (1957); Whitney v. Robertson, 124 U.S. 190, 194-95 (1888). Section 7852(d)(1) of the Internal Revenue Code states: "For purposes of determining the relationship between a provision of a treaty and any law of the United States affecting revenue, neither the treaty nor the law shall have preferential status by reason of its being a treaty or law." I.R.C. § 7852(d)(1).

100. Whitney, 124 U.S. at 194 (holding "the one last in date will control the other ... ."); Belotsky, supra note 6, at 65.


Id.
demonstrated Congress' initiative to override those bilateral treaties that engendered abusive treaty violations.\textsuperscript{108} TRA '86 instituted section 884 of the Internal Revenue Code (the "I.R.C.").\textsuperscript{104} an innovative branch profits tax, in an attempt to equalize the tax treatment of domestic subsidiaries and branches of non-U.S. corporations.\textsuperscript{105} Section 884(e) of the I.R.C. seeks to curb treaty shopping by explicitly confining treaty benefits to qualified residents\textsuperscript{106} of U.S. treaty partners.\textsuperscript{107} In addition, the Secretary of the U.S. Treasury De-

\begin{itemize}
  \item \textsuperscript{103} See Doernberg, supra note 12, at 173 (citing pressure placed on U.S. Congress to control unwieldy budget deficit as principal reason for enactment of TRA '86). Congress "intended the Act to override conflicting provisions in U.S. treaties." Explanation, supra note 102, at 1038.
  \item \textsuperscript{104} See I.R.C. § 884. The branch profits tax applies a 30% rate, notwithstanding any prohibition or limitation in a U.S. tax treaty. I.R.C. § 884(a).
  \item \textsuperscript{105} See Gustafson & Pugh, supra note 1, at 142-44 (discussing branch profits tax); Doernberg, supra note 12, at 173 (noting pressure on U.S. Congress to increase government revenues). The branch profits tax is "applied to a base intended to be equivalent to the amount which could have been distributed as a dividend by a hypothetical U.S. subsidiary of the foreign corporation whose only income, assets and liabilities are those of the U.S. business of the foreign corporation . . . ." Fred Feingold & David M. Rozen, New Regime of Branch Level Taxation Now Imposed on Certain Foreign Corporations, 66 J. Tax'n 2, 2 (1987); see I.R.C. § 884(e)(3) (taxing "dividend equivalent amount"). For further discussion of the branch profits tax, see Peter H. Blessing, The Branch Tax, 40 Tax Law. 587 (1987). The objective of the branch profits tax was analogous to the 30% tax on dividend distributions from domestic corporations to non-resident investors. Doernberg, supra note 12, at 178-79. See I.R.C. §§ 861(a)(2)(A), 871(a).
  \item \textsuperscript{106} See I.R.C. § 884(e)(1) stating that "[n]o treaty between the United States and a foreign country shall exempt any foreign corporation from the tax imposed . . . unless—(A) such treaty is an income tax treaty, and (B) such foreign corporation is a qualified resident of such foreign country") Section 884 of the I.R.C. establishes whether a corporation is a qualified resident. I.R.C. § 884(e)(4). The tests include:
  \begin{enumerate}
    \item 50% foreign ownership test or 50% percent base erosion (conduit) test. I.R.C. § 884(e)(4)(A); see also Treas. Reg. §§ 1.884-5(a)(1), (b)(1), (c).
    \item Stock of company, or stock of parent company, is primarily and regularly traded on an established securities market. I.R.C. § 884(e)(4)(B), (C); see also Treas. Reg. §§ 1.884-5(a)(2), (d)(1).
    \item Non-U.S. corporation is engaged in active conduct of business in residence-country, has a substantial presence in residence-country, and notwithstanding the exception for interest received, the U.S. business is an integral part of an active business conducted in the residence-country. Treas. Reg. §§ 1.884-5(a)(3), (e).
    \item Ruling by the Secretary of the U.S. Treasury that the corporation is a qualified resident. I.R.C. § 884(e)(4)(D); see also Treas. Reg. §§ 1.884-5(a)(4), (f).
  \end{enumerate}
  The first test requires that a taxpayer meet either the foreign ownership or the base erosion test. I.R.C. § 884(e)(4)(A)(i), (ii). But see supra notes 79, 81 and accompanying text (requiring that both tests be satisfied under 1981 U.S. Model Treaty).
  \item \textsuperscript{107} I.R.C. § 884(e)(1)(A); see Alan S. Lederman & Bobbe Hirsh, IRS Uses Expanded Conduit Principle to Limit Treaty Shopping, 76 J. Tax'n 170, 171 (1992) (discussing

demonstrated Congress' initiative to override those bilateral treaties that engendered abusive treaty violations.\textsuperscript{108} TRA '86 instituted section 884 of the Internal Revenue Code (the "I.R.C.").\textsuperscript{104} an innovative branch profits tax, in an attempt to equalize the tax treatment of domestic subsidiaries and branches of non-U.S. corporations.\textsuperscript{105} Section 884(e) of the I.R.C. seeks to curb treaty shopping by explicitly confining treaty benefits to qualified residents\textsuperscript{106} of U.S. treaty partners.\textsuperscript{107} In addition, the Secretary of the U.S. Treasury De-

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    \item Stock of company, or stock of parent company, is primarily and regularly traded on an established securities market. I.R.C. § 884(e)(4)(B), (C); see also Treas. Reg. §§ 1.884-5(a)(2), (d)(1).
    \item Non-U.S. corporation is engaged in active conduct of business in residence-country, has a substantial presence in residence-country, and notwithstanding the exception for interest received, the U.S. business is an integral part of an active business conducted in the residence-country. Treas. Reg. §§ 1.884-5(a)(3), (e).
    \item Ruling by the Secretary of the U.S. Treasury that the corporation is a qualified resident. I.R.C. § 884(e)(4)(D); see also Treas. Reg. §§ 1.884-5(a)(4), (f).
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  \item \textsuperscript{107} I.R.C. § 884(e)(1)(A); see Alan S. Lederman & Bobbe Hirsh, IRS Uses Expanded Conduit Principle to Limit Treaty Shopping, 76 J. Tax'n 170, 171 (1992) (discussing
partment is empowered, under appropriate circumstances, to exempt third-country corporations from the residency qualifications. Section 884(e) of the I.R.C. and the correlative Treasury Regulations, in contrast to the sparse explanatory language offered in preceding treaties, enhanced the utility of the anti-treaty shopping provision and served as the framework for future U.S. bilateral tax conventions.

Despite this affirmation, section 884 potentially violates U.S. tax treaties because non-U.S. corporations, unlike their U.S. counterparts, are subject to a branch profits tax on their earnings. U.S. tax conventions purposely include non-discrimination clauses to ensure that the United States does not tax enti-

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108. I.R.C. § 884(e)(4)(D). Eight factors that the Commissioner of the I.R.S. may take into consideration when determining whether a non-U.S. corporation is a qualified resident are: (1) Business reasons for establishing and maintaining corporation; (2) Date of incorporation compared to date that applicable U.S. bilateral treaty was entered; (3) Continuity of the historical business and ownership; (4) Extent to which the corporation satisfies one or more of the tests of section 884; (5) Extent to which U.S. trade or business is dependent on capital, assets, or personnel of the company; (6) Whether the company is a recipient of special tax benefits in the residence-country; (7) Whether the corporation is a member of an affiliated group; and (8) Extent to which the corporation would be entitled to comparable treaty benefits with respect to income tax treaty that would apply to that corporation if it had been incorporated in the country or countries of residence of the majority of its shareholders. Treas. Reg. § 1.884-5(f)(2)(i)-(viii).

109. See supra notes 77, 88 and accompanying text (attributing ineffectiveness, in part, to limited guidelines).

110. See Morrison & Bennett, supra note 15, at 332 (discussing substantial impact on U.S. bilateral tax accords).

111. See supra note 106 (discussing override of U.S. treaties unless corporation is qualified resident).

112. See Doernberg, supra note 12, at 180 (discussing Congress' intent to substitute branch tax for second-level withholding tax imposed on non-U.S. shareholders of U.S. corporations). Congress' purpose was to equalize the tax treatment of a non-U.S. corporation directly conducting a U.S. trade or business with the treatment of a U.S. subsidiary conducting such trade or business. Id. The U.S. Congress presumed that "a branch profits tax does not unfairly discriminate against foreign corporations because it treats foreign corporations and their shareholders together no worse than U.S. corporations and their shareholders . . . ." Explanations, supra note 102, at 1038.

113. See, e.g., 1981 U.S. Model Treaty, supra note 8, art. 24, 1 Tax Treaties (CCH) ¶ 211, at 10,582. Article 24 of the 1981 U.S. Model Treaty, entitled "Non-Discrimination," provides:

   Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements
ties from other countries more severely than its own nationals.\textsuperscript{114} Congress acknowledged the incongruity between section 884 and U.S. treaties, declining to abrogate existing tax treaties outright.\textsuperscript{115} Furthermore, the I.R.C. was amended in 1988 to recognize the IRS' inclination towards honoring international tax agreements.\textsuperscript{116} Notwithstanding this recognition, the annulment of existing bilateral conventions, though permissible under U.S. domestic law,\textsuperscript{117} constitutes an infraction of international law under the Vienna Convention on the Law of Treaties.\textsuperscript{118}


\textsuperscript{115} \textit{Explanations}, \textit{supra} note 102, at 1038. Congress' hesitation was manifest when it declared that it "generally did not intend to override U.S. income tax treaty obligations that arguably prohibit imposition of the branch profits tax. . . . Congress adopted this position, however, only on the understanding that the Treasury Department will renegotiate outstanding treaties that prohibit imposition of the tax." \textit{Id.} Congress' position was prudent. Doernberg, \textit{supra} note 12, at 180-81 (discussing unsubstantiated assumption by Congress that branch profits tax and secondary tax on dividend distributions to U.S. investors are equivalents).

\textsuperscript{116} \textit{See} I.R.C. § 894. This section states that "[t]he provisions of this title shall be applied to any taxpayer with due regard to any treaty obligation of the United States which applies to such taxpayer." \textit{Id.}

\textsuperscript{117} \textit{See supra} note 100 and accompanying text (noting that weight is given to more recent provision).

2. The Rostenkowski Bill: An Unsuccessful Attempt to Revise TRA '86

On May 28, 1992, Congressmen Rostenkowski [D-IL] and Gradison [R-OH] introduced House Bill 5270 (the "Rostenkowski Bill") to the Committee on Ways and Means to amend TRA '86.119 The Rostenkowski Bill proposed to curtail treaty abuse by repudiating treaty benefits granted to third-country residents subject to significantly lower taxes.120 House Bill 5270 imposed a narrow qualified resident requirement that did not include an active business test.121 Though eventually vetoed, the Rostenkowski Bill illustrates a plausible approach by the U.S. Congress that would reduce incidents of treaty shopping by abrogating U.S. tax treaties in force.122

D. U.S.-German Limitation on Benefits Provision: Precursor to the U.S.-Dutch Negotiations

Model \textsuperscript{124} and the OECD Model, \textsuperscript{125} was envisioned as the archetype for future negotiations. \textsuperscript{126} The qualified residence rules detailed in the U.S. branch profits tax \textsuperscript{127} noticeably influenced the limitation on benefits provision contained in Article 28 of the U.S.-F.R.G. Treaty. \textsuperscript{128} This provision controls the issuance of tax benefits to the intended recipients and prevents the extension to non-residents who cannot establish a substantial business in, or business nexus with, the intermediary treaty partner. \textsuperscript{129}

The first of the four paragraphs of Article 28 states alternative residency criterion, any one of which entitles conferment of benefits in the source-country. \textsuperscript{130} This provision articulates that an entity, other than a party who automatically qualifies, \textsuperscript{131} is not entitled to the benefits of the U.S.-F.R.G. Treaty unless that entity satisfies either an active business test, \textsuperscript{132} a coextensive foreign

\textsuperscript{124} See supra notes 79-88 and accompanying text (discussing 1981 U.S. Model Treaty). \\
\textsuperscript{125} See supra notes 89-96 and accompanying text (discussing OECD Model Treaty). \\
\textsuperscript{127} See supra notes 106, 108 and accompanying text (discussing rules under TRA '86). \\
\textsuperscript{128} See U.S.-F.R.G. Treaty, supra note 123, art. 28, S. Treaty Doc. No. 10, at 73-75, 2 Tax Treaties (CCH) ¶ 3249.57, at 28,166. \\
\textsuperscript{129} Id. \\
\textsuperscript{130} See id. art. 28, ¶ 1, S. Treaty Doc. No. 10, at 73-74, 2 Tax Treaties (CCH) ¶ 3249.57, at 28,166 (containing six subparagraphs that provide tests to determine residency). \\
\textsuperscript{131} See id. art. 28, ¶ 1(a), (b), S. Treaty Doc. No. 10, at 73, 2 Tax Treaties (CCH) ¶ 3249.57, at 28,166 (exempting individual, contracting nation, or political subdivision or local authority thereof from residency requirements). \\
\textsuperscript{132} Id. art. 28, ¶ 1(c), S. Treaty Doc. No. 10, at 73, 2 Tax Treaties (CCH) ¶ 3249.57, at 28,166. A company satisfies the active business test if “engaged in the active conduct of a trade or business in the first-mentioned Contracting State . . . . and the income derived from the other Contracting State is derived in connection with, or is incidental to, that trade or business.” Id. This subjective test can be traced back to the 1981 U.S. Model which denied treaty benefits if the entity was primarily interested in their procurement. See supra note 87 and accompanying text (discussing rule that broadly examined principal purpose of entity’s operations). In contrast, the U.S.-F.R.G. Treaty contains a more precise test. See U.S.-F.R.G. Treaty, supra note 123, art. 28, ¶
ownership and base erosion test,\textsuperscript{133} or a public company test.\textsuperscript{134} Unlike the 1981 U.S. Model Treaty\textsuperscript{135} and the U.S.-Finland Treaty,\textsuperscript{136} a company that fails to meet any of the aforementioned requirements can still seek recourse via a competent authority of the State in which the income in question arises.\textsuperscript{137}

\textsuperscript{133} U.S.-F.R.G. Treaty, supra note 123, art. 28, \textsection 1(e), S. TREATY Doc. No. 10, at 73-74, 2 Tax Treaties (CCH) \textsection 3249.57, at 28,166. The foreign ownership test and base erosion test provide:

e) aa) a person, more than 50 percent of the beneficial interest in which (or in the case of a company, more than 50 percent of the number of shares of each class of whose shares) is owned, directly or indirectly, by persons entitled to benefits of this Convention under subparagraphs (a), (b), (d), or (f) or who are citizens of the United States; and

bb) a person, more than 50 percent of the gross income of which is not used, directly or indirectly, to meet liabilities (including liabilities for interest or royalties) to persons not entitled to benefits of this Convention under subparagraphs (a), (b), (d), or (f) or who are not citizens of the United States . . .

\textit{Id.} This section is similar to the 1981 U.S. Model test, however more closely resembles section 884 of the I.R.C. by lowering the qualifying percentage in paragraph 1(e)(aa) from 75\% to 50\%. See supra note 79 (stating U.S. Model test); supra note 106 (presenting rules of branch profits tax).

\textsuperscript{134} U.S.-F.R.G. Treaty, supra note 123, art. 28, \textsection 1(d), 3(a)-(c), S. TREATY Doc. No. 10, at 73-74, 2 Tax Treaties (CCH) \textsection 3249.57, at 28,166. This test states:

1. A person . . . shall be entitled . . . to all the benefits . . . if such person is:

\ldots

d) a company in whose principal class of shares there is substantial and regular trading on a recognized stock exchange;

\ldots

3. For the purposes of paragraph 1, the term "recognized stock exchange" means:

a) the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for purposes of the Securities Exchange Act of 1934;

b) any German Stock exchange on which registered dealings in shares take place;

c) any other stock exchange agreed upon by the competent authorities of the Contracting States.

\textit{Id.}

\textsuperscript{135} See supra note 79 (lacking discretionary rule empowering competent authority in 1981 U.S. Model Treaty).

\textsuperscript{136} See supra note 70 (lacking discretionary rule in U.S.-Finland Treaty).

\textsuperscript{137} See U.S.-F.R.G. Treaty, supra note 123, art. 28, \textsection 2, S. TREATY Doc. No. 10, at
Though a considerable advancement in the limitation on benefits provision, the enactment of Article 28 ignited a controversy over whether the U.S.-F.R.G. Treaty conflicts with the Treaty of Rome. An action for breach of the Treaty of Rome may exist because U.S.-F.R.G. Treaty benefits are denied to European Community ("EC") members on the basis of their nationality. The U.S.-F.R.G. Memorandum of Understanding ("MOU") and the U.S. Senate Report on the U.S.-F.R.G. Treaty attempted to mitigate German concerns over conflicts involving a potential breach of the Treaty of Rome and an eventual

74. 2 Tax Treaties (CCH) ¶ 3249.57, at 28,166; supra note 108 and accompanying text (discussing discretionary power of Secretary of the U.S. Treasury Department under section 884 of I.R.C.).


139. See EEC Treaty, supra note 138, art. 67, ¶ 1, 298 U.N.T.S. at 42. Article 67 of the EEC Treaty states:

Member States shall, in the course of the transitional period and to the extent necessary for the proper functioning of the Common Market, progressively abolish as between themselves restrictions on the movement of capital belonging to persons resident in Member States and also any discriminatory treatment based on the nationality or on the place of residence of the parties or on the place in which such capital is invested.

Id.; see Federation of Netherlands Industry (VNO')/Baker & McKenzie Seminar, in The 1992 United States-Netherlands Tax Convention, supra note 8, at 92, 108 [hereinafter Seminar] (discussing possible breach); Reinhard Pöllath, Investing in Germany Under the New U.S.-German Tax Treaty, 2 J. Int'l Tax'n 175, 176 (1991) (presenting potential scenario of German company, with majority of non-German shareholders resident in other EC countries, not obtaining benefits under U.S.-F.R.G. Treaty). A citizen of a EC member state may initiate an action for breach either in the German courts or by asking the European Commission to commence an infringement procedure under Article 169 of the Treaty of Rome. See EEC Treaty, supra note 138, art. 169, 298 U.N.T.S. at 75 (stating that "[i]f the Commission considers that a Member State has failed to fulfil any of its obligations under this Treaty, it shall give a reasoned opinion on the matter . . . "); Seminar, supra, at 108 (discussing French company's filing of complaint with European Commission).

140. See Understanding Regarding the Scope of the Limitation on Benefits Article
override by U.S. legislation.\textsuperscript{141}

The U.S.-F.R.G. framework was instrumental in the ensuing U.S.-Dutch negotiations.\textsuperscript{142} The U.S.-Dutch delegations readily adopted Article 28 of the U.S.-F.R.G. Treaty,\textsuperscript{143} liberalizing and augmenting its requirements, in order to revamp the 1948 Treaty.\textsuperscript{144} Ultimately, the limitation on benefits provision in the U.S.-Netherlands Treaty mollified both the Dutch concern that their businesses qualify under the determinable rules and the U.S. resolve to thwart treaty shopping.\textsuperscript{145}

\textbf{II. THE U.S.-NETHERLANDS LIMITATION ON BENEFITS PROVISION}

The United States and the Netherlands successfully mitigated the concerns of their two divergent tax policies,\textsuperscript{146} signing in the Convention Between the Federal Republic of Germany and the United States of America, S. Treaty Doc. No. 10, 101st Cong., 2d Sess. 3 (1990) [hereinafter U.S.-F.R.G. Understanding]. The U.S.-F.R.G. MOU specifically provides that "[t]he discretionary authority granted to the competent authorities . . . should be exercised with particular cognizance of, the developments in, and objectives of, international economic integration, such as that between the member countries of the European Communities and between the United States and Canada." \textit{Id.} at 9.

\textsuperscript{141} U.S.-F.R.G. Report, \textit{supra} note 132, 2 Tax Treaties (CCH) ¶ 3256, at 28,296-97. The Senate Report on the U.S.-F.R.G. Treaty states that "[i]t appears that any corporation that would satisfy the limitation on benefits article of the proposed treaty would generally also meet the definition of 'qualified resident' for branch profits tax purposes in the Code." \textit{Id.}

\textsuperscript{142} Bennett & Morrison, \textit{supra} note 8, at 51 (describing prior negotiations as "desultory and fitful"). The limited progress in treaty negotiations was attributed by some to a belief that the Netherlands itself derived a benefit from third-country residents' use of the 1948 Treaty. U.S.-NETH. REPORT, \textit{supra} note 13, at 18. The U.S.-Dutch talks intensified after Germany agreed to a comprehensive anti-treaty shopping provision with the United States. Bennett & Morrison, \textit{supra} note 8, at 50-51.

\textsuperscript{143} Bennett & Morrison, \textit{supra} note 8, at 52 (noting overall structure of U.S.-Netherlands Treaty "mirrors" U.S.-F.R.G. provision). \textit{But see} Eilers & Brügmann, \textit{supra} note 126, at 20 (stating that Article 28 of U.S.-F.R.G. Treaty "should neither serve as a model for fashioning a Community standard nor as a model for German treaty policy).\textsuperscript{144}

\textsuperscript{144} Joseph DeCarlo, Jr., et. al., \textit{An Overview of the Limitation on Benefits Article of the New Netherlands-U.S. Income Tax Convention}, 22 Tax Mgmt. Int'l J. 271, 271 (1993). Due to the variances between the economies of the Netherlands and Germany, the more "rigorous" German provision would have been unacceptable to the Dutch government. \textit{Id.}; \textit{see} Bennett & Morrison, \textit{supra} note 8, at 51 (discussing need to further liberalize and affix immense quantity of additional detail to tests in U.S.-F.R.G. Treaty).

\textsuperscript{145} \textit{See} DeCarlo, \textit{supra} note 144, at 271.

what has been labeled "the single most important step required to improve the U.S. treaty network." Article 26 of the U.S.-Netherlands Treaty, unlike prior U.S. tax conventions, extends treaty benefits to third-country residents. The length and complexity of Article 26 supersedes the detail incorporated unless proven that entity is not entitled to such benefits. The narrower U.S. standard mandates a sufficient nexus. See id. (requiring demonstration that entity is qualified resident to obtain benefits). The theory of taxation, in the Netherlands, is based on the capital import neutrality principle, whereas the U.S. view is based on the capital export neutrality precept. See de Hosson, supra note 17, 1 at 1 (discussing other discrepancies, such as country size, transfer pricing methods, and balance between treaties and domestic law); Frank van Brunschot & Stef van Weeghel, Netherlands-United States: The New Tax Convention, 33 EUR. TAX'N 191, 202 (1993) (discussing "open and very much internationally oriented economy" of Netherlands).

147. Bennett & Morrison, supra note 8, at 3. For further discussion of the limitation on benefits provision in the U.S.-Netherlands Treaty, see Goossen, supra note 30; Philip T. Kaplan, Treaty Shopping Under the New U.S.-Netherlands Treaty, 47 BULL. FOR INT'L FISCAL DOCUMENTATION 175 (1993); Spector, supra note 48.


149. See van Brunschot & van Weeghel, supra note 146, at 206 (discussing grant of derivative benefits to residents of EC nations).

150. Bennett & Morrison, supra note 8, at 51. The Convention totals 100 pages of typescript and Article 26 consumes 23 pages of that text. Id. In addition, the Convention contains 19 more pages of explanation in the U.S.-Dutch MOU. Id. Sixteen of the Understanding's 30 articles are devoted to the limitation on benefits provision. See Understanding Regarding the Convention between the United States of America and the Kingdom of the Netherlands for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Dec. 18, 1992, U.S.-Neth., reprinted in 2 Tax Treaties (CCH) ¶ 6113, at 36,435 [hereinafter U.S.-Neth. Understanding].

151. See DeCarlo, supra note 144, at 272 (attributing complexity to numerous qualifications, exceptions, and modifications, as well as abundant definitions and other cross-references); Kerry L. Plutte, The New Dutch Treat: Are You Ready to Pay Your Share?, J. EUR. BUS., May-June 1993, at 12 (noting that Dutch holding companies must satisfy complex, restrictive, and unclear tests); Edward Troup, Of Limited Benefit: Article 26 of the New U.S./Netherlands Double Tax Treaty Considered, 3 BRIT. TAX REV. 97, 98 (1993) (noting that exodus from single page test was accomplished in "spectacular fashion").
rated into most tax statutes. This limitation on benefits provision embodies both the U.S. desire to combat treaty shopping and the Dutch apprehension that a revised provision would have an adverse impact upon a substantial segment of their economy.

A. Safe Harbors Provided Under Objective Tests

The technically elaborate Convention proffers taxpayers, courts, administrative bodies, and prospective U.S. treaty signatories an opportunity to delve into a limitation on benefits provision that clarifies a developing body of law. Article 26 represents a new level of sophistication in international tax treaties. This provision, similar to other limitation on benefits articles, restricts the eligibility for treaty benefits to bona fide residents.

Dutch and American entities that fit into one of the self-executing objective tests will be accorded treaty benefits. Non-qualifying entities will be forced to find favor with the competent tax authority of the source-country. Analogous to the U.S.-F.R.G. Treaty, benefits are allowed under the Convention if the resident is an individual, a Contracting State, a political subdivision, a local authority, or if the resident is a not-for-

153. See Bennett & Morrison, supra note 8, at 51 (describing language as "turgid, mind-numbing prose"). The provision’s intricacy necessitates its own glossary. Id.; see U.S.-Neth. Treaty, supra note 18, art. 26, ¶ 8, S. TREATY Doc. No. 6, at 76-82, 32 I.L.M. at 494-96.
154. See Bennett & Morrison, supra note 8, at 52 (discussing U.S.-Dutch solution to "very nettlesome issue").
155. See supra note 19 (discussing flexible and predictable application for bona fide residents of Contracting States).
157. See U.S.-NETH. REPORT, supra note 13, at 19 (stating that “[b]enefits are bestowed only upon those treaty country residents with a sufficient additional nexus, beyond simple residence, to the treaty country”).
158. See Bennett & Morrison, supra note 8, at 56 (discussing objective rules).
160. See supra note 131 and accompanying text (discussing qualified residents under U.S.-F.R.G. Treaty).
162. Id. art. 26, ¶ 1(b), S. TREATY Doc. No. 6, at 60, 32 I.L.M. at 487.
profit, tax exempt organization that also satisfies an ownership test. The remaining entities, including Dutch holding companies, must either: (1) satisfy a publicly traded test; (2) satisfy a test for subsidiaries of public companies; (3) hold more than a fifty percent ownership stake and satisfy a base erosion test; (4) conduct an active trade or business; or (5) satisfy a headquarters test.

1. Publicly Traded Entities

A public company is entitled to treaty benefits if a sufficient number of that company’s shares are traded actively enough on an acceptable stock exchange. Although similar to the language in paragraph 1(d) of the U.S.-F.R.G. Treaty, the Convention’s public company test more closely resembles section 884 of the I.R.C. Under the U.S.-Netherlands Treaty, an entity need only rebut evidence that it has engaged in a pattern of trading.

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163. Id. art. 26, ¶ 1(e), S. Treaty Doc. No. 6, at 62, 32 I.L.M. at 487-88.
164. See U.S.-NETH. REPORT, supra note 13, at 106-21 (describing objective tests of Convention).
165. U.S.-Neth. Treaty, supra note 18, art. 26, ¶ 1(c)(i), S. TREATY DOC. NO. 6, at 60, 32 I.L.M. at 487. A company is granted treaty benefits if “the principal class of its shares is listed on a recognized stock exchange located in either of the States and is substantially and regularly traded on one or more recognized stock exchanges . . . .” Id. For a detailed examination of the U.S-Dutch public company test, see Bennett & Morrison, supra note 8, at 56-57 (commenting that most public companies will easily qualify under this test); DeCarlo, supra note 144, at 274-75 (labeling this test as more detailed and specific than comparable tests in previous provisions).
168. See U.S.-Neth. Understanding, supra note 150, art. XXIV, 2 Tax Treaties (CCH) ¶ 6113, at 36,444. Article 24 of the U.S-Dutch MOU states that an entity “need not prove that it has not engaged in, but may need to rebut evidence that it has engaged in, a pattern of trades on a recognized stock exchange in order to meet these tests.” Id.
169. See U.S.-Neth. Treaty, supra note 18, art. 26, ¶ 8(f), S. TREATY DOC. NO. 6, at 79-80, 32 I.L.M. at 495. This section states:

f) The shares in a class of shares are considered to be substantially and regularly traded on one or more recognized stock exchanges in a taxable year if:

i) trades in such class are effected on one or more of such stock exchanges other than in de minimis quantities during every month; and

ii) the aggregate number of shares of that class traded on such stock exchange or exchanges during the previous taxable year is at least six percent of the average number of shares outstanding in that class during that taxable year.
Article 26(8)(a) of the Convention, mandating that the class of shares merely represent a majority of the voting power and value of the company, liberalizes the eighty percent requirement under the branch profits tax. However, a literal interpretation of Article 26(8)(a) and (b) adversely affects Dutch public companies because their depository receipts cannot represent a majority of the voting shares. Finally, cognizant of the participation of the Netherlands in the EC, the U.S.-Dutch MOU adds the stock exchanges of Frankfurt, London, and Paris to the list of permissible stock exchanges under subparagraph 8(d)(iv) of Article 26.

2. Subsidiaries of Public Companies

The test for subsidiaries, under Article 26, is considerably

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For purposes of this subparagraph, any pattern of trades conducted in order to meet the "substantial and regular trading" tests will be disregarded.

Id. But see Treas. Reg. § 1.884-5(d)(4)(B)(2). The branch profits tax requires that at least 10% of the average number of shares outstanding in that class during the taxable year are traded. Id.

170. See U.S.-Neth. Treaty, supra note 18, art. 26, ¶ 8(a), S. TREATY Doc. No. 6, at 76-77, 32 I.L.M. at 494. This section provides:

The term "principal class of shares" is generally the ordinary or common shares of the company, provided that such class of shares represents the majority of the voting power and value of the company. When no single class of shares represents the majority of the voting power and value of the company, the "principal class of shares" is generally those classes that in the aggregate possess more than 50 percent of the voting power and value of the company.

Id.


172. See U.S.-Neth. Treaty, supra note 18, art. 26, ¶ 8(a), (b), S. TREATY Doc. No. 6, at 76-77, 32 I.L.M. at 494. Dutch companies are often owned by foundations ("strichtingen"), which issue depository receipts ("certificates"). DeCarlo, supra note 144, at 274. Under this scenario, the voting power is retained by the foundation, and the equitable interest in the shares is vested in the holder of the receipts. Id. Although the depository receipts are recognized as shares under Article 26(8)(b), this class of shares does not represent the majority of the voting power and value of the company as required under Article 26(8)(a). See U.S.-Neth. Treaty, supra note 18, art. 26, ¶ 8(a), S. TREATY Doc. No. 6, at 76-77, 32 I.L.M. at 494. The Convention's Agreed Minutes successfully remedied an inevitable predicament. See Sleurink, supra note 148, at 25 (noting that this uncertainty was removed by providing that holders of depository receipts or trust certificates will be considered to have voting power with respect to such shares).

173. See Sleurink & Andersen, supra note 20, at 212 (noting that this is first U.S. tax convention that accounts for EC membership).

174. U.S.-Neth. Understanding, supra note 150, art. XXII, 2 Tax Treaties (CCH) ¶ 6113, at 36,443 (noting that competent tax authorities may add or remove stock exchanges from list).
less stringent than analogous provisions in TRA '86\textsuperscript{175} and H.R. 5270.\textsuperscript{176} This relaxed test presents a two-part analysis that hinders clearly abusive situations.\textsuperscript{177} The first part applies to both Dutch and U.S. subsidiaries of publicly traded companies.\textsuperscript{178} The initial determination examines whether more than fifty percent of a subsidiary's stock is owned by five or fewer companies with residency in either the United States or the Netherlands.\textsuperscript{179} The second test, unique to this anti-treaty shopping provision, applies only to Dutch corporations and addresses Dutch membership in the EC.\textsuperscript{180} Ownership of the subsidiary by residents of the Netherlands must equal at least thirty percent.\textsuperscript{181} Further-

\begin{quotation}
\begin{itemize}
\item \textsuperscript{175} Treas. Reg. § 1.884-5(d)(1)(ii). A subsidiary, under the branch profits tax, is a qualified resident if:
\begin{itemize}
\item At least 90 percent of the total combined voting power of all classes of stock of such foreign corporation entitled to vote and at least 90 percent of the total value of the stock of such foreign corporation is owned . . . by a foreign corporation that is a resident of the same foreign country or a domestic corporation and the stock of such parent corporation is primarily and regularly traded on an established securities market in that foreign country or in the United States, or both.
\end{itemize}
\item \textsuperscript{176} See H.R. 5270, supra note 119, § 302, at 70. A subsidiary, under H.R. 5270, would qualify under one of three formidable tests. \textit{Id.} First, its interests “are primarily and regularly traded on an established securities market in such country . . . .” \textit{Id.} § 302(c)(3)(B)(i), at 72. Second, at least 50\% of the parent’s shareholders are residents of that country. \textit{Id.} § 302(c)(3)(A)(i), at 71. Finally, if the subsidiary is “wholly owned by another foreign entity which is organized in such foreign country and the interest in which is so traded” and it is not base eroding. \textit{Id.} § 302(c)(3)(A)(ii), (B)(ii), at 72.
\item \textsuperscript{177} See U.S.-Neth. Treaty, supra note 18, art. 26, ¶ 1(c)(ii)-(iv), S. TREATY Doc. No. 6, at 60-61, 32 I.L.M. at 487. The U.S.-Dutch compromise, between full and no application of the base erosion test to subsidiaries, is yet another factor that distinguishes the Convention from the U.S.-F.R.G. Treaty. See U.S.-F.R.G. Treaty, supra note 123, art. 28, S. TREATY Doc. No. 10, at 73-75, 2 Tax Treaties (CCH) ¶ 3249.57, at 28,166 (lacking subsidiary test).
\item \textsuperscript{178} See U.S.-Neth. Treaty, supra note 18, art. 26, ¶ 1(c)(ii), S. TREATY Doc. No. 6, at 60, 32 I.L.M. at 487.
\item \textsuperscript{179} \textit{Id.} art. 26, ¶ 1(c)(ii)(A), S. TREATY Doc. No. 6, at 60, 32 I.L.M. at 487. This section grants benefits if “more than 50 percent of the aggregate vote and value of all of [the company’s] shares is owned, directly or indirectly, by five or fewer companies which are resident of either State, the principal classes of the shares of which are listed and traded as described in subparagraph (c)(i) . . . .” \textit{Id.} All companies in the chain of ownership that are used to satisfy the ownership requirements of this subparagraph must meet the residency requirements. \textit{Id.} art. 26, ¶ 8(k), S. TREATY Doc. No. 6, at 81, 32 I.L.M. at 496.
\item \textsuperscript{180} \textit{Id.} art. 26, ¶ 1(c)(iii), S. TREATY Doc. No. 6, at 60-61, 32 I.L.M. at 487.
\item \textsuperscript{181} \textit{Id.} art. 26, ¶ 1(c)(iii)(A), S. TREATY Doc. No. 6, at 60-61, 32 I.L.M. at 487. This test requires that “at least 30 percent of the aggregate vote and value of all of [the
more, seventy percent or more of the aggregate vote and value of all shares must be controlled by residents of the United States or by EC members.\textsuperscript{182}

In addition to the elements set forth, neither the subsidiary nor the company, under either test, may constitute a conduit company.\textsuperscript{183} A conduit company, under paragraph 8(m) of Article 26, makes interest and royalty payments in excess of ninety percent of the aggregate receipts of such items during the same taxable year.\textsuperscript{184} However, benefits of the Convention will still be granted to a conduit company if it fulfills a diluted base erosion test as defined in paragraph 5(d).\textsuperscript{185}

Dutch company's] shares is owned, directly or indirectly, by five or fewer companies resident in the Netherlands, the principal classes of the shares of which are listed and traded as described in subparagraph (c)(i) . . . ." \textit{Id.}

182. \textit{Id.} art. 26, ¶ 1(c)(iii)(B), \textit{S. Treaty Doc. No.} 6, at 61, 32 I.L.M. at 487. This section requires that

[A]t least 70 percent of the aggregate vote and value of all of its shares owned, directly or indirectly, by five or fewer companies that are residents of the United States or of member states of the European Communities, the principal classes of shares of which are substantially and regularly traded on one or more recognized stock exchanges . . . .

\textit{Id.}

183. \textit{Id.} art. 26, ¶ 1(c)(ii)(B), (iii)(C), \textit{S. Treaty Doc. No.} 6, at 60-61, 32 I.L.M. at 487. Both sections state that the company cannot be a conduit company, as defined in subparagraph 8(m). \textit{Id.}

184. \textit{Id.} art. 26, ¶ 8(m), \textit{S. Treaty Doc. No.} 6, at 82, 32 I.L.M. at 496. This paragraph provides:

For purposes of subparagraph (1)(c)(ii)(B) and (1)(c)(iii)(C), the term "conduit company" means a company that makes payments of interest, royalties and any other payments included in the definition of deductible payments (as defined in subparagraph (5)(c)) in a taxable year in an amount equal to or greater than 90 percent of its aggregate receipts of such items during the same taxable year.

\textit{Id.} This test was most likely created to cover Dutch financing intermediaries. \textit{See} Spector, \textit{supra} note 48, at 165 (noting that bulk of income and expense for financing companies is interest and royalties). However, this test may cause unintended results if the interest and royalty expense is small in relation to the company's overall income and expense. \textit{See id.} (discussing that company with interest income of U.S.$1,000 and interest expense of U.S.$1,000, with no other deductible payments made or received, is a conduit company even if company has operating income of U.S.$1,000,000 for year). In addition, a bank or insurance company will be able to avoid the conduit test by showing that it is actively engaged in the conduct of its trade and is controlled by associated enterprises that are qualified persons. U.S.-Neth. Treaty, \textit{supra} note 18, art. 26, ¶ 8(m)(i), (ii), \textit{S. Treaty Doc. No.} 6, at 82, 32 I.L.M. at 496.

185. U.S.-Neth. Treaty, \textit{supra} note 18, art. 26, ¶ 1(c)(iv), \textit{S. Treaty Doc. No.} 6 at 61, 32 I.L.M. at 487. This section provides that "in the case of a conduit company (as defined in paragraph 8(m)) that satisfies the requirements of subparagraph (c)(ii)(A) or (c)(iii)(A) and (B), such company satisfies the conduit base reduction test set forth
3. Fifty Percent Ownership Test and Fifty Percent Base Erosion Test

The two-part test that appears in the U.S.-F.R.G. Treaty, the branch profits tax regulations, and H.R. 5270, emerges once again in Article 26. While leaving the ownership test virtually unchanged, the base erosion test receives three significant additions. First, in recognition of the increasing unity in the EC, the test permits a resident of the Netherlands to make deductible payments of less than seventy percent of gross income to non-qualified persons. However, if these payments are not made to qualified residents nor citizens of the EC, the distribution must be less than thirty percent of gross income. Second, the applicable gross income constitutes the greater of the gross income from the previous year or the average gross income over the previous four years. The final, and perhaps

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in paragraph 5(d)." Id.; see id. art. 26, ¶ 5(d), S. TREATY Doc. No. 6, at 74-75, 32 I.L.M. at 493 (counting only deductible payments made to associated enterprises and denying benefits only if tax burden in third-country is less than 50% of the rate in residence-state); Bennett & Morrison, supra note 8, at 59 (describing this special test as "quite watered down" in comparison to regular base erosion safe harbor).

186. See supra note 133 and accompanying text (noting that foreign ownership and base erosion test must be satisfied under U.S.-F.R.G. Treaty).

187. See supra note 106 (noting that section 884(e)(4)(A) of I.R.C. requires fulfillment of one of two tests).

188. See supra note 121 (discussing that entity, under H.R. 5270, must satisfy base erosion or foreign ownership rule).


190. Id. art. 26, ¶ 1(d)(i), S. TREATY Doc. No. 6, at 61-62, 32 I.L.M. at 487. A taxpayer meets the foreign ownership test, if "more than 50 percent of the beneficial interest in which (or, in the case of a company, more than 50 percent of the aggregate vote and value of all of its shares, and more than 50 percent of the shares of any "disproportionate class of shares") is owned, directly or indirectly, by qualified persons . . . ." Id.

191. Id. art. 26, ¶ 5(a), S. TREATY Doc. No. 6, at 73, 32 I.L.M. at 492. The basic base erosion test remains unaltered. Id. art. 26, ¶ 5(a)(i), S. TREATY Doc. No. 6, at 73, 32 I.L.M. at 492. See Goossen, supra note 30, at 45 (stating that base reduction test "has developed into the primary basis for the assumption of the treaty shopping motive . . . .").


193. Id. art. 26, ¶ 5(a)(ii)(B), S. TREATY Doc. No. 6, at 73, 32 I.L.M. at 492.

194. Id. art. 26, ¶ 5(b), S. TREATY Doc. No. 6, at 73-74, 32 I.L.M. at 492-93. Subparagraph 5(b) states that

[T]he term "gross income" means gross income for the first taxable year preceding the current taxable year; provided that the amount of gross income for the first taxable year preceding the current taxable year will be deemed to be
most notable, modification is that the deductible payments do not include arm's length payments for either the right to use tangible property in the ordinary course of business or remuneration at arm's length for services performed in the payer's country.\textsuperscript{195}

4. Active Trade or Business Test

An entity that fails to satisfy one of the safe harbors articulated in paragraph one of Article 26\textsuperscript{196} will next attempt to meet the active trade or business test.\textsuperscript{197} Under this complicated rule,\textsuperscript{198} the taxpayer must first be engaged in the active conduct of a trade or business in the residence country.\textsuperscript{199} This requirement may be satisfied by utilizing several attribution rules that include direct conduct, indirect conduct through a partnership, and indirect conduct through control of an entity.\textsuperscript{200} The last

\textsuperscript{195} Bennett & Morrison, \textit{supra} note 8, at 60; U.S.-Neth. Treaty, \textit{supra} note 18, art. 26, \textsection 5(c), S. Treaty Doc. No. 6, at 74, 32 I.L.M. at 493.

\textsuperscript{196} U.S.-Neth. Treaty, \textit{supra} note 18, art. 26, \textsection 1, S. Treaty Doc. No. 6, at 59-62, 32 I.L.M. at 486-88. These tests include the publicly traded, subsidiary, shareholder ownership, and base reduction. \textit{Id.}

\textsuperscript{197} \textit{Id.} art. 26, \textsection 2, S. Treaty Doc. No. 6, at 62-70, 32 I.L.M. at 488-91. Prior provisions contain a similar test. \textit{See supra} note 87 and accompanying text (addressing paragraph 2 of 1981 U.S. Model); \textit{supra} note 132 and accompanying text (discussing U.S.-F.R.G. test); \textit{supra} note 106 (discussing rule in branch profits tax).

\textsuperscript{198} See Bennett & Morrison, \textit{supra} note 8, at 60 (noting that this provision is by far most complex); Goossen, \textit{supra} note 30, at 45 (stating that test is "incredibly long and complex" and "Dutch and English texts seem to be contradictory"); van Brunschot & van Weeghel, \textit{supra} note 146, at 204 (describing wording of Convention as "mind-boggling complexity"). Articles 12 through 17 of the U.S.-Dutch MOU offer examples of these concepts. \textit{See U.S.-Neth. Understanding, supra} note 150, arts. XII-XVII, 2 Tax Treaties (CCH) \textsection 6113, at 36,438-41.

\textsuperscript{199} U.S.-Neth. Treaty, \textit{supra} note 18, art. 26, \textsection 2(a), S. Treaty Doc. No. 6, at 62, 32 I.L.M. at 488. The test initially provides:

A person resident in one of the States shall also be entitled to the benefits of this Convention with respect to income derived from the other State if such person is engaged in the active conduct of a trade or business in the first-mentioned-State (other than the business of making or managing investments, unless these activities are banking or insurance activities carried on by a bank or insurance company) . . . .

\textit{Id.}

\textsuperscript{200} \textit{Id.} art. 26, \textsection 2(e), S. Treaty Doc. No. 6, at 66-68, 32 I.L.M. at 489-90; \textit{see} Bennett & Morrison, \textit{supra} note 8, at 64 (describing attribution section as "one of the more practical aspects" of intricate test); Sleurink & Andersen, \textit{supra} note 20, at 217.
method includes upstream, \textsuperscript{201} downstream, \textsuperscript{202} lateral, \textsuperscript{203} or inward relationships. \textsuperscript{204} The U.S.-Netherlands Treaty strengthens the attribution concept alluded to in the second example of the U.S.-F.R.G. MOU. \textsuperscript{206}

In addition, the taxpayer must satisfy one of two tests. \textsuperscript{207} First, the income derived in the source-country must be connected, and the income producing activity substantial, to a trade or business in the residence-country. \textsuperscript{208} In contrast to the constrictions of TRA '86, \textsuperscript{209} the active trade or business test is relaxed by including activities that are part of or are complimentary to one another. \textsuperscript{210} Whether the income recipient's trade or

\begin{enumerate}
\item \textsuperscript{201} See U.S.-Neth. Treaty, supra note 18, art. 26, \textsuperscript{1} 2(e)(vi), S. Treaty Doc. No. 6, at 67, 32 I.L.M. at 490 (extending from person to controlling person). The group, limited to five persons, must be residents of either the Contracting States, EC, or an identified nation. See U.S.-Neth. Understanding, supra note 150, art. XVI, 2 Tax Treaties (CCH) \textsuperscript{1} 6113, at 36,440-41 (listing identified nations).
\item \textsuperscript{202} See U.S.-Neth. Treaty, supra note 18, art. 26, \textsuperscript{1} 2(e)(iii), (iv) S. Treaty Doc. No. 6, at 66, 32 I.L.M. at 489 (extending from person to another person controlled by first person).
\item \textsuperscript{203} See id. art. 26, \textsuperscript{1} 2(e)(vii), S. Treaty Doc. No. 6, at 67, 32 I.L.M. at 490 (extending to persons in common control).
\item \textsuperscript{204} See id. art. 26, \textsuperscript{1} 2(e)(v), S. Treaty Doc. No. 6, at 66-67, 32 I.L.M. at 489-90 (extending from consolidated group of companies to member of group).
\item \textsuperscript{205} See id. art. 26, \textsuperscript{1} 2(e), S. Treaty Doc. No. 6, at 66-68, 32 I.L.M. at 489-90 (requiring controlling beneficial interest to be held). A controlling beneficial interest is generally a beneficial interest, held directly or indirectly, representing more than 50% of the outstanding vote and value. Id. art. 26, \textsuperscript{1} 2(f), S. Treaty Doc. No. 6, at 68, 32 I.L.M. at 490. If a person maintains 50% or less of the value and voting power of a second person, then the second person's indirect ownership of a third person may not be utilized by the first person. Id. art. 26, \textsuperscript{1} 2(f)(i), S. Treaty Doc. No. 6, at 68, 32 I.L.M. at 490. In addition, a person must directly hold a beneficial interest of at least 10% in the third person to be considered part of a group that owns a controlling beneficial interest. Id. art. 26, \textsuperscript{1} 2(f)(ii), S. Treaty Doc. No. 6, at 68, 32 I.L.M. at 490.
\item \textsuperscript{206} See U.S.-F.R.G. Understanding, supra note 140, at 5 (stating that "[b]enefits are not denied merely because the income is earned by a German holding company and the relevant activity is carried on in Germany by a German subsidiary"); Bennett & Morrison, supra note 8, at 64 (discussing strengthened attribution concept in U.S.-Netherlands Treaty).
\item \textsuperscript{207} U.S.-Neth. Treaty, supra note 18, art. 26, \textsuperscript{1} 2(a)(i), (ii), S. Treaty Doc. No. 6, at 62-63, 32 I.L.M. at 488.
\item \textsuperscript{208} Id. art. 26, \textsuperscript{1} 2(a)(i), S. Treaty Doc. No. 6, at 62, 32 I.L.M. at 488. This test creates a dual requirement. See Sleurink & Anderson, supra note 20, at 218 (discussing integration and substantiality criteria).
\item \textsuperscript{209} See Treas. Reg. § 1.884-5(e)(1)(iii) (discussing "integral part" requirement). A business is an integral part if it comprises "in principal part, complementary and mutually interdependent steps . . . in the production and sale or lease of goods or in the provision of services." Treas. Reg. § 1.884-5(e)(4)(i).
\item \textsuperscript{210} See U.S.-Neth. Treaty, supra note 18, art. 26, \textsuperscript{1} 2(b), S. Treaty Doc. No. 6, at
business is substantial will be determined by analyzing the proportionate share of the activity in the source-country, the nature of the activities performed, and the relative contributions made in both countries.\footnote{211} An entity can include business conducted in other EC nations, if its Dutch activity exceeds fifteen percent of the assets, gross income, and payroll ratios in the entire EC.\footnote{212}

63, 32 I.L.M. at 488. Although the Convention does not clarify which tangential activities will qualify, the first three examples of the U.S.-F.R.G. MOU will provide guidance. \textit{See} U.S.-F.R.G. Understanding, \textit{supra} note 140, at 4-6. These examples, however, do not make reference to the 'complementary to' concept. \textit{Id.}

211. U.S.-Neth. Treaty, \textit{supra} note 18, art. 26, \textsection 2(c), \textit{S. Treaty Doc. No. 6}, at 63, 32 I.L.M. at 488. This general concept is too vague for taxpayers to apply with certainty. Goossen, \textit{supra} note 30, at 31. Therefore, the standard to determine whether the trade or business is substantial will be the Convention's detailed, three-factor safe harbor. U.S.-Neth. Treaty, \textit{supra} note 18, art. 26, \textsection 2(c), \textit{S. Treaty Doc. No. 6}, at 63-65, 32 I.L.M. at 488-89. The test provides:

[T]he trade or business of the income recipient will be deemed to be substantial if, for the preceding taxable year, the average of the ratios for the following three factors exceeds 10 percent (or in the case of a person electing to apply subparagraph (h), 60 percent) and each of the ratios exceeds 7.5 percent (or in the case of a person electing to apply subparagraph (h), 50 percent), provided that for any separate factor that does not meet the 7.5 percent test (or in the case of a person electing to apply subparagraph (h), the 50 percent test) in the first preceding taxable year the average of the ratios for that factor in the three preceding taxable years may be substituted:

i) the ratio of the value of assets used or held for use in the active conduct of the trade or business by the income recipient in the first-mentioned State (without regard to any assets attributed from a third state under subparagraph (h), except in the case of a person electing to apply subparagraph (h)) to all, or, as the case may be, the proportionate share of the value of such assets so used or held for use by the trade or business producing the income in the other State;

ii) the ratio of gross income derived from the active conduct of the trade or business by the income recipient in the first-mentioned State . . . to all, or, as the case may be, the proportionate share of the gross income so derived by the trade or business producing the income in the other State; and

iii) the ratio of the payroll expense of the trade or business for services performed within the first-mentioned State . . . to all, or, as the case may be, the proportionate share of the payroll expense of the trade or business for services performed in the other State.

\textit{Id.} In contrast, the test under the branch profits tax compares the value of the non-U.S. corporation to a worldwide aggregate. \textit{See} Treas. Reg. \textsection 1.884-5(e)(3) (1993).

212. U.S.-Neth. Treaty, \textit{supra} note 18, art. 26, \textsection 2(h), \textit{S. Treaty Doc. No. 6}, at 69-70, 32 I.L.M. at 490-91 (providing that Dutch business must exceed 15\% of assets, gross income, and payroll ratios). This election, however, is not overly beneficial. \textit{See id.} art. 26, \textsection 2(c), \textit{S. Treaty Doc. No. 6}, at 63-65, 32 I.L.M. at 488-89. The percentages in subparagraph (c) increase from 10\% to 60\% and from 7.5\% to 50\% when the election is taken, thereby tainting any advantage. \textit{See supra} note 211 (detailing applicable percentages when subparagraph (h) is applied). In addition, if a taxpayer elects subpara-
Alternatively, the income derived in the source-country must be incidental\textsuperscript{213} to the income derived in the residence-country.\textsuperscript{214}

5. Headquarters Test

The final objective test, unique to the Convention, confers treaty benefits to a company that functions as a headquarter company for a multinational corporate group.\textsuperscript{215} The test, imperative for many ordinary Dutch companies, will not extend to treaty shoppers operating through a Dutch holding company.\textsuperscript{216} A company with headquarters in the Netherlands will qualify if it provides both independent discretionary authority\textsuperscript{217} and a substantial part of the overall supervision and administration of operations\textsuperscript{218} in at least five countries.\textsuperscript{219} The headquarters cannot receive more than twenty-five percent of its gross income from

\footnotesize{graph (h), the income that is considered incidental cannot be "greater than four times the amount of income that would have been considered incidental to the trade or business actually conducted in the Netherlands." U.S.-Neth. Treaty, \textit{supra} note 18, art. 26, \textsection 2(d), S. TREATY Doc. No. 6, at 65, 32 I.L.M. at 489.}

\textsuperscript{213} U.S.-Neth. Treaty, \textit{supra} note 18, art. 26, \textsection 2(d), S. TREATY Doc. No. 6, at 65, 32 I.L.M. at 489. Income is incidental if the "production of such income facilitates the conduct of the trade or business . . . ." \textit{Id.} An example is the interest income earned from the investment of working capital. \textit{Id.; see U.S.-F.R.G. Understanding, supra} note 140, at 7-8 (providing illustration of incidental income); Bennett & Morrison, \textit{supra} note 8, at 62 (stating that "amount of income that can be considered 'incidental' is generally left to the amount of strain the word 'incidental' can withstand").

\textsuperscript{214} U.S.-Neth. Treaty, \textit{supra} note 18, art. 26, \textsection 2(a)(ii), S. TREATY Doc. No. 6, at 63, 32 I.L.M. at 488.

\textsuperscript{215} \textit{Id.} art. 26, \textsection 3, S. TREATY Doc. No. 6, at 70-71, 32 I.L.M. at 491-92.

\textsuperscript{216} See Bennett & Morrison, \textit{supra} note 8, at 65 (noting that even holding companies with substantial employees and some real management or financing activities will have difficulty qualifying under this test).

\textsuperscript{217} U.S.-Neth. Treaty, \textit{supra} note 18, art. 26, \textsection 3(e), S. TREATY Doc. No. 6, at 71, 32 I.L.M. at 491 (granting benefits if headquarter "has, and exercises, independent discretionary authority to carry out the functions").

\textsuperscript{218} \textit{Id.} art. 26, \textsection 3(a), S. TREATY Doc. No. 6, at 70, 32 I.L.M. at 491. Article 18 of the U.S.-Dutch MOU states that "a person will be considered a headquarters company if it performs a significant number of the following functions for the group: group financing (which cannot be its principal function), pricing, marketing, internal auditing, internal communications and management." U.S.-Neth. Understanding, \textit{supra} note 150, art. XVIII, 2 Tax Treaties (CCH) \textsection 6113, at 36,442 (noting list not intended to be exhaustive).

\textsuperscript{219} U.S.-Neth. Treaty, \textit{supra} note 18, art. 26, \textsection 3(b), S. TREATY Doc. No. 6, at 70-71, 32 I.L.M. at 491. The headquarter test applies if "the corporate group consists of corporations resident in, and engaged in an active business in, at least five countries, and the business activities carried on in each of the five countries (or five groupings of countries) generate at least 10 percent of the gross income of the group . . . ." \textit{Id.}
the other Contracting State. Furthermore, the business activities carried on in any country, other than the country of residence of the headquarter company, must generate less than fifty percent of the gross income of the group.

B. Circumscribed Derivative Benefits For Taxpayers

Uncharacteristic of U.S. bilateral tax conventions, the U.S.-Netherlands Treaty includes a limited derivative benefits provision. A Dutch company, controlled by a third-country resident, will be entitled to treaty benefits for a particular payment of income if equivalent treaty benefits for that distribution exist between the United States and the third-country. This narrow test applies only to dividends, branch tax, interest, and royalty items of Dutch companies. In addition, more than thirty percent of the aggregate vote and value of all shares must belong to qualified residents of the Netherlands, and more than seventy percent must belong to EC members. Finally, the company

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220. *Id.* art. 26, ¶ 3(d), S. TREATY Doc. No. 6, at 71, 32 I.L.M. at 491.
221. *Id.* art. 26, ¶ 3(c), S. TREATY Doc. No. 6, at 71, 32 I.L.M. at 491. The Dutch company meets this test "if the required ratios are met when averaging the gross income of the preceding four years." *Id.* art. 26, ¶ 3(g), S. TREATY Doc. No. 6, at 71, 32 I.L.M. at 491-92.
222. *Id.* art. 26, ¶ 4(a), S. TREATY Doc. No. 6, at 71-72, 32 I.L.M. at 492. The derivative concept appears in TRA '86 within the factors the Commissioner of the I.R.S. may take into consideration. *See supra* note 108 (listing factors). The regulations, pertaining to section 884(e)(4)(D) of the I.R.C., provide that to "[t]he extent to which the foreign corporation would be entitled to comparable treaty benefits with respect to all articles of an income tax treaty that would apply to that corporation if it had been incorporated in the country or countries of residence of the majority of its shareholders." Treas. Reg. § 1.884-5(f)(2)(viii).
223. *See Bennett & Morrison, supra* note 8, at 66 (discussing historical U.S. opposition to granting derivative benefits).
225. U.S.-Neth. Treaty, *supra* note 18, art. 26, ¶ 4(a) (i), S. TREATY Doc. No. 6, at 72, 32 I.L.M. at 492. This section, therefore, will not apply to a Dutch subsidiary that is wholly-owned by a third-country entity. Bennett & Morrison, *supra* note 8, at 67.
226. U.S.-Neth. Treaty, *supra* note 18, art. 26, ¶ 4(a) (ii), S. TREATY Doc. No. 6, at 72, 32 I.L.M. at 492. The test, however, is further limited by providing:

In determining whether, pursuant to subparagraph (a)(ii), a company's shares are owned by residents of member states of the European Communities, only those shares shall be considered which are held by persons that are residents of states with a comprehensive income tax Convention with the United States, as long as the particular dividend, profit or income subject to the branch tax, interest or royalty payment in respect of which treaty benefits
must satisfy the base reduction test described in paragraph five of Article 26.  

C. Safety-Valve Under Competent Authority Determination

Treaty benefits, otherwise denied under the objective tests, may still be elicited through the competent tax authority in the source-country. This vested discretionary power, present in H.R. 5270 and the U.S.-F.R.G. Treaty, was described in significant detail in the regulations pertaining to section 884(e)(4)(D) of the I.R.C. Although the U.S.-Dutch provision provides a haven for taxpayers, the permissive language enables U.S. courts to find no abuse of the IRS' discretion even when the taxpayer does not possess a tainted motive.

Articles 19, 20, and 21 of the U.S.-Dutch MOU enumerate relevant factors for the tax authorities to consider when determining whether to grant benefits of the Convention. Article 19 details six factors to be used by the competent authority when determining whether the establishment, acquisition, or maintenance of a corporation has or had as one of its principal purposes the obtaining of benefits under the Convention. These factors are claimed would be subject to a rate of tax under that Convention that is no less favorable than the rate of tax applicable to such company under Articles 10 (Dividends), 11 (Branch Tax), 12 (Interest) or 13 (Royalties) of this Convention.

Id. art. 26, ¶ 4(b), S. Treaty Doc. No. 6, at 72-73, 32 I.L.M. at 492.

227. Id. art. 26, ¶ (4)(a)(iii), S. Treaty Doc. No. 6, at 72, 32 I.L.M. at 492.

228. Id. art. 26, ¶ 7, S. Treaty Doc. No. 6, at 76, 32 I.L.M. at 493-94 (noting that competent tax authorities in both nations most confer before treaty benefits are denied).

229. See H.R. 5270, supra note 119, § 302(c)(3)(D), at 73 (discussing authority of Secretary of U.S. Treasury).

230. See supra note 157 and accompanying text (recognizing discretionary power of competent tax authority).

231. See supra note 108 and accompanying text (listing eight factors).


233. Bennett & Morrison, supra note 8, at 53-54 (noting that since motive is not determinative factor, IRS may deny benefits even when taxpayer's purpose is pure).


235. Id. art. XIX, 2 Tax Treaties (CCH) ¶ 6113, at 36,442-43. The six factors are:

1. the date of incorporation of the corporation in relation to the date that this Convention entered into force;

2. the continuity of the historical business and ownership of the corporation;
factors evaluate the length, purpose, and legitimacy of the operations in the recipient country. In addition, Article 21 of the U.S.-Dutch MOU accounts for the membership of the Netherlands in the EC by allowing the competent tax authority to evaluate changes in circumstances that disqualify a company from obtaining the benefits of the Convention.

III. TREATY SHOPPERS MUST COMPLY WITH THE U.S. TAX TREATY NETWORK UNDER ARTICLE 26

On January 1, 1994, the United States embarked upon a new era of tax treaty negotiations. The 1948 Treaty, entered into initially to protect concerned investors still nervous about the financial upheavals of World War II, was unable to deter sophisticated tax avoidance practices that emerged in subsequent years. The prevalence of treaty abuse hindered U.S. efforts to formulate a coherent taxation policy with its trade partners and prompted the U.S. Congress to pass anti-treaty shopping legislation. The Netherlands, grasping the formidable implications

(3) the business reasons for the corporation residing in its State of residence;
(4) the extent to which the corporation is claiming special tax benefits in its country of residence;
(5) the extent to which the corporation's business activity in the other State is dependent on the capital, assets, or personnel of the corporation in its State of residence; and
(6) the extent to which the corporation would be entitled to treaty benefits comparable to those afforded by this Convention if it had been incorporated in the country of residence of the majority of its shareholders.

Id. 236. Id. One question certain to arise under the fourth factor is whether the Dutch participation exemption constitutes a special tax benefit. See Bennett & Morrison, supra note 8, at 54-55 (discussing consequences of this question to Dutch holding company).

237. See U.S.-Neth. Understanding, supra note 150, art. XXI, 2 Tax Treaties (CCH) ¶ 6113, at 36,443 (noting that “change in circumstances that would cause a company to cease to qualify for treaty benefits under paragraphs 1 and 2 of Article 26... need not necessarily result in a denial of benefits”). In addition, the U.S.-Dutch MOU addresses post-acquisition reorganizations. See Spector, supra note 48, at 173-74 (providing examples). Finally, certain companies engaged in stock and securities trading activities will automatically be entitled to the benefits of the Convention. See U.S.-Neth. Understanding, supra note 150, art. XX, 2 Tax Treaties (CCH) ¶ 6113, at 36,443.

238. See supra note 18 (discussing when U.S.-Netherlands Treaty entered into force).


240. See supra notes 51-57 and accompanying text (discussing U.S. dissatisfaction
of an impending U.S. unilateral override of the 1948 Treaty, invigorated negotiations towards a new tax accord. The resulting limitation on benefits provision exceeds its predecessors in both complexity and length. Though far from perfect, Article 26 of the U.S.-Netherlands Treaty is an impressive debut for a contemporary tax treaty that recognizes the EC, addresses the economic concerns of the Netherlands, and legitimizes U.S. efforts to combat treaty shopping through its bilateral tax conventions.

A. Reaffirming Cooperative Efforts to Prevent Treaty Shopping

The duration of the U.S.-Dutch deliberations highlighted the polemic nature of the treaty shopping dilemma. The Dutch government refused the rigorous conditions set forth under Article 28 of the U.S.-F.R.G. Treaty, desiring a tax accord that recognized its internationally-oriented economy. In contrast, the United States would not sign a tax treaty that did not explicitly bridle abusive treaty practices. The incongruous U.S.-Dutch positions necessitated an intricate, albeit workable, limitation on benefits provision.

with treaty shopping); supra notes 102-10 and accompanying text (describing anti-treaty shopping provision in TRA '86).
241. See supra note 142 (describing prior negotiations as lackluster).
242. See supra notes 150-51 and accompanying text (discussing length and complexity of Article 26).
243. See Troup, supra note 151, at 97 (discussing European dimension).
244. See supra note 144 and accompanying text (noting that revisions in U.S.-F.R.G. Treaty were necessary due to Dutch economy).
245. See Troup, supra note 151, at 97 (noting that United States has been at "forefront of attempts to curb treaty abuse").
246. See Goossen, supra note 30, at 15 (attributing delay in U.S.-Netherlands Treaty primarily to controversy over limitation on benefits article).
247. DeCarlo, supra note 144, at 271 (discussing disparity between Dutch and German economies).
248. See supra note 146 (discussing Dutch economy).
249. See Kaplan, supra note 147, at 175 (discussing U.S. Treasury Department's requirement that tax treaties contain anti-treaty shopping provisions to restrain treaty shopping).
250. See supra notes 145-46 and accompanying text (discussing differences between two countries).
This compromise reinforced the role of tax treaties in advancing international trade and investment. The fundamental goal of tax treaties is the removal of the adverse effects of double taxation on the international movement of goods, services, capital, and people. Embracing a unilateral approach, not only places the United States in violation of international law, but also exposes U.S. businesses to retaliatory legislation by U.S. trading partners. Article 26 of the U.S.-Netherlands Treaty sidesteps the potential predicament of a U.S. treaty override by requiring a U.S.-Dutch meeting within six months of the filing of a grievance by one of the countries.

B. Restricting Benefits to Bona Fide Residents

The U.S.-Netherlands Treaty forces treaty shoppers to either restructure their Dutch operations or else forfeit previously granted relief under the 1948 Treaty. Since these mul-
tionals historically paid little tax to the Dutch government.\textsuperscript{260} Article 26 will not adversely affect the Dutch economy.\textsuperscript{261} The Convention revamped existing tests\textsuperscript{262} and instituted fresh approaches to appropriately determine those entities with a sufficient nexus to the Contracting States.\textsuperscript{263} The consequential achievement of the U.S.-Netherlands Treaty is its courageous embrace of unchartered analyses in order to allay the diverse concerns of the two negotiating teams. The innovative headquarters test was drafted specifically to prevent an exodus of the international companies located in the Netherlands.\textsuperscript{264} The U.S. Treasury Department's prior refusal to allow for derivative benefits was successfully mitigated.\textsuperscript{265} In addition, subsidiaries of publicly traded corporations must meet less stringent safe harbors\textsuperscript{266} and the previously unfettered triangular structures are the focus of the Protocol.\textsuperscript{267} Arguably the most profound achievement of the Convention is its explicit, though regrettably incomplete, recognition of the Dutch membership in the EC.\textsuperscript{268}

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\textsuperscript{260} See supra notes 33-50 and accompanying text (discussing ability of holding company to escape taxation in both United States and Netherlands under 1948 Treaty).

\textsuperscript{261} Telephone Interview with Frans de Neree, Financial Counselor, Netherlands Embassy, United States (Feb. 1, 1994).

\textsuperscript{262} See supra notes 165-214 and accompanying text (discussing requirements under publicly traded, subsidiary, ownership, base erosion, and active trade tests).

\textsuperscript{263} See supra notes 215-21 (discussing novel headquarters test). Surprisingly, Article 26 does not address abuse through the use of multiple holding company structures. See Kaplan, supra note 147, at 180 (providing example and noting that in absence of published anti-avoidance rule these structures will be difficult to locate).

\textsuperscript{264} See supra notes 211-17 and accompanying text (discussing headquarters test).

\textsuperscript{265} See supra note 223 (noting historic U.S. opposition).

\textsuperscript{266} See supra notes 175-85 (discussing subsidiary test).

\textsuperscript{267} See supra notes 47, 148 (discussing Protocol).

\textsuperscript{268} See Reinhard Pöllath, Germans Remain Cool About Treaty, INT'L TAX REV., July-Aug. 1993, at 29, 30 (stating that U.S.-Dutch negotiators should be congratulated for implementing idea that EC is common market, but also blamed for reflecting idea vaguely and insufficiently). Several tests in the Convention account for the participation of the Netherlands in the EC. See supra notes 173-74 and accompanying text (noting addition of European stock exchanges); supra notes 180-82 and accompanying text (discussing subsidiary test); supra notes 192-93 and accompanying text (allowing higher distribution if resident of European Community nation); supra note 201 (recognizing European Community in attribution concept); supra note 212 and accompanying text (discussing election if business conducted in European Community); supra note 226 and accompanying text (examining derivative benefits); supra note 237 and accompa-
Regardless of the Convention's import, the complexity\textsuperscript{269} of several tests will require technical advice\textsuperscript{270}. This guidance will signify increased costs for taxpayers\textsuperscript{271}. The eventual effectiveness of Article 26 of the Convention will likely hinge on how its tests are interpreted by the respective competent tax authorities\textsuperscript{272}. The spirit of compromise, embodied in the drafting of Article 26 and the U.S.-Dutch MOU, portends favorable interpretations for citizens of the EC and other bona fide Dutch companies\textsuperscript{273}.

1. Impact of the Convention on Dutch Economy

Under the 1948 Treaty, the Netherlands was an ideal place to situate a holding company\textsuperscript{274}. The Dutch intermediary distributed most of its income, through deductible payments, to persons not entitled to benefits under the 1948 Treaty. Companies from Australia, Hong Kong, Singapore, and Taiwan established holding companies in the Netherlands\textsuperscript{275} to minimize the

\textsuperscript{269} See H. David Rosenbloom, Commentary, 9 Am. J. Tax Pol'y 77, 92 (1991). The increasing complexity of limitation on benefits provisions has been met with reservations. Mr. Rosenbloom stated:

The limitation on benefits article is inevitably difficult to administer. There has not been a single reported instance in which one of these provisions has been invoked in the 15 years they have been around. The article was never intended to require elaborate interpretation, and it was never intended to occupy substantial time of the competent authorities or the courts. It was intended as a prophylactic device tending to limit treaty benefits in general and to preclude a given treaty from operating in favor of the entire world. Such a purpose does not require an Internal Revenue Code in miniature.

\textit{Id.}

\textsuperscript{270} See Goossen, \textit{supra} note 30, at 45 (supporting conclusion that Convention is "unworkable" because Dutch State Council suggested "to form a joint U.S.-Dutch bureau to assist multinationals with the interpretation and application of this treaty").

\textsuperscript{271} See van Brunschot & van Weeghel, \textit{supra} note 146, at 209 (noting that costs will be "considerable").

\textsuperscript{272} See U.S.-NETH. REPORT, \textit{supra} note 13, at 22 (discussing interpretation and application as potential difference between new treaty tests and predecessor tests). This conclusion mirrors that reached under the U.S.-F.R.G. provision. See \textit{supra} note 132 (noting impact of interpretation and application).

\textsuperscript{273} See Seminar, \textit{supra} note 139, at 95 (noting that IRS' rulings under similar branch profit tax tests and IRS' consideration of numerous factors indicate willingness to grant treaty benefits); \textit{supra} notes 234-37 (discussing factors in U.S.-Dutch MOU for competent authorities to consider).

\textsuperscript{274} See Kral & Serota, \textit{supra} note 27 at 442.

\textsuperscript{275} See Ian Dinnison & Trevor Hughes, Aussies Lose Out on Benefit Limitations,
thirty percent U.S. withholding rate on their U.S. investments.276 If these same companies fail to qualify under the recently enacted provisions of the Convention, their aggregate tax may exceed sixty-eight percent of profits.277 Notwithstanding the absence of treaty shoppers forced to relocate, the viable Dutch economy will not falter.278

2. Potential Victim: The U.K. "Mixer" Company

Several U.K. companies, uninterested in the conventional aspects of treaty shopping, may be adversely impacted by the U.S.-Netherlands Treaty.279 In the United Kingdom, companies are prohibited from obtaining the maximum foreign tax credit on taxes assessed on distributions of their subsidiary's dividends.280 U.K. companies may obtain lost foreign tax credit benefits by establishing a mixing company in the Netherlands.281 A mixing company permits dividends from different sources to flow into the Dutch holding company, thus enabling the U.K. parent company to receive dividends from a single non-U.K. company.282 Though this practice was permissible under the 1948 Treaty, the U.K. mixing company will likely fail the objec-

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276. See supra note 14 (discussing U.S. withholding tax rate).
277. See supra note 46 (estimating 12% net savings under 1948 Treaty to companies that repatriated profits). Soft-drinks manufacturer Yeo Hiap Seng and its Dutch holding company, Chun King International BV, will be affected by the U.S.-Netherlands Treaty. Id.
278. See supra note 261 and accompanying text (discussing nominal impact on Dutch economy). Over the past decade, Japan, the United Kingdom, and the Netherlands constituted nearly half of the direct non-U.S. investment into the United States. Robert Haslach, The Dutch Role in U.S. Business, EUR., June 1991, at 30 (reviewing inception and growth of Dutch investment in United States). But see Paul Lee, Dutch Low-Tax Reputation at Risk, INT'L TAX REV., Dec.-Jan. 1994, at 19 (commenting that U.S.-Netherlands Treaty and draft anti-avoidance laws are eroding the appeal of Netherlands for international investors). Tax professionals discuss Switzerland, Luxembourg, Belgium, and Ireland as potential sites for holding companies. Id. However, the greatest impact of the Convention on the Dutch economy may have already passed because investors began planning for the changes over two years ago. Id.
279. See supra note 27, at 442.
280. Id. (discussing that foreign tax credits are generally computed on source-by-source basis). Ideally, a U.K. company would ignore disparate tax rates and apply excess tax credits from high-tax jurisdictions to the unused tax credits from low-tax jurisdictions. Id.
281. Id.
282. Id.
tive tests under Article 26 and be forced to seek an affirmative ruling from a competent tax authority. If a U.K. mixing company is denied benefits under the U.S.-Netherlands Treaty, it will face a severe increase in its tax burden.

C. Article 26 Embraces the Dutch Commitment to the European Community

One of the notable achievements of the U.S.-Netherlands Treaty is its recognition of the EC. Despite this acknowledgment, an action for breach against the Netherlands may still exist because all EC residents are not treated similarly under the Convention. If a case against the Netherlands is brought before the European Court of Justice, the aggrieved parties must prove discrimination.

The appropriate punishment, if the Netherlands is found to have violated the Treaty on European Union, is difficult to determine. The penalties range from remuneration for the parties injured to the foolhardy revocation of the Convention in its entirety. Pragmatically, the absence of a common EC tax treaty policy towards non-members necessitates the continued renegotiation of U.S. bilateral treaties in order to prevent the adoption of a stringent, unilateral anti-treaty shopping provision.

283. See supra note 224 and accompanying text (discussing discretionary authority).


286. See Troup, supra note 151, at 104 (noting difficulty in determining what consequences would be if Netherlands were found guilty of discriminatory treatment).

287. See Seminar, supra note 139, at 108-09.

288. See Ioannou, supra note 34, at 50 (discussing accord of EC on most issues, except taxes, which member countries still control). The Treaty of Maastricht failed to establish a unified tax policy. Id.

289. See Seminar, supra note 139, at 109 (discussing likelihood of adoption of uni-
The U.S.-Dutch negotiators, attempting to avoid the U.S.-
F.R.G. controversy, recognized the EC when framing the tests
contained in Article 26 of the Convention. Acceptance of the
EC, however, is not comprehensive. For example, under the
definition of an EC member state, in Article 26, Portugal is
excluded because it has not entered into an income tax treaty with
the United States. Although unlikely that the European Court
of Justice will find that the U.S.-Netherlands Treaty violates the
Treaty on European Union, the conflict has not been suppressed
entirely. Nevertheless, the Convention and the recent double
taxation convention between the United States and Mexico manifest a friendlier U.S. policy aimed at granting treaty benefits
to companies substantially owned by third-country residents that

lateral legislation by U.S. Congress if tax treaty negotiations falter). The U.S. has begun
tax treaty negotiations with Belgium, Ireland, and Portugal. Goossen, supra note 30, at
15 n.14.

290. Tax Treaties: Netherlands' First Chamber Ratifies U.S. Tax Treaty Despite Contro-
Tax Advisers expressed reservations in a letter to the Finance Committee of the First
Chamber. Id. One of the specific concerns of the association was that "[t]he treaty is a
violation of the European Community treaty, since not all EC members would be
-treated as qualifying shareholders in the limitation of [sic] benefits article." Id.; see El-
lers & Brügmann, supra note 126, at 20 (commenting that U.S.-F.R.G. Treaty violates
applicable EC law).

291. See U.S.-Neth. Treaty, supra note 18, art. 26, S. Treaty Doc. No. 6, at 59, 32
I.L.M. at 486. Article 21 of the U.S-Dutch MOU states:

[T]he legal requirements for the facilitation of the free flow of capital and
persons within the European Communities, together with the differing inter-
nal income tax systems, tax incentive regimes, and existing tax treaty policies
among member states of the European Community, will be considered.

U.S.-Neth. Understanding, supra note 150, art. XXI, 2 Tax Treaties (CCH) ¶ 6113, at
36,443; see supra note 268 and accompanying text (discussing Convention's recognition
of Dutch participation in EC).

292. See U.S.-Neth. Treaty, supra note 18, art. 26, ¶ 8(h), S. Treaty Doc. No. 6 at
80, 32 I.L.M. at 495 (stating that "[t]he term 'member state of the European Communi-
ties' means, unless the context requires otherwise: (i) the Netherlands; and (ii) any
other member state of the European Communities with which both States have in effect
a comprehensive income tax Convention). Another restriction appears under the de-
rivative benefits test. See supra note 226 (counting ownership of residents of countries
with U.S. bilateral treaties with tax rate no less favorable than Convention rate).

293. See DeCarlo, supra note 144, at 279-80 (discussing possible violation of EEC
Treaty).

294. See Convention between the Government of the United States of America and
the Government of the United Mexican States for the Avoidance of Double Taxation
and the Prevention of Fiscal Evasion with respect to Taxes on Income, Sept. 18, 1992,
ties (CCH) ¶ 5903, at 35,807.
belong to a regional organization.  

D. A New Era in U.S. Tax Treaty Policy

The U.S.-Netherlands Treaty, notwithstanding its implicit purpose, will serve a meaningful role in the drafting of future limitation on benefits provisions. U.S. and Dutch taxpayers are now equipped with objective, self-executing safe harbors that can be applied with greater certainty than its predecessors. The extraordinary detail in the U.S.-Netherlands Treaty, though unlikely to be adopted fully in future U.S. tax treaties, illuminates an undeveloped body of law. One questionable trend in U.S. tax conventions is the reliance on administrative authorities. The increasing dependence on the discretionary rulings of competent tax authorities minimizes the primary role of the objective tests and enables these bureaucrats to become law makers. The U.S. Treasury Department now has an opportunity to forge an authoritative tax treaty policy that embraces and develops both detailed objective tests to facilitate compliance and circumscribed subjective determinations to avoid an automatic set of rules that could result in unfair decisions.


296. See Bennett & Morrison, supra note 8, at 68 (discussing aspects that "may serve the U.S. Treasury well in the future"); Goossen, supra note 30, at 15-16 (noting that Article 26 will be used as model during negotiations with other EC nations and will be incorporated into new U.S. Model Treaty).

297. See Bennett & Morrison, supra note 8, at 51-52 (discussing that increased detail makes "self-executing 'safe harbors' more safe and more self-executing than they would otherwise be"). The Convention, unlike prior treaties, provides a mechanical three-factor test to determine if a taxpayer's activities are substantial. See supra note 211 (discussing formula that includes ratios of the value of assets, gross income, and payroll expense).

298. But see Goossen, supra note 30 (noting that "extreme intricacy ... will result, unintentionally, in an even more restricted application of the treaty").

299. See Eilers & Brügmann, supra note 126, at 18-19 (noting that U.S.-F.R.G. Treaty "granted both tax administrations impossibly broad and constitutionally questionable discretionary powers"); Pöllath, supra note 268, at 31 (discussing problems with excessive reliance on administrative authority).

300. See supra note 88 and accompanying text (discussing ineffectiveness of 1981 U.S. Model Treaty due to absence of definitions). Nevertheless, the active business test would benefit from simplification. See supra note 198 (noting complexity).
CONCLUSION

As critics lament over the length and complexity of Article 26 of the U.S.-Netherlands Treaty, this limitation on benefits provision will have a significant impact on hindering treaty shopping. Multinationals that have procured favorable treaty benefits through Dutch intermediaries will have to reconsider the Netherlands as the preeminent location for their holding companies. The U.S.-Netherlands Treaty protects the U.S. tax base and encourages productive negotiations focused on effecting future income tax conventions. These bilateral treaties foster international economic growth and frustrate the adoption of unreasonable unilateral legislation by a myopic, revenue-hungry U.S. Congress. Although questions persist and complications will arise through the application of this intricate provision, future commentators will herald Article 26 of the Convention as the provision that effectively closed the doors on the treaty shoppers.

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