

SHEARMAN & STERLING,
New York, N.Y., May 12, 1965.

Memorandum to Hon. Stanley S. Surrey, Assistant Secretary of the Treasury.

Subject: H.R. 5916 and article 7 of the Income Tax Treaty between the United States and the Netherlands.

The purpose of this memorandum is to point out an inequity in article 7 of the Income Tax Treaty between the United States and the Netherlands (the "treaty") when considered in conjunction with the proposed legislation concerning taxation of foreign investments ("H.R. 5916").

The problems arises because under section 4 of H.R. 5916 dividends paid to a Netherland-Antilles Corp. which owns the stock of a U.S. holding corporation, which in turn owns the stock of U.S. operating corporations, will be taxed at a 30 percent rate although under article 7 of the treaty the rate of such tax would be limited to 5 percent if the Netherland-Antilles Corp. owned the stock of the U.S. operating company directly.

Schlumberger, Ltd. ("SL") is a Netherland-Antilles Corp. which commenced business in 1957. At the time SL was organized an Internal Revenue Code, section 367, ruling was obtained to the effect that the exchanges involved in such organization were not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax. SL is sole stockholder of two U.S. corporations each of which has U.S. subsidiaries. Since SL is a foreign corporation, the U.S. companies have not been permitted to file a single consolidated return. For various management and business reasons and in order to permit the filing of a single consolidated return SL proposes to combine its U.S. subsidiaries into a single affiliated group under a U.S. holding company. In the absence of the proposed plan of reorganization, SL would qualify under H.R. 5916 and the United States-Netherlands Income Tax Treaty for the 5-percent tax on dividends received from its U.S. operating subsidiaries.

However, under the protocol of September 28, 1964, article 7 of the treaty (which limits the tax on dividends to 15 or 5 percent) is made inapplicable to dividends received by a Netherland-Antilles Corp. if it is receiving certain tax benefits under Netherland-Antilles law (which benefits SL is receiving) unless the payer of the dividends, that is the U.S. corporation, is owned at least 25 percent by the foreign corporation, and:

"(a) the payer of such income is a U.S. corporation (*other than a U.S. corporation, 60 percent or more of the gross income of which is derived from interest except to the extent derived by a corporation the principal business of which is the making of loans, dividends, royalties, rents from real property, or gain from the sale or other disposition of stock, securities, or real property, or gain from the sale or other disposition of stock, securities, or real property*)."

[Emphasis added.]

Under the proposed reorganization the new U.S. corporation as the parent of the U.S. operating companies would receive most of its income from dividends from such subsidiaries and, accordingly, under the protocol the dividends from the U.S. corporation to SL would not qualify for the treaty rate but would be taxed at a 30-percent rate under H.R. 5916.