There would appear to be no policy reason why the 5-percent rate should not apply to dividends from the new U.S. company to SL. Dividends from wholly owned operating subsidiaries are not the type of investment income against which the protocol is directed. It is submitted that the nature of the U.S. parent company's income should be determined not by looking at it individually, but by looking at the consolidated income of the entire group. To do otherwise would be to penalize the form of the U.S. organization despite the substance of the consolidated operations which generate the income from which the dividends paid to SL are derived. This argument has even greater weight when it is considered that the U.S. subsidiary of SL and its subsidiaries intend to file consolidated returns. Under the consolidated return regulations dividends received by one member of an affiliated group from another member are not treated as dividends for consolidated taxable income purposes (1.1502–31(b)(2) (ii), (v)) but are ignored.

In this connection it is most significant that in article VII of the treaty itself dividends received by a U.S. subsidiary from its subsidiary corporation are not considered the type of passive income which would cause dividends to the Netherlands parent to be taxed at a rate greater than the reduced rate. To the same effect see the U.S. tax treaties with Austria, Denmark, Finland, Ireland, Israel, Italy, Luxembourg, New Zealand, Norway, Sweden, Switzerland, and the United Kingdom.

The treaty with the Netherlands and all of the above treaties provide that dividend income "other than" dividend income from a subsidiary corporation is considered in determining whether the payer has the specific amount of passive income which will deprive it of the benefit of the reduced rate.

In addition, the draft Double Taxation Convention on Income and Capital prepared by the Organization for Economic Cooperation and Development (OECD) provides that dividends paid by a company to a resident of the other contracting state shall be taxed by the country of payment at not more than 15 percent (5 percent where the recipient is a corporation which owns 25 percent or more of the stock of the paying corporation). Thus, under the draft provision dividends received by a U.S. company from its U.S. subsidiaries and paid to a foreign parent would be taxed at a 5-percent rate.

H.R. 5916 should be amended to eliminate the above-described inequity. This could be accomplished in either of the following ways:

(1) Add a new subsection to section 11 to provide that income received by a U.S. corporation from a subsidiary corporation shall not, for the purpose of applying any treaty obligation of the United States, be considered dividend income.

(2) Add a new subsection to section 11 to provide that for purposes of applying any treaty obligation of the United States the income of a U.S. corporation, if it so elects, shall be computed on a consolidated basis.

There are probably other equally effective ways of eliminating the above inequity; for example, in the pending protocol to the treaty with the Netherlands or in the regulations under the 1964 protocol to the effect that the "other than" exception set forth in the treaty would apply as if set forth in full in the protocol.

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