

The Mutual Agreement Tiebreaker — OECD and Dutch Perspectives

by Jean-Paul van den Berg and Bart van der Gulik

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A crucial question that is constantly raised about tax treaties is: Do I, the taxpayer, have access to the treaty's benefits? The first hurdle that should be cleared is that of the taxpayer's residency.

A complication arises if the taxpayer is a dual resident entity, that is, a person that is a resident of both contracting states under the first paragraph of article 4, the residency article, of the OECD model convention.¹ For entities, this is addressed by the third paragraph of the residency article. Under the well-established rule of article 4(3) of the OECD model convention, a dual resident entity will for purposes of the treaty only be treated as a resident of the contracting state in which its place of effective management is located. For this tiebreaker provision to work properly there needs to be a common understanding between the two contracting states on the meaning of the term "place of effective management." Although the commentary to the OECD model convention provides a set of guidelines, various interpretations still seem possible.

For illustration, we point to the discussions at the joint IFA/OECD seminar at the International Fiscal Association congress in Vienna.² Two main interpretations seem to exist. According to one interpretation the

place of effective management is the place where the board of directors meets, and according to another it is the place where the senior management operates.³

In July 2008 the OECD published the latest update of the OECD model convention and the commentary. The update contains clarifications regarding several provisions of the OECD model convention. One of those clarifications relates to the tiebreaker rule in article 4(3) of the OECD model convention. The commentary first reiterates the preference for the place of effective management tiebreaker rule (article 4(3) of the OECD model convention and paragraphs 22-24 of the commentary).

In paragraph 24.1 of the commentary, however, it is recognized that, as a result of the different interpretations of the place of effective management, some countries consider it appropriate to deal with dual residents in a different manner. To meet these countries' concerns, the commentary contains an alternative provision for article 4(3) of the OECD model. This alternative provision refers to the mutual agreement procedure in the case of a dual resident entity and provides that the residency should be decided on by mutual agreement.

³R. Russo, "The 2008 OECD Model: An Overview," *European Taxation*, Sept. 2008, p. 459. We should add that other interpretations and variations seem conceivable. For instance, one could take a more legal approach, under which more emphasis is put on the place where the directors, who have the authority to effectively manage the taxpayer, meet to exercise their authority, only deviating when there are clear nominee-type or rubber-stamping situations. Another may put more emphasis on the place where the decisions are taken in substance, which requires a much more detailed understanding of the facts and may create much more ambiguity, especially when a company has only one director who makes a decision in silent contemplation.

¹OECD, Model Tax Convention on Income and on Capital, Paris: OECD, July 2008, and its predecessors. Any reference to tax treaties in this article is, unless stated otherwise, meant as a reference to tax treaties that contain similar provisions as the OECD model convention, and persons, other than individuals, will be referred to as entities.

²For a report on the discussions, see J.F. Avery Jones, "Place of Effective Management as a Residence Tie-Breaker," *Bulletin for International Taxation*, Vol. 59, No. 1, 2005, pp. 20-24.

In this article, we will analyze the consequences of the use of a mutual agreement tiebreaker provision — more specifically, the situation whereby *no* mutual agreement is reached. Special attention will be given to some triangular situations. Also, we will analyze the application of the mutual agreement tiebreakers in tax treaties already concluded by the Netherlands and compare those with the consequences of the OECD mutual agreement tiebreaker.

I. Treaty Residence and Dual Residents

A. Treaty Residence

Under article 4(1) of the OECD model convention, residency of persons for the purposes of the treaty is defined as follows:

For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

According to paragraphs 3, 4, and 8 of the commentary to article 4 of the OECD model convention, the wording “liable to tax” means a full liability to tax according to the domestic taxation laws of the contracting state in which residency is claimed. In the Netherlands, for instance, there are generally two reasons by which an entity would, in principle, be fully liable to (corporate income) tax: The entity could qualify as a domestic tax resident of the Netherlands either as a result of an all facts and circumstances test (the place of effective management generally being the most important circumstance) or by reason of its incorporation under Dutch law (the so-called incorporation fiction).⁴ An entity will typically be referred to as a dual resident for purposes of a tax treaty if it is, leaving aside application of that treaty, fully liable to tax under the domestic taxation laws of both contracting states and consequently qualifies as a tax treaty resident of both contracting states under article 4(1) of the OECD model convention. In that case the

⁴One could wonder whether the jurisdiction under the laws of which an entity is incorporated should be regarded as “criterion of a similar nature.” We note that in the Dutch context both the Parliamentary History to the Tax Arrangement for the Kingdom (*Belastingregeling voor het Koninkrijk*) (see *Tweede Kamer*, 1984-1985, 18 747 (R 1271), No. 6, p. 15) and the commentary (see paragraphs 4 and 8 of the commentary to article 4 of the OECD model convention and also the reservations made to that article by Canada in paragraph 27 and the United States in paragraph 31) provide good arguments that it should.

dual residency will normally be undone by applying the tiebreaker rule laid down in article 4(3) of the OECD model convention.

B. OECD Mutual Agreement Tiebreaker

As already indicated in the introduction, the commentary states a preference for the place of effective management of an entity as the tiebreaker rule for solving dual residency (article 4(3) of the OECD model convention). As an alternative, however, the mutual agreement tiebreaker is introduced in paragraph 24.1 of the commentary to article 4(3) of the OECD model convention. This alternative provision reads as follows:

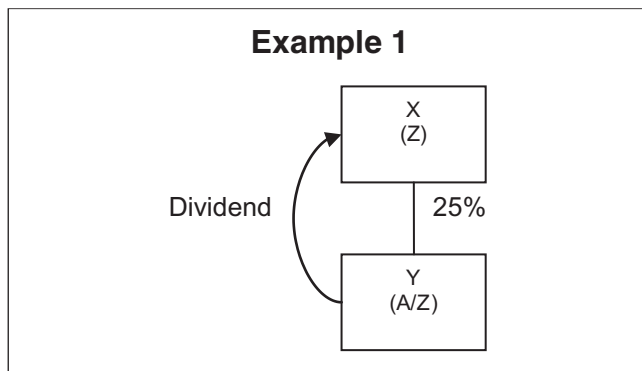
3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting States.

Under this mutual agreement tiebreaker, the contracting states would need to determine where a specific entity should be regarded as a resident for purposes of the tax treaty between the contracting states based on the specific factors that are important for determining residency in those contracting states, as listed. As opposed to the reference to the mutual agreement procedure in case of dual resident individuals, there is no obligation for the competent authorities of the contracting states to reach an actual agreement on the residency of a dual resident entity. Taking into account the defensive attitude of the contracting states that this provision seems to reflect — if no agreement is reached, the contracting states are not required to grant the dual resident entity treaty benefits — it seems overly optimistic to count on a swiftly reached mutual agreement. It would seem that a solution could generally be reached more swiftly if the taxpayer would seek to cease the dual residency itself. The entity will, absent a mutual agreement, remain a resident of both contracting states for treaty purposes and will, for instance, be subject to exchanging information as such.⁵

⁵For the view that in this case the dual resident, in principle, would qualify as a resident of both contracting states under the treaty except for purposes of claiming benefits of the treaty, see C. van Raad, *De algemene artikelen van het Nederlands-Amerikaans*

(Footnote continued on next page.)

We will illustrate the potential consequences of the use of the OECD mutual agreement tiebreaker with two examples below. In these examples we will assume that the tax treaty between State A and State Z is in conformity with the OECD model convention but contains the alternative (mutual agreement) tiebreaker provision in article 4(3).



In Example 1, Y (A/Z) is a resident of both State A and State Z under article 4(1) of the A-Z tax treaty. We will assume that State A and State Z have not entered into a mutual agreement regarding Y (A/Z) nor have they agreed on any tax treaty entitlement for Y (A/Z). Y (A/Z) distributes a dividend to its 25 percent shareholder X (Z), which is a tax resident of State Z. Suppose that under their domestic laws, both State Z and State A apply a dividend withholding tax of 20 percent, and that under the A-Z tax treaty the rate of the withholding tax in the source state would be reduced to 5 percent if the dividend is distributed to a company resident of the other contracting state holding at least 25 percent of the capital of the distributing company. The question arises whether X (Z) could apply for a reduced dividend withholding tax rate under the A-Z tax treaty.

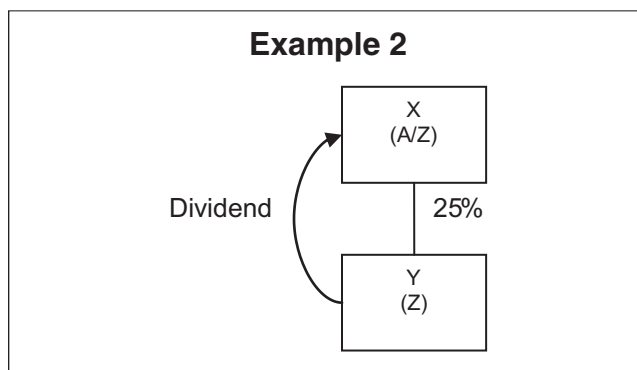
A reduction under the A-Z tax treaty (that is, leaving aside any domestic reductions, exemptions, and so forth) for the withholding of State Z would not be possible. State Z, the resident state of the recipient, would in principle not be restricted by the treaty to levy its domestic dividend withholding tax. From State Z's perspective there would be a distribution from one of its residents to another of its residents.⁶ One might expect, however, that State Z would grant X (Z) full relief or

belastingverdrag, Weekblad voor Fiscaal Recht, WFR 1993/401; and R. Russo, "The 2008 OECD Model: An Overview," European Taxation, Sept. 2008, p. 460. See also the explanatory note to the 1992 tax treaty between the Netherlands and the United States (Tweede Kamer, 1992-1993, 23 220, No. 3, p. 17).

⁶Article 10(1) of the A-Z tax treaty would not limit State Z's entitlement to tax the dividend.

exemption from the dividend withholding tax it levies under its own domestic laws.

A reduction of withholding tax levied by State A under the A-Z tax treaty would appear to be possible. From State A's perspective the dividend would be distributed by one of its residents to a company resident in State Z holding 25 percent in the capital of the distributing company. The fact that for treaty purposes Y (A/Z) is also a resident of State Z does not change this. X (Z)'s entitlement to the reduction would not be prevented by the last sentence of article 4(3) of the A-Z tax treaty as that sentence only affects the entitlement of the dual resident, Y (A/Z) itself, to treaty benefits. State A would be restricted to a levy of 5 percent under article 10(2)(a) of the A-Z tax treaty, which would, in principle, be creditable for X (Z) under the wording of article 23A(2) of the A-Z tax treaty.



Example 2 uses the same facts as Example 1, only now it is X (A/Z) that qualifies as a resident of both State A and State Z under article 4(1) of the A-Z tax treaty and Y (Z) is only resident in State Z. Again, State A and State Z have not entered into a mutual agreement under the tiebreaker, nor have they agreed on any tax treaty entitlement for X. In this situation State Z would seek to levy withholding tax on the dividend distributed by Y (Z). Both State A and State Z would fully tax X (A/Z), which could include the dividend it receives from Y (Z). Under article 4(3) of the A-Z tax treaty, X (A/Z) will not be entitled to any relief or exemption — including a reduction of State Z withholding tax or a credit in State A for State Z withholding tax, if any.

It follows that the unresolved dual residency under the mutual agreement tiebreaker might lead to situations of double taxation (for example, double levy of dividend withholding tax or double levy of corporate income tax). We should note, however, that in reality, potential double taxation in some situations might not occur as a result of the domestic tax rules of the countries involved. Under the domestic laws of State A and State Z, X (A/Z) might be entitled to an arrangement

to avoid economic double taxation (for example, a participation exemption or credit system) and to avoid legal double taxation (for example, in State Z it could be entitled to an exemption or credit/refund for the withholding tax levied by State Z itself). For instance, in a Dutch context, the application of the participation exemption⁷ and the corresponding dividend withholding tax exemption⁸ could mitigate the adverse effects of unresolved dual residency.

II. Triangular Cases

A. General

1. *The OECD Commentary*

In the triangular case whereby a dual resident entity receives income from a third state, the question arises whether the dual resident can claim the benefits of the tax treaties concluded by both of its resident states with the third state from which it derives income. Suppose X is an entity resident in both State A and State Z, but State Z wins the tiebreaker under the rule of article 4(3) of the A-Z tax treaty (typically, State A would be referred to as the loser state and State Z as the winner state).

Since July 2008, the commentary has specifically addressed the above-described triangular case in the second sentence of paragraph 8.2 of the commentary to article 4(1) of the OECD model convention, which reads:

It [the second sentence of article 4(1)] also excludes companies and other persons who are not subject to comprehensive liability to tax in a Contracting State because these persons, whilst being residents of that State under that State's tax law, are considered to be residents of another State pursuant to a treaty between these two States.

It follows that according to the commentary, the dual resident entity X is no longer fully liable to tax in loser State A because it is a resident of State Z under article 4(3) of the A-Z tax treaty. X can therefore not be regarded as a tax treaty resident of loser State A for purposes of article 4(1) of another tax treaty to which loser State A is a party.

2. *The Dutch Approach*

In the Netherlands, the Dutch Supreme Court decided on a similar situation in its decision of February 28, 2001, No. 35 557, BNB 2001/295. This case involved a company incorporated under Dutch law, which was effectively managed in the Netherlands Antilles and which paid a dividend to its Belgian resident shareholder. At issue was the question whether the Netherlands was entitled to levy Dutch dividend with-

holding tax on the dividend distribution by the company. To answer this question the Supreme Court addressed whether the company qualified as a resident of the Netherlands for purposes of the 1970 Belgium-Netherlands tax treaty.⁹

The Supreme Court ruled that the company did not qualify as such because it was not fully liable to tax in the Netherlands as a result of it being a tax resident only of the Netherlands Antilles under the tiebreaker of the tax arrangement of the Kingdom of the Netherlands (BRK)¹⁰ and that the Netherlands could therefore not levy its dividend withholding tax. It reasoned that because the company qualified as a resident only of the Netherlands Antilles under the BRK, the company was in fact only subject to tax in the Netherlands for its Dutch-source income and not for its worldwide income.

This decision in BNB 2001/295 has been heavily debated in Dutch tax literature.¹¹ Some authors argue that the decision should be broadly applied, while others maintain that the decision should not be applied to Dutch tax treaties in general, arguing that the BRK was involved and not an actual tax treaty.¹² However, if

⁹Convention between the Government of the Kingdom of the Netherlands and the Government of the Kingdom of Belgium for the avoidance of double taxation with respect to taxes on income and capital and for the settlement of some other questions on tax matters, signed in Brussels on October 19, 1970.

¹⁰*Belastingregeling voor het Koninkrijk*. This is a law containing an arrangement similar to double tax treaties, among the Netherlands and its overseas territories.

¹¹See, e.g., C. van Raad, T. Bender, and S.C.W. Douma, "De Hoge Raad op een drielandpunt — Over verdragsgerechtigheid van een dual resident tot loser-land-verdragen," *Weekblad voor Fiscaal Recht*, WFR 2001/257; and S. van Weeghel, in his note to BNB 2001/295.

¹²In its decision the Supreme Court refers to Article II of the protocol to the 1970 Belgium-Netherlands tax treaty, which states:

The statement "under the laws of that State" that is used in article 4, paragraph 1, also means such laws of that State which are amended or supplemented on the basis of international conventions.

Absent this provision, which is unique for this treaty, one could wonder whether the "laws of a state" would also include applicable bilateral conventions. The Dutch term "*wetgeving*" that is commonly used in double tax treaties could be interpreted more restrictively than the English term "laws" — one could argue that *wetgeving* only refers to a state's domestic statutes. It seems appropriate, however, to interpret this term more broadly in the context of a bilateral tax treaty that is based on the OECD model convention (not the least because of the English text of the OECD model convention and the great importance the Dutch Supreme Court ascribes to the OECD commentary; see Dutch Supreme Court, Sept. 2, 1992, No. 27 252, BNB 1992/379). Also, if a more restrictive interpretation is supported, one could argue that it should be the domestic statutes to the extent they can be applied taking into account the applicable

(Footnote continued on next page.)

⁷Article 13 Dutch Corporate Income Tax Act 1969.

⁸Article 4(1)(a) Dutch Dividend Withholding Tax Act 1965.

we take into account the comments by Frank van Brunschot, one of the Supreme Court judges that rendered the decision, in his candid speech in August 2004¹³ supporting a broad application of the rule expressed in BNB 2001/295, and the even more recent wording of paragraph 8.2 of the commentary, we feel that on balance, a broad application would be appropriate. In our view the following general rule should apply: An entity resident in the Netherlands under Dutch domestic law but resident of another state under the tiebreaker provision in the tax treaty between the Netherlands and that other state would not qualify as a resident of the Netherlands for purposes of all other Netherlands tax treaties that contain an OECD-like article 4(1), because as a consequence of that tiebreaker provision the Netherlands is no longer entitled to fully tax the entity.¹⁴

B. Mutual Agreement Tiebreakers

In view of the discussion in Section II.A, it is interesting to note that if there is a dual resident company and the two states of residence concluded a tax treaty containing the OECD mutual agreement tiebreaker clause and these states did not reach a mutual agreement on the residency of that dual resident entity, the

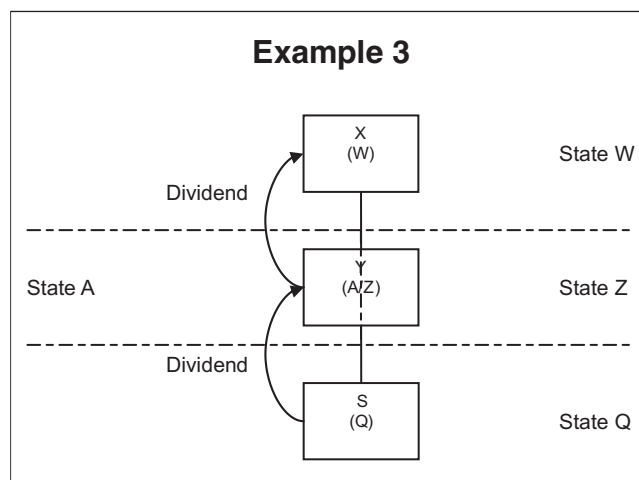
treaties (see S. van Weeghel in his note to BNB 2001/295), and one should realize that, to take effect, a bilateral treaty is ratified by way of a formal ratification law — a domestic statute — by the Dutch legislator. Also, it should be noted that a broad application of the decision seems to be in accordance with the position of the Dutch underminister of finance regarding the issuance of tax residency certificates in triangular cases. In his decree of June 12, 1989, No. IFZ89/320, V-N 1989/2501, the Dutch underminister of finance stated that a Dutch BV, which is effectively managed from the U.K. and consequently qualifies as a resident of the U.K. for purposes of the tax treaty between the Netherlands and the U.K., is not eligible for a Dutch tax residency certificate for purposes of other tax treaties to which the Netherlands is a party and which contain a provision similar to article 4(1) of the OECD model convention. The reason for this is that the Dutch underminister holds that the Dutch BV is only subject to tax on its source income in the Netherlands.

¹³For publication, see F.W.G.M. van Brunschot, "The Judiciary and the OECD Model Tax Convention and Its Commentaries," *Bulletin for International Taxation*, Vol. 59, No. 1, 2005, p. 9.

¹⁴The same conclusion should apply to Dutch tax treaties that contain a provision similar to article 4(1) of the OECD model convention even without the second sentence thereof. After all, in BNB 2001/295, the 1970 Belgium-Netherlands tax treaty did not contain that second sentence, and nevertheless the Supreme Court ruled that the company was not a tax treaty resident of the Netherlands. Apparently, the Dutch Supreme Court regards the second sentence as a clarification to the first sentence of article 4(1) of the OECD model. (In literature this position is taken by, for example, F.G.F. Peters, *De aanmerkelijkbelangregeling in internationaal perspectief*, Deventer 2007, p. 165; and A.J. van Soest, *Belastingen*, 22nd print, Deventer 2004, p. 699.)

dual resident entity will remain fully liable to tax in both contracting states (there is no winner and loser state).

Consequently, the reasoning in paragraph 8.2 of the commentary to article 4(1) of the OECD model convention cannot apply to the dual resident entity. This would mean that the dual resident would, in principle, not be excluded from the benefits of the tax treaties of each of the contracting states with third states. In other words, in relation to third states, the dual resident entity may simultaneously be entitled to the benefits of two tax treaties: the tax treaties of each of the contracting states with that third state. It is generally understood that in the case of simultaneous application of tax treaties, the more restrictive tax treaty should be applied.¹⁵ Consequently, the taxpayer has an interest in leaving the dual residency unresolved. Example 3 below intends to further clarify this.



In this example, S (Q) is a tax resident of State Q. Y (A/Z) is, again, a resident of both State A and State Z under article 4(1) of the A-Z tax treaty, and State A and State Z have not resolved Y (A/Z)'s dual residency. X (W) is a tax resident of State W. Suppose that:

- State Q does not have a tax treaty with State W;
- State Q and State A have a tax treaty that contains a 0 percent treaty rate for dividends, while the rate under the tax treaty between State Q and State Z is 10 percent;
- State A and Z both apply a full participation exemption to the dividends received by Y (A/Z);

¹⁵See, e.g., C. van Raad, "The 1992 OECD Model Treaty: Triangular Cases," *European Taxation*, Sept. 1993, p. 301.

- State A and Z both have a tax treaty with State W that contains a 0 percent dividend withholding tax; and
- no antiabuse measures apply.

In this example the benefit of the dual residence would be that Y (A/Z) is able to apply the lower of the treaty rates of the Q-A tax treaty and the Q-Z tax treaty, which is the 0 percent rate of the Q-A tax treaty. Should the A-Z tax treaty contain a classic tiebreaker and Y (A/Z)'s place of effective management be located in State Z, the 10 percent rate of the Q-Z tax treaty would apply (at least, it would under the interpretation of paragraph 8.2 of the commentary to article 4(1) of the OECD model convention). The obvious benefit of the mutual agreement tiebreaker (provided no mutual agreement is reached) is that Y (A/Z) can cherry-pick the most beneficial treaty rates for inbound dividends from third countries. The potential adverse effects of the dual residence (double levy of corporate income tax at the level of Y (A/Z) and double levy of dividend withholding tax on dividend distribution by Y (A/Z)) in this example are neutralized by the domestic law of State A and State Z (participation exemption) and the tax treaties between states A and Z and State W.¹⁶

Departing from our conclusion on the broad application of the reasoning in BNB 2001/295 (which is similar to that in paragraph 8.2 of the commentary to article 4(1) of the OECD model convention), the obvious benefit of an unresolved tiebreaker that was indicated above may also emerge in cases in which the Netherlands would be involved. If we would, for instance, assume that in the case of Example 3 above, the Netherlands would be State Q, then Y could normally on a dividend distribution by S claim the most desirable of the benefits of the tax treaty between the Netherlands and State A and the tax treaty between the Netherlands and State Z. In that case the Netherlands would consequently be limited to the 0 percent dividend tax treaty rate instead of the 10 percent rate.

The benefit of the use of a company that is dual resident for purposes of a tax treaty containing a mutual agreement tiebreaker (that is, the cherry-picking of tax treaty rates) is, in principle, dependent on the condition that no mutual agreement is reached. Once a mutual agreement is reached and the dual resident entity is qualified therein as a tax treaty resident of one of the contracting states, under the reasoning of paragraph 8.2 of the commentary to article 4(1) of the

¹⁶If one or both of states A and Z would, for example, have been entitled to levy 5 percent withholding tax upon the dividend distribution to X, in principle, State W would seem obliged to grant a credit for both levies under the tax treaties with State A and State Z respectively (except, for instance, if also State W would apply a full participation exemption system).

OECD model convention and BNB 2001/295, this benefit would no longer be available.¹⁷ One may wonder what the chances are that a mutual agreement would actually be reached and, if it is, whether the agreement could be given retroactive effect.

The rationale of the mutual agreement tiebreaker seems to be to discourage the use of dual resident entities.

Paragraph 24.1 of the commentary to article 4 of the OECD model convention¹⁸ and article 25(1) of the OECD model convention¹⁹ contain indications that the mutual agreement procedure regarding the tax treaty residency tiebreaker of a dual resident entity will normally be initiated by the dual resident entity itself. This seems logical as the dual resident entity itself, not the contracting states, would be aware that both contracting states wish to tax it and would be confronted with double taxation as a result of its dual residence that can be avoided by a mutual agreement between the contracting states. It would normally be in the interest of the dual resident that a mutual agreement is reached so that double taxation could be avoided. The rationale of the mutual agreement tiebreaker seems to be to discourage the use of dual resident entities by penalizing such use with double taxation, which may only be avoided if the dual resident takes action itself (that is, initializing the mutual agreement procedure or by ceasing to be resident in one of the two contracting states).

¹⁷For instance, if in case of Example 3 a mutual agreement would be reached between State A and State Z in which Y (A/Z) would be qualified as a resident of State Z, then State Q would be able to levy 10 percent dividend withholding tax as Y (A/Z) would qualify as a tax treaty resident for purposes of the Q-Z treaty only (and not anymore as a tax treaty resident of the Q-A tax treaty as well).

¹⁸“Also, since the application of the provision would normally be requested by the person concerned through the mechanism provided for under paragraph 1 of Article 25.”

¹⁹“Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the contracting state of which he is a resident or, if his case comes under paragraph 1 of article 24, to that of the contracting state of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.”

In contrast to the above, in the typical structure whereby the dual resident entity would be able to benefit from the absence of a mutual agreement while the potential adverse effects (double taxation) of the dual residence are neutralized by the domestic tax laws of the states (for example, participation exemption), it would be in the interest of the dual resident not to initiate a mutual agreement procedure. This would make it unlikely that a mutual agreement would be reached. There are two reasons why it would seem doubtful that the contracting states themselves would take the initiative to start a mutual agreement procedure.

First, although article 25 of the OECD model convention, which contains the procedural rules for mutual agreements, authorizes the competent authorities of both contracting states to conclude mutual agreements under their own initiative,²⁰ it seems to follow from the commentary on article 25 of the OECD model convention that such authorization, in principle, does not relate to individual cases but is limited to general problems relating to categories of taxpayers. For example, paragraph 50 of the commentary to article 25 of the OECD model reads as follows:

The first sentence of this paragraph [paragraph 3] invites and authorises the competent authorities to resolve, if possible, difficulties of interpretation or application by means of mutual agreement. These are essentially difficulties of a general nature which concern, or which may concern, a category of taxpayers, even if they have arisen in connection with an individual case normally coming under the procedure defined in paragraphs 1 and 2.

Also, paragraph 56 reads as follows:

This paragraph [paragraph 4 of article 25 of the OECD model convention] determines how the competent authorities may consult together for the resolution by mutual agreement, either of an individual case coming under the procedure defined in paragraphs 1 and 2 or of general problems relating in particular to the interpretation or application of the Convention, and which are referred to in paragraph 3.

Based on the above in connection with paragraph 24.1 of the commentary to article 4 of the OECD model convention (see footnote 18), in our view it could be argued that the competent authorities should

normally not enter into a mutual agreement as to the tax treaty residence of an entity without being asked to by that entity.

Second, in our view, the competent authorities of the contracting states will, in principle, not have an active interest in starting the mutual agreement procedure, as doing so would result in one of them becoming the loser state. Without mutual agreement, both contracting states in principle would be able to levy taxes from the dual resident entity, while the taxing powers of a loser state could be limited. It would seem odd for either contracting state to be willing to forfeit its domestic taxation rights on its own initiative.²¹

Suppose that, despite what has been said above, a mutual agreement is reached. That agreement would typically provide that the relevant company is resident, for purposes of the tax treaty, in one of the states during a certain period.²² It would not seem strange that the agreement would relate to a period before its conclusion, that is, the contracting states would agree to grant treaty benefits to an entity as if that entity was, during that time, resident only of one of the contracting states (after application of article 4(3) of the relevant tax treaty). This raises the question whether this intended retroactive effect will also affect the company's entitlement to the benefits of other tax treaties. The argument could be that, after application of the tiebreaker, the company is no longer fully taxable in the loser state and therefore should not be regarded as a resident of that state for purposes of tax treaties between that state and third states. For the period after the conclusion of the agreement, this would appear to be in line with the second sentence of paragraph 8.2 of the commentary to article 4(1) of the OECD model convention.

²¹Also, sometimes there may even be an incentive for one of the contracting states not to enter into a mutual agreement, for instance, if one of the contracting states (Y) would apply a participation exemption and has a tax treaty with the third state (Q) containing a 0 percent rate while the other contracting state (X) would on a net basis tax dividends at 25 percent corporate income tax and has a tax treaty with that third state (Q) containing a 10 percent rate. In this situation, X has an incentive not to reach a mutual agreement because without the mutual agreement it can levy 25 percent corporate income tax on the dividends without the obligation to give a credit for the 10 percent withholding tax levied by Q. In the best case (if it would win the tie break) X would have to grant a credit for the 10 percent tax Q is now entitled to levy, and in the worst case (if it loses the tie break) it would lose all of its entitlement to tax the dividend.

²²See the last sentence of paragraph 24.1 of the commentary on article 4 of the OECD model:

Since the facts on which a decision will be based may change over time, the competent authorities that reach a decision under that provision should clarify which period of time is covered by that decision.

²⁰Article 25(3) of the OECD model convention reads:

The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

It is doubtful, however, whether this would also apply to the period before the mutual agreement is concluded. The agreement does not alter the fact that during that period the company was fully liable to tax in the state that later became the loser state. We should add that the agreement would be made according to a more or less discretionary decision by that state; the alternative tiebreaker provision only requires the contracting states to endeavour to reach an agreement and does not lay down strict rules as to how to determine the treaty residency, but rather enunciates relevant factors. In practical terms, the company should be able to obtain a residency statement in both states (which would be correct at the time of issuance). We see no basis in the OECD model convention or the commentary for the position that a retroactive determination of tax treaty residence by mutual agreement between two contracting states should retroactively affect the tax treaty status of the dual resident for purposes of other treaties.

III. Tiebreakers in Dutch Treaties

The Dutch tax treaties with Canada, the U.S., Latvia, and Estonia, and the new Dutch tax treaty with the U.K. (which has not yet entered into force) contain provisions that approximate the OECD mutual agreement tiebreaker.²³ Like the OECD mutual agreement tiebreaker, these tiebreakers do not contain an obligation for the contracting states to resolve the dual residency by reaching mutual agreement, and they contain an arrangement in case the dual residency is not solved. There are also differences. These and their impact will be discussed below.

A. Latvia and Estonia

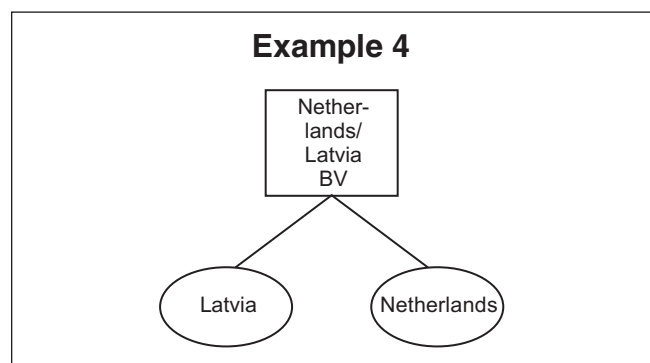
The tiebreakers in the Dutch tax treaties with Estonia and Latvia are identical and read as follows:

Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the States shall endeavour to settle the question by mutual agreement having regard to its place of effective management, the place

²³Some tax treaties entered into by the Netherlands contain no tiebreaker for entities at all (Germany and Ireland), and some contain a combination of a place of effective management and a mutual agreement tiebreaker (for China and Turkey, in case of dual residency the place of effective management is decisive, but if that place is in one and the head office is in the other contracting state, a mutual agreement is required). The tax treaties between the Netherlands and Japan, Nigeria, Thailand, and the Philippines contain mutual agreement tiebreakers that seem to create an obligation for the contracting states to determine how to deal with the dual residence, and none of these four treaties contains an arrangement for the situation that no mutual agreement would be reached (which seems consistent with an obligation to reach agreement).

where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such company shall not be entitled to claim any benefits under this Convention, except that such company may claim the benefits of Articles 24 (Elimination of Double Taxation), 26 (Non-Discrimination) and 27 (Mutual Agreement Procedure).

The main difference with the OECD mutual agreement tiebreaker is that in case there is no mutual agreement, the dual resident under the Dutch treaties between Latvia and Estonia is still entitled to claim the benefits of the elimination of double taxation provision. This approach may lead to a different result than the OECD approach would. Examples 4 and 5 illustrate this.



Netherlands/Latvia BV is a company resident both in the Netherlands and Latvia. It carries on a business through permanent establishments in the Netherlands and Latvia.²⁴ Suppose there is no mutual agreement between the Netherlands and Latvia and both the Netherlands and Latvia will levy tax on Netherlands/Latvia BV's worldwide income. In case of the OECD mutual agreement tiebreaker, the levy on worldwide income by both states would in principle — absent unilateral double tax relief — be the end result ("not be entitled to any relief or exemption from tax provided by this Convention").

Under the Latvia-Netherlands tax treaty,²⁵ the dual resident can claim the treaty benefit of article 24

²⁴From a Dutch perspective it would be meaningless to state that a Dutch resident company carries on a business through a permanent establishment in the Netherlands, but from that perspective the permanent establishment in Latvia would be relevant, and vice versa.

²⁵Convention between the Government of the Kingdom of the Netherlands and the Republic of Latvia for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital, signed in The Hague on March 14, 1992.

(elimination of double taxation) of the Latvia-Netherlands tax treaty. Article 24(2) of that treaty in relevant part reads as follows:

However, where a resident of the Netherlands derives items of income which according to . . . Article 7 . . . of this Convention may be taxed in Latvia and are included in the basis referred to in paragraph 1, the Netherlands shall exempt such income.

The question arises whether the Netherlands should grant an exemption for the profits that can be attributed to the Latvian permanent establishment. In this respect, we feel that two different interpretations are possible. Under the first interpretation, one could argue that Latvia does not tax the profits attributable to the permanent establishment because it may do so *according to article 7* as Netherlands/Latvia BV is, as a result of article 4(3), not entitled to claim the benefits of article 7. Consequently, the Netherlands should not grant the exemption. This interpretation would result in the same outcome as under the OECD mutual agreement tiebreaker.

Under the second interpretation, for purposes of applying article 24 one would ignore the fact that under article 4(3) the dual resident cannot claim the benefits of article 7. The dual resident is not claiming the benefits of article 7, but those of article 24 and the wording “according to article 7 may be taxed” in the latter article should be interpreted taking into account that Netherlands/Latvia BV qualifies as a tax treaty resident of both contracting states (and ignoring that the benefits of article 7 itself may not be claimed). This would mean that, for purposes of the double taxation relief, the taxation of the profits by Latvia would be in accordance with article 7 and that the Netherlands should grant the exemption accordingly. This interpretation would result in a different outcome compared with the OECD mutual agreement tiebreaker (under which no double taxation relief is possible). One should also consider that under this approach the relief (credit or exemption) that the contracting state applying the elimination of double taxation clause would grant would not exceed the smaller of the concessions that would be available if the dual resident:

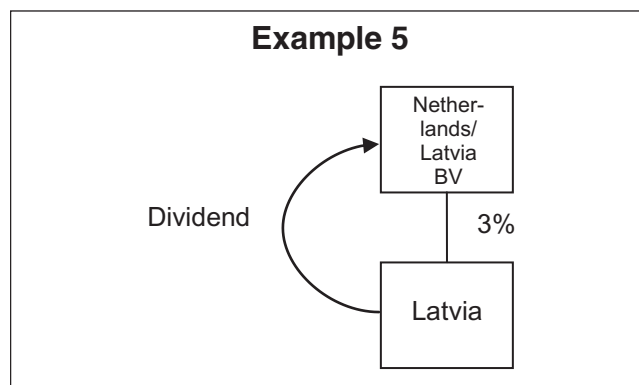
- was only resident of that contracting state; or
- was only resident of the other contracting state.

The logic of this approach would be that the contracting state should at least be willing to grant the entity the smaller of the two possible reliefs (credit or exemption) that would be available if the dual residency would be resolved by mutual agreement.²⁶

²⁶To take another example, suppose a dual resident X (A/Z) receives a dividend from Y (Z). If, under a tiebreaker State A would be the loser state (X would be resident only of State Z),
(Footnote continued in next column.)

To conclude, we believe that the second interpretation is the more logical one as it fits that the dual resident is considered a resident of both contracting states for purposes of the treaty and it gives meaning to the inclusion in article 4(3) that the dual resident can claim the benefits of the double taxation relief provision (under the first interpretation this reference would effectively be meaningless).

The application of the elimination of double taxation provision may also lead to differences in comparison with the OECD mutual agreement tiebreaker if the dual resident entity receives a dividend distribution from either the Netherlands or Latvia. We refer to Example 5 below.



Netherlands/Latvia BV is, again, a dual resident company. It holds 3 percent of the shares in a Latvian company (to which the Dutch participation exemption does not apply). Suppose that Latvia levies 25 percent dividend withholding tax²⁷ and that there is no mutual agreement between the Netherlands and Latvia. In principle, Latvia would not have to reduce its withholding tax rate to 15 percent under article 10(2)(b) of the Latvia-Netherlands tax treaty because Netherlands/Latvia BV is not entitled to treaty benefits according to article 4(3) of the Latvia-Netherlands tax treaty. Both the Netherlands and Latvia will include the dividend in

State A would not be able to levy any tax on the dividends received by X. If, however, State A would be the winner state (X would be resident only of State A), State A would be able to impose its corporate income tax on the dividends received, but would have to grant a credit for withholding tax levied by State Z up to 15 percent. If no mutual agreement is reached it seems to have merit if State A would at least have to grant the smaller concession: a credit for withholding tax not exceeding 15 percent (and not exceeding the second limit).

²⁷In reality, Latvia would, in principle, only levy 10 percent dividend withholding tax under its domestic tax law. Consequently, the case in this example would in reality not occur. It is, however, instructive to demonstrate how mutual agreement tiebreakers, as the one in the Latvia-Netherlands tax treaty, would work out in some situations. For that reason we will in this paragraph ignore this and other particulars of Latvian tax law.

their taxable base. Under article 4(3) in conjunction with article 24(3) of the Latvia-Netherlands tax treaty, the Netherlands should, however, grant a credit for the items of income that according to article 10(2) may be taxed in Latvia to the extent that these items are included in the basis referred to in paragraph 1.

If one would apply the second interpretation, which, as discussed under Example 4 above, we believe is the more logical one, the Netherlands should grant a credit, but only for 15 percent. This is the withholding tax that according to article 10(2) of the Latvia-Netherlands tax treaty may be taxed in Latvia. The remaining 10 percent may not be taxed in Latvia on the basis of article 10(2) of the Latvia-Netherlands tax treaty, but on the basis that Netherlands/Latvia BV is not entitled to the benefits of the Latvia-Netherlands tax treaty and that Latvia consequently is not restricted to effectuate its domestic taxing rights. As a result, this 10 percent will remain uncreditable in the Netherlands. Under the OECD mutual agreement tiebreaker, in principle, no Latvian withholding tax would be creditable in the Netherlands because under this tiebreaker an entity is not entitled to any relief or exemption from tax unless the contracting states have agreed otherwise (25 percent remains uncreditable).

B. The U.K.

The mutual agreement tiebreaker in the new Netherlands-U.K. tax treaty²⁸ (article 4(4)) reads as follows:

Where by reason of the provisions of paragraph 1 of this Article a person other than an individual is a resident of both Contracting States, then the competent authorities of the Contracting States shall determine by mutual agreement the Contracting State of which that person shall be deemed to be a resident for the purposes of this Convention. In the absence of a mutual agreement by the competent authorities of the Contracting States, the person shall not be considered a resident of either Contracting State for the purposes of claiming any benefits provided by the Convention, except those provided by Article 21, Article 24 and Article 25.²⁹

²⁸Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Kingdom of the Netherlands for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains, signed in London on September 26, 2008. The tax treaty has not yet entered into force.

²⁹The fifth paragraph of article 4 of the new Netherlands-U.K. tax treaty contains an exception: Paragraph 4 does not apply to dual listed companies. Such an entity will be deemed to be resident in its state of incorporation if the company's primary listing is in that state. We suspect this exception was drafted with one or more specific companies in mind.

Its first sentence does not mention any factors that should be taken into account by the contracting states when determining the residency by mutual agreement, which may create some uncertainty for dual resident companies.³⁰ Its second sentence differs from the OECD mutual agreement tiebreaker as well. Instead of using the principle that if there is no mutual agreement the dual resident company is not entitled to the benefits of the treaty (OECD approach), under this treaty the dual resident will not be considered a resident of either contracting state for purposes of claiming any benefits provided by the convention except those provided by article 21 (elimination of double taxation), article 24, and article 25. This different approach leads to differences in the outcome compared with the OECD mutual agreement tiebreaker.

First of all, it would affect the rights of some U.K. and Dutch resident taxpayers other than the dual resident entity (even those that do not control the dual residency, let alone the absence of a mutual agreement), while under the OECD approach only the dual resident taxpayer itself would be denied entitlement to treaty benefits. For example, if a Dutch/U.K. dual resident company would distribute a dividend to a U.K. resident shareholder (which holds 4 percent of the shares and voting power), it seems that the U.K. resident shareholder would not be able to claim the reduced (10 percent) dividend withholding tax rate of article 10(2)(a)(i) of the new tax treaty for the Dutch dividend withholding tax. After all, the U.K. resident shareholder would in that case be claiming the benefit of article 10(2)(a)(i) of the convention, while the dual resident is not considered a resident for purposes of claiming *any* benefits under the convention.³¹

Consequently, the Netherlands-U.K. tax treaty does not seem to restrict the Netherlands from levying its 15 percent dividend withholding tax. Under the wording of the OECD mutual agreement tiebreaker it seems that the U.K. resident shareholder would be able to claim the reduced rate. (See, *mutatis mutandis*, Example 1 above.) The U.K. or Dutch recipient of cross-border

³⁰It should be noted that although no factors are mentioned in article 4(4), the U.K. in its explanatory memorandum (Explanatory Memorandum to the double taxation relief and international tax enforcement (taxes on income and capital) (Netherlands) order 2009, 2009, No. 227) to the new Netherlands-U.K. tax treaty mentions factors that are comparable to the ones mentioned in the OECD mutual agreement tiebreaker. At the time of writing this article, the Netherlands had not yet published an explanatory note.

³¹It is, however, considered a resident of both contracting states for all other purposes, thus also for purposes of the wording, "However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident and according to the laws of that State," at the beginning of article 10(2)(a)(i) of the treaty.

interests and royalties may be faced with the same issue (but the Netherlands does not levy a withholding tax on ordinary interest and royalty payments). It follows that the uncertainty that will in most cases result from a mutual agreement tiebreaker would under the new Netherlands-U.K. approach also adversely affect some persons other than the dual resident itself.³²

In addition to the above, a difference from the OECD mutual agreement tiebreaker would be that a Dutch/U.K. dual resident entity would be entitled to double taxation relief under the Netherlands-U.K. tax treaty. In our view, the double taxation relief, in principle, should work out the same way as for purposes of the Latvia-Netherlands tax treaty. (See examples 4 and 5 above.)

C. Canada

The first sentence of article 4(3) of the Canada-Netherlands tax treaty³³ is in accordance with the OECD mutual agreement tiebreaker. Its second sentence, however, deviates:

In the absence of such agreement, such person shall be deemed not to be a resident of either State for the purposes of Articles 6 to 21 inclusive and Articles 23 and 24.

Instead of denying treaty benefits to the dual resident (OECD approach), this treaty excludes the dual resident wholly from being a resident for purposes of articles 6 to 21 and 23 and 24 of the treaty (article 22 is the elimination of double taxation clause). This approach is similar to that of the new Netherlands-U.K. tax treaty (although in that case, the dual resident is only not deemed to be a resident for the purpose of *claiming any benefits* of the excluded articles in the treaty) and could also affect others than the dual resident itself. In this respect an observation needs to be made relating to article 21A of the Canada-Netherlands tax treaty. This is the “other income” article and was added in the first protocol of 1993,³⁴ which did not change the wording of article 4(3). It follows that a dual resident will still be resident of both contracting states for the purpose of article 21A of the Canada-Netherlands tax treaty (the second sentence of article 4(3) does not apply).

How this works out can best be illustrated by the example of a Dutch/Canadian dual resident company

that distributes a dividend to its Canadian shareholder (which holds 25 percent of the shares). In that case, the Netherlands would seek to levy its 15 percent dividend withholding tax. Article 10 of the Canada-Netherlands tax treaty according to its wording would not seem to apply. That article relates to a dividend distributed by an entity resident in one of the contracting states, which the dual resident is deemed not to be. This would guide us to article 21A (other income) of the Canada-Netherlands tax treaty.³⁵ That article, however, stipulates in paragraph 2 that a contracting state may levy 25 percent tax on income derived from sources in that contracting state. Consequently, the Netherlands would then not be restricted in levying its 15 percent dividend withholding tax.

Another observation is that because the dual resident entity’s tax treaty residence has been excluded wholly for purposes of the articles 6 through 21, examples 4 and 5 above would work out differently under the Canada-Netherlands tax treaty. If we substitute Latvia for Canada in those examples, the result should, in our view, be that there is no income that, according to articles 7 and 10(2), may be taxed in Canada. After all, the dual resident does not qualify as a resident of either contracting state for purposes of these articles. This would mean that in case of examples 4 and 5, *mutatis mutandis* the dual resident would not be entitled to any double taxation relief under article 22 (elimination of double taxation) of the Canada-Netherlands tax treaty when it refers to articles 7 and 10(2). This point of view is in accordance with Dutch parliamentary history to the Canada-Netherlands tax treaty, which, based on a comparable reasoning, states that article 22 (elimination of double taxation) effectively is not applicable.³⁶

Interestingly, the solution for the above-described effective lack of double taxation relief could be provided by the reference in article 22 of the Canada-Netherlands tax treaty to the second paragraph of article 21A (other income). As mentioned above, for purposes of article 21A of the Canada-Netherlands tax treaty, the dual residency is not taken away. The result would be that all items of income derived by the dual resident would be governed by article 21A of the Canada-Netherlands tax treaty because the items of

³²One could for instance also think of the situation of a director, resident in one of the contracting states, of a dual resident company.

³³Agreement between Canada and the Kingdom of the Netherlands for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed in The Hague on May 27, 1986, and amended by the protocols signed in The Hague on March 4, 1993, and August 25, 1997.

³⁴1993 protocol signed in The Hague on March 4, 1993.

³⁵In BNB 2001/295 (see above) the Supreme Court applied the dividend article of the 1970 Belgium-Netherlands tax treaty to a dividend distributed by a company resident in neither contracting state. We agree with the annotator who, with a hint of understatement, commented that by doing so the Supreme Court had reached, if not crossed, the boundaries for treaty interpretation. It has been suggested that the Supreme Court desired to lay down a general rule that would also apply to tax treaties lacking a provision on other income.

³⁶*Handelingen, 33ste vergadering Eerste Kamer*, June 2, 1987, pp. 33/1497-33/1501.

income have not been dealt with by the previous articles.³⁷ If a dual resident would derive an item of income from a source in Canada, that item of income, under article 21A(2) of the Canada-Netherlands tax treaty, could be taxed in Canada at a rate not exceeding 25 percent of the gross amount, and under article 22(3) the Netherlands should grant double tax relief for that Canadian tax.³⁸

D. The United States

Regarding the U.S. we should note that the 1992 Netherlands-U.S. income tax treaty³⁹ contains a mutual agreement tiebreaker that is to a great extent comparable to the OECD mutual agreement tiebreaker.⁴⁰ The most notable difference with the OECD version is the reference to article 25(4) of the treaty (U.S. tax credit). Except for this difference, the tiebreaker generally works out the same as the OECD mutual agreement tiebreaker (reference is therefore made to the discussion and the examples in Section I.B). In the Dutch parliamentary history to the Netherlands-U.S. tax treaty, it has been confirmed that the dual resident remains resident of both contracting states and that it is (merely) not entitled to claim the benefits of the treaty itself (other persons than the dual resident would therefore not be affected; see also footnote 5).⁴¹

IV. Conclusion

The OECD mutual agreement tiebreaker may, when no mutual agreement is reached, lead to situations of

double taxation and therefore would appear to discourage taxpayers from creating a dual residency situation. There may, however, also be a benefit as long as the domestic tax laws of the contracting states take away potential double taxation (for example, through domestic exemptions). This is because if no mutual agreement is reached, a dual resident entity will remain fully liable to tax in both contracting states, and therefore, in principle, has access to the tax treaty network of both contracting states. In that case, the reasoning of BNB 2001/295 and the commentary — that a dual resident is no longer fully liable to tax in the loser state of the tiebreaker and therefore would no longer qualify as a resident of that state under other tax treaties — does not seem to apply. Consequently, the dual resident entity might be able to cherry-pick the most beneficial of the treaties that its two states of residence have concluded with a third state. It follows that this benefit is dependent on there being no mutual agreement on the taxpayer's residency. Once mutual agreement is reached, the benefit, under the approach of the commentary, would cease to exist. Due to a lack of an incentive for the dual resident entity and the contracting states in such a situation, however, it seems most likely that no mutual agreement would actually be sought.

The Netherlands has already concluded tax treaties containing a mutual agreement tiebreaker that predate the OECD mutual agreement tiebreaker. The mutual agreement tiebreaker clauses in the tax treaties with Latvia, Estonia, the U.K., the U.S., and Canada approximate the OECD approach but also contain differences that could affect the outcome. The tax treaties with Estonia, Latvia, the U.K., and Canada grant the benefit of application of the elimination of double taxation clause, while the tax treaty with Canada and the new tax treaty with the U.K. seem to extend the limitations of application of the treaty benefits to some persons other than the dual resident itself.

In view of the subtly different outcomes due to differences in wording of the various mutual agreement tiebreakers discussed in Section III above, we would on the one hand agree with the general comment of the OECD that the usual tiebreaker based on an entity's place of effective management is preferable, but on the other hand welcome the inclusion by the OECD of the alternative, hoping that this would create a uniform — and in some cases more balanced — approach if a mutual agreement tiebreaker is preferred. We do feel that in a subsequent update the OECD should consider applying the elimination of double taxation clause to dual resident entities under the OECD mutual agreement tiebreaker provision, also if the tie is not broken. ◆

³⁷We reiterate the caveat made in note 35 above.

³⁸The same seems to apply in the reverse situation: Dutch tax on Dutch-source income should be eligible for relief under article 22(5) of the Canada-Netherlands tax treaty.

³⁹Convention between the Kingdom of the Netherlands and the United States of America for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, signed in Washington on December 18, 1992, and amended by protocols signed on October 13, 1993, and March 8, 2004.

⁴⁰“Where by reason of the provisions of paragraph 1, a company is a resident of both States, the competent authorities of the States shall endeavour to settle the question by mutual agreement, having regard to the company's place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such company shall not be entitled to claim any benefits under this Convention, except that such company may claim the benefits of paragraph 4 of Article 25 (Methods of Elimination of Double Taxation) and of Articles 28 (Non-Discrimination), 29 (Mutual Agreement Procedure) and 37 (Entry into Force).”

⁴¹Explanatory note to the 1992 tax treaty between the Netherlands and the United States (*Tweede Kamer*, 1992-1993, 23 220, No. 3, p. 17).