The Dutch Bill: Redefining a Permanent Establishment

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I. INTRODUCTION

During 1988, the Dutch State Council considered a bill which would extend the Netherlands tax jurisdiction to the Netherlands continental shelf, an area which "is neither Netherlands territory nor [in] Netherlands territorial waters." This bill ("Dutch Bill") is scheduled to take effect January 1, 1990. Its purpose is to capture more revenue by taxing exploratory vessels within the Netherlands continental shelf.

It follows a growing international trend to decrease the time period for permanent establishments. If enacted, the Dutch Bill will accomplish its purpose by redefining the time period for a permanent establishment. An activity carried on in the Netherlands continental shelf area for any thirty days within a twelve month period is a permanent establishment. Under the Dutch Bill, foreign corporations conducting business within this area for thirty days will be deemed to have a permanent establishment within the Netherlands for domestic tax purposes. Accordingly, a corporation will be taxed on any profits and its employees will be taxed on their earnings.

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3 Telephone interview with Glyn Wheeler, Tax Chairman of the International Association of Drilling Contractors (IADC) (Mar. 24, 1989). Exploratory vessels are mobile offshore drilling units which include jack-up, semisubmersible, or drilling ships used to develop for oil or gas. Letter from Glyn Wheeler to Natasha E. Brandt (Aug. 3, 1989) (discussing revisions to this Note)[hereinafter Letter of Aug. 3, 1989].
4 This assumption is made based on Norway's reasoning for establishing a shorter period for permanent establishments in offshore areas. See Norway, in 12 LEGISLATIVE HISTORY OF UNITED STATES TAX CONVENTIONS 218-19 (S.I. Roberts ed. 1986).
6 Id.
but only those profits and earnings from Dutch sources.\(^7\)

The Dutch Bill is an important piece of legislation, and opposition from oil contractors, such as those represented by the International Association of Drilling Contractors ("IADC"), was to be expected. Nonetheless, this note concludes that the Netherlands is within its authority in enacting this legislation and, indeed, the Dutch Bill is part of a discernible trend in international practice.

This note will discuss the impact that the Dutch Bill will have on U.S. corporations by considering the importance of the continental shelf area and the burden that the Bill will place on exploratory vessels and its employees. The note will then describe the important terms of the U.S.-Netherlands tax treaty and the opposition that the Bill is receiving. The United Kingdom, Norway and Canada have similar provisions which tax exploratory vessels which remain in their continental shelf areas for short time periods and are used to support the Netherlands enactment of the Dutch Bill. Other arguments suggested by various commentators also endorse this growing international trend.

II. TAXING WITHIN THE CONTINENTAL SHELF

Continental shelves are important areas for oil exploration. Their formations such as basins are ideal for finding natural resource reserves.\(^8\) In the North Sea, sedimentary rocks are located in two distinct basins, the Northern and Southern North Sea Basins.\(^9\) When basins contain porous sedimentary rocks, they are prone to collect organic matter.\(^10\) That organic matter becomes stagnant and the creation of hydrocarbons becomes highly probable.\(^11\) Hydrocarbons can occur in a gas or liquid form of petroleum.\(^12\) As these basins in the North Sea are large, they are prime areas for gas and oil exploration.

With this type of activity going on, countries bordering the North Sea naturally wish to impose taxes within the area to increase revenues. To be taxed, a person or entity must generate income.\(^13\) Exploratory vessels do not produce oil; they merely explore and develop for gas and oil.\(^14\) Therefore, any exploration income is generated from contracts en-

\(^8\) D. Keto, Law And Offshore Oil Development: The North Sea Experience 17 (1978).
\(^9\) Id. at 17-18.
\(^10\) Id. at 17.
\(^11\) Id.
\(^12\) Id. at 18.
\(^13\) Deloitte, Haskins & Sells, supra note 7, at 24.
\(^14\) D. Keto, supra note 8, at 18.
tered into to explore for future wells.\textsuperscript{15}

To counteract unfavorable tax laws, the United States has encouraged its citizens to work abroad by giving tax incentives to employees working overseas.\textsuperscript{16} The United States has also negotiated several tax treaties with countries that claim areas within the North Sea to avoid double taxation and heavy taxation of U.S. nationals.\textsuperscript{17}

\section*{III. Terms Within Tax Treaties}

The Convention Between the Kingdom of the Netherlands and the United States of America with Respect to Taxes on Income and Certain other Taxes\textsuperscript{18} ("U.S.-Netherlands tax treaty") defines the two countries in terms which do not include the area beyond the land territory.\textsuperscript{19} Despite this exclusion, the Netherlands can still exercise sovereignty rights over the area. Moreover, in the treaty the period an activity must be carried on to be a permanent establishment is more than twelve months,\textsuperscript{20} the uniform provision from the Organization for Economic Co-operation and Development ("OECD") model convention.\textsuperscript{21}

The base from which a foreign corporation has enough ties to the country to be subject to its domestic taxes is a permanent establishment.\textsuperscript{22} A growing international trend is for treaties to single out offshore activities and create a shorter time period for a permanent establishment locating within the country's continental shelf, as discussed above.\textsuperscript{23}

A permanent establishment is a fixed place of business in which the management and the place of business of a corporation are located for a stated period of time.\textsuperscript{24} However, a fixed place where only the purchase


\textsuperscript{20} Id.

\textsuperscript{21} Morgan, \textit{IRS, GMCS and AODS: IRS General Counsel Memorandums}, 28 \textit{TAX NOTES} 274, 276 (1985).

\textsuperscript{22} DELOITTE, HASKINS \& SELLS, \textit{supra} note 7, at 65.

\textsuperscript{23} U.S.-U.K. Tax Treaty, \textit{supra} note 17, at art. 27A; U.S.-Norway Tax Treaty, \textit{supra} note 17, at art. 4A.

\textsuperscript{24} U.S.-Netherlands Tax Treaty, \textit{supra} note 18, at art. II(1).
of goods is conducted does not qualify.\textsuperscript{25} The type of fixture is not the sole criteria, for the fixed place can be a branch, an office, a factory, a workshop, or a warehouse, and presumably, even a vessel.\textsuperscript{26} Rather, the length of time that a corporation remains in this fixed place determines whether the corporation can be taxed by the country in which it is currently located. Even though a vessel may move to various points within a country's sovereignty area, the vessel will still be said to have a "fixed" place. The project in which the corporation is engaged delineates this place.\textsuperscript{27}

The U.S.-Netherlands tax treaty also contains a provision which allows each state to apply its own laws when terms are not defined within the treaty.\textsuperscript{28} The Netherlands can use this provision, among others, in creating domestic legislation to define a permanent establishment period specifically for offshore activities.

\textbf{IV. OPPOSITION TO THE DUTCH BILL}

Because of the harsh results that fall primarily on U.S. citizens employed on exploratory vessels, the greatest opposition to the Dutch Bill from within the United States has been from the IADC.\textsuperscript{29} The IADC is concerned about the decrease in U.S. activity within the Netherlands continental shelf which would result from the enactment of the Dutch Bill.\textsuperscript{30} This Bill will place a heavy burden on the drilling contractors and their employees in the Netherlands continental shelf.\textsuperscript{31}

When there is little or no income generated by the exploring corporation, the tax consequences of the Dutch Bill will fall on the employees of the exploratory vessels.\textsuperscript{32} Placing the burden on employees may cause the exploratory vessels to hire nationals of the taxing country or nationals from neighboring countries. Among other things, the Dutch Bill could affect the number of U.S. citizens that U.S. corporations may retain on exploratory vessels in the Netherlands continental shelf,\textsuperscript{33} because neighboring countries may provide a more favorable tax burden on employees through the tax treaties between the two countries.\textsuperscript{34}

\textsuperscript{25} \textit{Id.} at art. II(1)(c).
\textsuperscript{26} \textit{Id.}
\textsuperscript{27} \textit{Id.} at art. II.
\textsuperscript{28} \textit{Id.}
\textsuperscript{29} \textit{TAX NOTES, Netherlands, supra note 2.}
\textsuperscript{30} \textit{Focus on the Treasury: Incoming Treasury Letters, 39 TAX NOTES 936 (1988) [hereinafter TAX NOTES, Focus on the Treasury].}
\textsuperscript{31} \textit{TAX NOTES, Netherlands, supra note 2.}
\textsuperscript{32} \textit{Estes, supra note 15, at 249.}
\textsuperscript{33} \textit{TAX NOTES, Netherlands, supra note 2; Telephone interview with Glyn Wheeler, supra note 3, at Dec. 21, 1988.}
\textsuperscript{34} See \textit{Estes, supra note 15, at 245.}
quently, U.S. corporations could possibly replace U.S. employees working on U.S. exploratory vessels within the Netherlands continental shelf with U.K. employees, since the agreements between the countries create fewer tax disadvantages for U.K. nationals working under the Netherlands tax laws.

The IADC is specifically concerned with the sale status to be imposed on movement of exploratory vessels in and out of the Netherlands continental shelf area; gain or loss from such imposed sale will have to be recognized, even though no actual sale takes place. The depreciation allowances taken in the tax year(s) that the vessel is present within the continental shelf may be recaptured or reclaimed, “denying the U.S. contractor [in particular] capital cost recovery.” The IADC also argues that such sale status imposed on exploratory vessels would create havoc in the industry, but the United Kingdom also treats such movements in and out of its continental shelf area as having sale status.

Even with such opposition, the Dutch Bill is merely following other countries which claim areas within the North Sea and other large bodies of water in reducing the permanent establishment period. The IADC’s opposition would not deter the Netherlands decision to adopt this Bill and follow this evident international practice.

V. FOLLOWING THE TREND

Due to the tremendous activity within the North Sea area, the Netherlands, as one of the major issues in the North Sea Continental Shelf, is following the trend towards gaining more revenue from the activity in the area; specifically from the exploratory vessels. Even though the U.S.-Netherlands tax treaty contains no provision particularizing permanent establishments for offshore activities — a provision found in

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35 TAX NOTES, Netherlands, supra note 2.
36 Estes, supra note 15, at 246.
37 TAX NOTES, Netherlands, supra note 2.
38 TAX NOTES, Focus on the Treasury, supra note 30.
39 Id.
40 Id. The drilling contractor retains a lower net allowable tax depreciation while operating in the Netherlands. Letter of Aug. 3, 1989, supra note 3.
41 TAX NOTES, Focus on the Treasury, supra note 30, at 936. This sale is imposed if the rig does not return within a two to three year period to the U.K. continental shelf. Letter of Aug. 3, 1989, supra note 3.
42 In 1987, it was measured that “420,000 ship movements take place yearly in the North Sea.” Ijistra, Regional Co-operation in the North Sea: An Inquiry, 3 INT’L J. OF ESTUARINE AND COASTAL L. 181, 183 (1988). This figure was taken from a report put out by the Hague on maritime traffic. Id. The number of oil platforms numbered 30 for the Netherlands, 13 for Norway, and 90 for the U.K. in 1986. Id. at 184. These figures were taken from a report conducted from June 1985 to June 1986 by the Paris Commission. Id.
other tax treaties in which the United States is a party — the Netherlands is decreasing the permanent establishment period by enacting domestic law. Through domestic legislation the Netherlands is exercising its sovereignty rights over its North Sea area.

The United Kingdom, the Netherlands, and Norway claim a substantial part of the continental shelf within the North Sea. The United Kingdom and Norway have tax treaties with the United States which provide for the shortened thirty day period for the determination of permanent establishments offshore. The Netherlands is merely increasing its revenue by extending its tax jurisdiction through domestic legislation. As exploratory vessels generally remain in an area for less than twelve months, a twelve month threshold allows most vessels to escape taxation by the Netherlands. Decreasing the time period to thirty days increases the probability that a vessel will be taxed. Mobility no longer allows exploratory vessels to escape taxation as the exigencies of exploration mandates a stay longer than thirty days within the Netherlands continental shelf area of the North Sea.

The United States has maintained its sovereign right to tax activities in its portion of the North American continental shelf. Through exercising its sovereign right, the Netherlands is also following the growing trend of shortening the permanent establishment period for activities within continental shelves. The difference is that the Netherlands has chosen to follow this trend through domestic legislation while other countries, mentioned above, have done so through treaties.

A. The Netherlands

An examination of the Netherlands' corporate and personal income tax structures is necessary to determine how the Dutch Bill will affect exploratory vessels and the employees on these vessels. The source of the Netherlands' authority to pass such domestic legislation will also be discussed. As mentioned, the Netherlands does not have the authority through the specific language within the U.S.-Netherlands tax treaty. But article II(2) of the treaty is read broadly to endorse the trend toward

43 Netherlands, 2 Tax Treaties (CCH) § 5856D (Aug. 1966).
44 TAX NOTES, Netherlands, supra note 2. The Dutch Bill can be passed by a two-thirds vote of the States General. Neth. Const. art. 91, infra note 74.
45 Ijistra, supra note 42, at 184.
46 U.S.-U.K. Tax Treaty, supra note 17, at art. 27A; U.S.-Norway Tax Treaty, supra note 17, at art. 4A.
48 Estes, supra note 15, at 246.
49 Morgan, supra note 21, at 275. It does so through I.R.C. § 638 and Treas. Reg. 1-638-1. Id.
an international practice.\textsuperscript{50} The Netherlands Constitution best supports the Dutch Bill with its override provisions and the requirement of compliance with international practices.

1. Corporate Taxes

Exploratory vessels are subject to corporate taxes when the permanent establishment threshold is met. To compute the corporate tax,\textsuperscript{51} profits need to be converted to guilders (Dfl.).\textsuperscript{52} A tax rate of forty percent applies for the first $119,000 (Dfl. 250,000) in profits; a rate of thirty-five percent applies to profits above $119,000 (Dfl. 250,000).\textsuperscript{53}

The corporate tax rates were reduced in 1987, but the reduction was coupled with a broadening of the top tax base. Several deductions were eliminated including the equity deduction ("a profit deduction of 1 percent of qualifying equity at the beginning of the bookyear representing a permanent difference with accounting income"),\textsuperscript{54} the basic WIR premium (which is a tax-free investment premium of 12.5 percent),\textsuperscript{55} and other business expense deductions.\textsuperscript{56}

Reasonable depreciation deductions are still allowed for corporate assets. An asset used in a corporation's trade whether tangible or intangible is depreciable if its value diminishes over time.\textsuperscript{57} This deduction allows a corporation to decrease taxable income, which is useful for exploratory vessels which do not generate much income. By decreasing its corporate tax level, the Netherlands has increased its need to collect more revenue from other taxable areas. And because exploratory vessels themselves do not contribute toward lost revenue from the reduction of corporate tax rates,\textsuperscript{58} the focus is shifted to the corporation's employees.


\textsuperscript{51} The corporate tax in the Netherlands is derived from the 1810 Mining Act and the 1965 Continental Shelf Mining Act. van Raad, The Netherlands Model Income Tax Treaty, 8-9 Intertax 241, 242 (1988).


\textsuperscript{53} de Vries, Changes in Netherlands Corporate Income Taxation — How do they Affect the Foreign Investor?, 10 Intertax 334, 335 (1988).

\textsuperscript{54} Id. at 335.

\textsuperscript{55} Id. at 334-35. WIR is Wet Investeringsrekening or Investment Account Act. When entrepreneurs invest in assets they are entitled to this premium, which is used to reduce the assessment of corporate income taxes. Loyens & Volkmaars, Government Incentives in the Netherlands, 4-5 Intertax 108, 110 (1987).

\textsuperscript{56} de Vries, supra note 53, at 334-35. The equity deduction and WIR premium are to be eliminated in October, 1988 and July, 1989, respectively. Id. at 335.

\textsuperscript{57} Netherlands, in FOREIGN TAX LAW PUBLISHERS, INC., 22 TAX LAWS OF THE WORLD 7 (1988). Depreciation deductions may allow a corporation to report a loss under U.S. tax law.

\textsuperscript{58} See supra notes 13-16 and accompanying text.
2. Personal Taxes

The employees of foreign corporations are subject to taxes within the Netherlands to a greater extent than the corporations themselves. The personal income tax rate,\textsuperscript{59} which includes social security taxes,\textsuperscript{60} progressed as high as seventy-two percent for incomes over $109,302 in 1988.\textsuperscript{61}

IADC opposition arises because U.S. employees on exploratory vessels would be taxed at higher rates in the Netherlands than in the United States; where rates range from fifteen to thirty-three percent.\textsuperscript{62} These high Netherlands tax rates will create a burden on U.S. employees if the allowable tax credit in the United States for income generated in the Netherlands does not cover the entire amount paid to the Netherlands, as is likely to be the case.\textsuperscript{63} This personal income tax can be a revenue source for the Netherlands which would compensate for any lost revenue due to the decrease of its corporate tax rate.

3. Authority

The Netherlands legislature, if pressed to do so, could sufficiently support the enactment of the Dutch Bill. Support that is available to the legislature is addressed below. Currently the U.S.-Netherlands tax treaty requires that a business be fixed for a twelve month period before it is a permanent establishment and taxable by the Netherlands.\textsuperscript{64} With the Dutch Bill, the Netherlands intends to conflict with the treaty’s provision on permanent establishments to create a shorter permanent establishment period for offshore activities. In order to make this domestic legislation binding on the parties involved, the Netherlands must override the current tax treaty or claim that it is merely extending the treaty by acting on an area not defined in the treaty.\textsuperscript{65}

The language contained within the U.S.-Netherlands tax treaty will be examined first. The Netherlands is defined within the treaty as includ-
ing only the land territory of Europe. There is no indication that this definition includes the continental shelf or any part of the territorial waters. The Geneva Convention of April 29, 1958 granted sovereignty rights for those countries only wanting to explore or exploit natural resources within the continental shelf. But it was argued that these sovereignty rights did not include the right to tax in this area. The Netherlands appears to have disregarded the limitation on sovereignty rights under the Geneva Convention and the U.S.-Netherlands tax treaty because it has included the continental shelf within its tax jurisdiction in various other tax treaties.

Specific language within article II(2) of the U.S.-Netherlands tax treaty may be interpreted as authorizing the enactment of the Dutch Bill. Article II(2) states that any term that is undefined shall have the same meaning that it has under the law of the taxing State, unless the context of the treaty requires a different definition. Using this Article, one can argue that an "offshore" permanent establishment is not defined within the U.S.-Netherlands tax treaty, and therefore the Netherlands can use its domestic legislation to establish the definition.

Article II(2) can also be used for the extension of the Netherlands continental shelf area. Since the Netherlands continental shelf is not defined within the treaty, the domestic law of the Netherlands applies. The United States used this argument to tax drilling activity on its continental shelf; thus the Netherlands should not be prohibited from using this same argument to exercise its sovereignty to shorten the offshore permanent establishment period. In exercising this right of sovereignty, the Netherlands would comply with procedures and limitations set out in its Constitution.

The Netherlands Constitution is the second source that will be examined. If the U.S.-Netherlands tax treaty does not allow the Netherlands to enact the Dutch Bill, then the Netherlands government has its own provisions to act.

Specific language within the Constitution can be used to overcome conflicts between the Dutch Bill and the U.S.-Netherlands tax treaty.

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66 *Netherlands* ¶ 5802, supra note 19, at 5803-3, art. II.
68 *Id.*
69 *Id.* at 276.
70 *Id.* J.R. MacDONALD, supra note 50, at 1413.
71 *Id.*
72 *Id.* at 1415. The United States has subsequently withdrawn its claim of taxation against the Dutch drilling contractor operating on the U.S. continental shelf. Letter of Aug. 3, 1989, supra note 50.
73 J.R. MacDONALD, supra note 50, at 1415.
The Netherlands Constitution contains certain override provisions. Article 91, paragraph 3 of the Constitution states "[a]ny provisions of a treaty that conflict with the Constitution or which lead to conflicts with it may be approved by the Chambers of the States General only if at least two-thirds of the votes cast are in favor." This appears to specifically allow the Dutch Bill to be passed by the States General, even though it may conflict with the U.S.-Netherlands tax treaty. Article 91, paragraph 1 of the Constitution also lends support to override any conflict with a treaty that domestic legislation may have.

International rules of law together with the Netherlands Constitution also support the enactment of the Dutch Bill. A purpose of the Constitution is to "promote the development of the international rule of law." Also, the Constitution requires compliance with the interests of the international community as a whole, when the parties involved have a conflict. By imposing a shorter permanent establishment time period for offshore activities, the Netherlands is merely following its Constitution and a common standard which may eventually become an international practice.

The process of generating acceptance by numerous countries is one of the ways that provisions, such as a shorter permanent establishment time period, become international law. By decreasing the permanent establishment period for offshore activities, the Netherlands would be following a developing standard within continental shelf areas. The Dutch Bill is a means for the Netherlands to exercise its sovereign rights through its Constitution and to encourage the development of international law in the North Sea.

Under article II(2) of the U.S.-Netherlands tax treaty undefined terms are left for domestic legislation to determine. The Geneva Convention also supports the extension of the Netherlands tax jurisdiction. Within the Netherlands itself, the Netherlands governmental structure together with its Constitution allows for overriding treaty provisions and resolving conflicts in light of international practices. There does seem to

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74 Neth. Const., Sec. 2, reprinted in The Netherlands, X Constitutions Of The Countries Of The World 26 (Blaustein and Flanz eds. 1988).
75 Id. at art. 91.
76 Id. Paragraph 1 reads, in part, "[t]he Kingdom shall not be bound by treaties, nor shall such treaties be denounced without the prior approval of the States General." Id.
77 Id. at art. 90. The international rule being the decrease of a permanent establishment from a twelve month time period to a lesser time period; be it six months, three months, or 30 days.
78 Id. at art. 94 and supp. art. 63.
79 Amin, The Legal Regime of the Continental Shelf: Bloc Thinking, 25 J. L. Soc'y Of Scotland 150, 152 (1980). By having an activity followed by numerous countries, the activity eventually becomes an international practice. Id.
80 Id.
81 See supra notes 67-69 and accompanying text.
be a trend developing towards shortening the offshore permanent establishment period and the Netherlands is following in step.

Analyzing the different tax structures of the United Kingdom, Norway and Canada helps to support the Dutch Bill by showing it does not impose such an unusual burden on the United States' exploratory vessels and employees. Following the idea of a developing international practice, the discussion will focus on the similarities of these three countries to the Netherlands and how each of the three countries decreased its permanent establishment period for offshore activities.

B. United Kingdom

The continental shelf areas shared by the United Kingdom and Norway and the United Kingdom and the Netherlands have been delineated using the median line, which is the usual procedure for dividing offshore areas between countries.\(^82\) The United Kingdom controls the largest portion of the North Sea.\(^83\)

The Continental Shelf Act of 1964\(^84\) extended the tax jurisdiction for the U.K. government onto the continental shelf of the North Sea.\(^85\) By 1975 the United Kingdom changed the definition of its tax jurisdiction to include the territorial sea in its tax treaty with the United States.\(^86\) By a 1976 protocol to the U.S.-U.K. tax treaty, the period for an offshore permanent establishment was shortened to thirty days.\(^87\) The Netherlands had to overcome the lack of these changes within its treaty with the United States.

The 1976 protocol provision, article 27A, in the U.S.-U.K. tax treaty deals specifically with offshore activities, which is very similar to the provision in the U.S. treaty with Norway.\(^88\) Like the Dutch Bill's

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\(^{82}\) Jones, United Kingdom, 9 INT'L BUS. LAW. 282 (1981).

\(^{83}\) D. KETO, supra note 8, at 29. The United Kingdom, unlike the Netherlands, divides its area of the continental shelf into blocks measuring roughly 100 square miles when issuing licenses for exploration and production. Id. at 84-87. Taxes are then “levied on a field-by-field basis rather than a company-by-company basis.” G.L. DARLINGTON and F.G. SANDISON, TAX MANAGEMENT: BUSINESS OPERATIONS IN THE UNITED KINGDOM — TAXATION A-46 (1988)[hereinafter DARLINGTON & SANDISON]. Losses are deductible only from income from the same field. Id. The block method is a convenient way to keep track of the traffic and regulate the licensing of oil related traffic in the United Kingdom’s continental shelf area. D. KETO, supra note 8, at 24, 86. The Netherlands does not use this system because their continental shelf area is smaller, and thus easier to control. See id. at 29.

\(^{84}\) Continental Shelf Act, 1964.

\(^{85}\) I C. CHANCE, DOING BUSINESS IN THE UNITED KINGDOM, 16-6 (1987).

\(^{86}\) U.S.-U.K. Tax Treaty, supra note 17, at art. 3. See also United Kingdom, in 15 LEGISLATIVE HISTORY OF UNITED STATES TAX CONVENTIONS 365, 404 (S.I. Roberts ed. 1986); Hammer, US/UK: The New Treaty, 33 THE TAX EXECUTIVE 7, 9 (1980). For the U.K. the term “continental shelf” is used. Id.

\(^{87}\) United Kingdom, 3 Tax Treaties (CCH) ¶ 8103AA, at 8107-21 (July, 1982).

\(^{88}\) This provision for Norway will be addressed in the next section.
permanent establishment provisions, this treaty provision overrides the definition of a permanent establishment in article 5 of the 1975 U.S.-U.K. treaty. Article 5 stated a twelve month period. The time period imposed by article 27A, which is similar to the Dutch Bill, is "30 days in aggregate in any 12 month period." The taxing country obtains revenue sooner from new installations of drilling platforms in the North Sea and also more exploratory vessels will be taxed.

Exploratory vessels can be taxed when they move out of the U.K. continental shelf as well, because these movements are treated as a sale of the vessel. When moving out of the area, the vessel will be treated as being disposed of at its then market price: if this is above the tax written down value this will give rise to a 'balancing charge' being a clawback of allowances which is effectively taxed as a revenue receipt." This burden to be imposed by the Dutch Bill is one that received opposition from the IADC. The use of the sale status and shorter permanent establishment period by the United Kingdom does not appear to hinder the United States from conducting business in the United Kingdom's continental shelf, because it was negotiated within their tax treaty and U.S. companies are still within the U.K. continental shelf conducting activities. In view of this, the IADC opposition would be of little consequence to the Netherlands' decision to enact the Bill.

The current effect on U.S. exploratory vessels in the U.K. continental shelf is shown by examining the tax rates in the United Kingdom. The corporation tax rate is currently twenty-five percent for very small corporations. The corporation tax rate for all other corporations is thirty-five percent. These rates average ten to fifteen percent lower than the Netherlands tax rates. But, these rates will not apply to exploratory vessels if they do not generate profits or income. The current 1988-89 tax rates for personal income taxes are twenty-five percent for

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89 United Kingdom, supra note 87.
90 Id.
91 Id.
92 Jones, supra note 82, at 284.
93 Id. Clawback is defined under Netherlands tax law as a pay back of allowances given to a taxpayer. Loyens & Volkmaars, supra note 55, at 110.
94 D. KETO, supra note 8 at 18.
96 Britain's Tax System, supra note 95, at 8; England Law Digest, supra note 95. The threshold of 500,000 pounds is converted at an exchange rate of $1.613 for each pound. N.Y. Times, supra note 95. It is a progressive tax for income between $172,000 and $860,000. England Law Digest, supra note 95.
97 See supra note 53 and 61 and accompanying text.
income of up to $33,196 and forty percent for income over $33,196.\textsuperscript{98} The Netherlands rate is up to fifty percent more.\textsuperscript{99} While the U.S. employees are taxed only slightly more in the United Kingdom,\textsuperscript{100} the Netherlands impose more of a burden on the U.S. employees in the North Sea.

In addition to the corporate tax within the United Kingdom, there is a unique petroleum taxation system. Revenue from this system is derived from three sources: 1) "licence royalty, [2)]petroleum revenue tax (PRT) and [3)] corporation tax, levied in that order."\textsuperscript{101} The royalty is set at 12.5 percent of the value of oil and gas produced.\textsuperscript{102} This royalty will not apply to exploratory vessels with no oil production. The PRT "is levied at a rate of 75 per cent subject to various reliefs."\textsuperscript{103}

This PRT provision plus the other restrictions and taxes placed on permanent establishments operating in the United Kingdom's continental shelf reaps "substantial tax take from [oil] production."\textsuperscript{104} The overall tax rate in this area is 85.78\%.\textsuperscript{105} After looking at, this aggregate figure and the tax rates in the Netherlands, the forty percent rate and the seventy-two percent rate seem quite fair in comparison.\textsuperscript{106} Even with these provisions, not including the imposition of sale status for vessels moving out of the area, the United States still maintains corporations within the North Sea.\textsuperscript{107}

The Dutch Bill is more lenient in comparison to the current U.K.

\textsuperscript{98} Britain's Tax System, supra note 95, at 6. The amount of 19,000 pounds as been converted by the exchange rate of Sept. 28, 1989 which is $1.613 for one pound. N.Y. Times, supra note 95.

\textsuperscript{99} See supra note 53 and 61 and accompanying text.

\textsuperscript{100} The U.S. tax rates are fifteen percent for income below $50,000, twenty-five percent for income between $50,000 and $75,000 and thirty-four percent for income above $75,000. I.R.C. § 11 (West 1990). Note also that non-resident employees are not required to pay social security taxes to the Netherlands.

\textsuperscript{101} Britain's Tax System, supra note 95, at 9.

\textsuperscript{102} Id.

\textsuperscript{103} Id. The license royalty and the PRT are deducted from profits before the corporation tax is computed on corporation profits. Id. at 10. Under the U.S.-U.K. tax treaty, exemptions allowed by the source country are not applicable to the country with the permanent establishment. International Tax and Business Service, 5 Taxation in the United Kingdom 60 (1983). This allows the country with the permanent establishment to collect more revenues by imposing irregular taxes. The Netherlands is eliminating some of its irregular taxes to allow U.S. corporations and U.S. employees to be able to deduct the taxes paid to the Netherlands from U.S. imposed taxes. See supra notes 54-56 and accompanying text.

\textsuperscript{104} DARLINGTON & SANDISON, supra note 83, at A-45.

\textsuperscript{105} Id. at A-47.

\textsuperscript{106} See supra note 53 and 61 and accompanying text.

\textsuperscript{107} D. KETO, supra note 8, at 94-95. The United Kingdom places a high tax burden on foreign corporations remaining off its shores for more than thirty days and the United States has agreed by treaty to allow such imposition through taxation. Estes, supra note 15, at 245. Any unbearable burden placed on exploratory vessels seems to have been a compromise of means that allowed the United Kingdom the provision of a shortened permanent establishment period. Id.
taxation imposed on petroleum corporations. The United Kingdom decreased the permanent establishment time period through a treaty provision rather than by domestic legislation, although it could have shortened the period using domestic legislation. This provision supports the growing international trend in the North Sea and other continental shelves.

C. Norway

Norway also claims part of the continental shelf within the North Sea. Therefore, it will be important to examine similarities with the Netherlands and Norway.

The official position of Norway is, if a tax treaty does not specifically mention the continental shelf area, the treaty will not apply. However, this position is not carried through in practice, for even when a treaty is silent, the Norwegian government is apt to apply the treaty provisions to its continental shelf. The Netherlands is also applying domestic legislation, the Dutch Bill in particular, to its continental shelf even though this area is omitted from its treaties, such as the U.S.-Netherlands tax treaty. What is not prohibited by a treaty or other provision, a country will diligently use to achieve its ends, such as to gain more tax revenues.

In the Convention Between the United States of America and the Kingdom of Norway for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Property ("U.S.-Norway Tax Treaty") signed in 1971, the separate countries were defined for the first time to include the territorial sea and the seabed and subsoil of the "areas adjacent to the territorial sea," the continental shelf. The United Kingdom has reached this plateau in its tax treaty particularly with the United States, while the Netherlands lacks this provision. In a protocol signed in 1980, the definition of a permanent estab-
lishment was amended for specific application to offshore activities. This provision is very similar to that found in the U.S.-U.K. tax treaty. But this provision is not present for the Netherlands to rely on.

Looking to other treaty provisions, one finds that usually an employee who is present in Norway for an aggregate period of one hundred eighty-three days or more will be taxed on income derived in Norway. Paragraph 4 of article 4A of the U.S.-Norway tax treaty "provides a standard exclusion of the first 60 days' wages of employees of drilling contractors and others subject to it." In comparison, as the Dutch Bill stands, the employees are taxed after thirty days, thus overriding the one hundred eighty-three day provision of the U.S.-Netherlands tax treaty.

This provision for employees of drilling contractors was created because of the higher income tax rates in Norway. The greatest income tax rate is potentially forty-eight percent on net income. If income exceeds $26,640, there is a six percent "top tax." Norway also has a petroleum revenue tax ("PTA") on petroleum production, much the same as the United Kingdom's PRT tax. The Dutch Bill is not placing a substantial tax burden on U.S. corporations because similar burdens are being imposed by the United Kingdom and Norway. The United Kingdom and Norway are merely taking advantage of an interna-

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112 Id. Notwithstanding article 4 of the U.S.-Norway Tax Treaty, article 4A specifically addresses offshore activities. It sets out that "exploration or exploitation of the seabed and sub-soil" of the continental shelf creates a permanent establishment when the activity is conducted "for a period . . . exceeding 30 days in the aggregate in any 12 month period." Id. at art. 4A; Norway, Tax Treaties (CCH) ¶ 6058, at 6065, art. 4A (Feb. 1982). Article 4A was "intended to deal primarily with the activities of certain U.S. independent drilling contractors and their employees in the Norwegian sector of the North Sea." Norway, supra note 4, at 218. It is assumed by this author that this is the same tax base that the Netherlands hopes to reach with its new legislation.

113 See supra note 87 and accompanying text.


115 Norway, supra note 4, at 220.

116 U.S. Netherlands Tax Treaty, supra note 18, at art. XVI.

117 Norway, supra note 4, at 220.

118 Norway Law Digest, in VIII MARTINDALE-HUBBELL LAW DIRECTORY IN EIGHT VOLUMES 7 (1989). One level is the State tax which ranges from ten to twenty-three percent of net income over $4,884. The second level is the community or township tax which is twenty-five percent of income. Id. The threshold of 33,000 kroner is converted at the exchange rate of $.145 for each krone. N.Y. Times, supra note 95.

119 Norway Law Digest, supra note 118. The threshold of 180,000 kroner is converted at the exchange rate of .145 dollars for each krone. N.Y. Times, supra note 95. The credit that U.S. employees receive for this Norwegian tax on their earnings from Norwegian sources is less than the tax paid to Norway. Norway, supra note 4, at 218. The U.S. employees of exploratory vessels are paying a heavy tax burden and the U.S.-Norway tax treaty still exists with the thirty day provision.

120 Norway Law Digest, supra note 118. The threshold of 33,000 kroner is converted at the exchange rate of .145 dollars for each krone. N.Y. Times, supra note 95. The purpose of this tax is to channel revenue to the State. ARNTZEN, BUGGE AND UNDERLAND, supra note 109, at 243.

121 See supra note 101 and accompanying text.
tional trend which is collecting more revenue from offshore activity, much like the Netherlands Dutch Bill will do.

D. Canada

Canada supports an international practice argument because it does not claim an area in the North Sea.\(^{122}\) Canada has negotiated with the United States to have a three month period for offshore permanent establishments rather than a thirty day period.\(^{123}\)

The most recent tax treaty between the United States and Canada, the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital ("U.S.-Canada tax treaty"), signed in September of 1980, as amended by protocols signed in Ottawa on June 14, 1983 and in Washington on March 28, 1984, created a three month threshold for offshore permanent establishments.\(^{124}\) Although the decrease from the twelve-month period is not as great as in Norway, the United Kingdom and the Netherlands, the decrease does give Canada a broader tax basis that would allow taxing more exploratory vessels in the area. But, once again, this provision was negotiated through a treaty. It was not an act of imposing domestic legislation on other countries, like the Dutch Bill.\(^{125}\)

Canada has enacted domestic legislation which incorporates its continental shelf within its legislative authority. Section 255 of the Income Tax Act includes the territorial sea within Canada's tax base.\(^{126}\) Domestic legislation can be used to extend the tax jurisdiction of a country, which lends support to the Netherlands in enacting the Dutch Bill.

Canada is an example of negotiations which allow some benefit to

\(^{122}\) Canada has extensive oil reserves off the coast of Newfoundland. With prospects for oil production, comes foreign corporations locating in Canada's continental shelf area. National Supply's Drilling Outlook, 1980 OIL AND GAS J. 123 (Jan. 14, 1980).

\(^{123}\) See Estes, supra note 15, at 248. The United States has allowed the thirty day period for activities in the North Sea and it is even willing to give concessions to Canada and other countries.

\(^{124}\) Canada, Tax Treaties (CCH) ¶ 1317 (April 1984). The new paragraph reads,

The use of an installation or drilling rig or ship in a Contracting State to explore for or exploit natural resources constitutes a permanent establishment if, but only if, such use is for more than three months in any twelve-month period.

\(^{125}\) In 1983, legislation was proposed by Canada to extend its jurisdiction to the continental shelf area. Contract Drillers and Retroactive Canadian Treaty Changes, 20 TAX NOTES 368 (1983). This legislation was proposed with retroactive effect. Id. But, after extensive talks with the United States, whose residents and citizens would have had to have paid the most back taxes, the Canadian government changed the legislation to have merely prospective effect. Id. Like the Netherlands, Canada still has the right to enact such legislation.

both parties involved, while not denying sovereignty rights over the continental shelf area. It also contributes to the growing trend.

VI. OTHER SUPPORT FOR THE DUTCH BILL

Other areas which support the Dutch Bill include an inherent right of countries recognized by the International Court of Justice.\textsuperscript{127} There has been a recognized trend from the 1940s onward for jurisdictional rights over the continental shelf.\textsuperscript{128} The continental shelf is seen as a natural prolongation of the land territory,\textsuperscript{129} and therefore it can be regulated by domestic legislation. Sovereignty rights are not limited by international rules of law\textsuperscript{130} and there is not an override provision within the U.S.-Netherlands tax treaty which prohibits enacting the Dutch Bill.\textsuperscript{131} These areas all support the Netherlands legislation.

In the \textit{Tunisian - Libyan case},\textsuperscript{132} decided by the International Court of Justice ("ICJ") in 1982,\textsuperscript{133} Judge Jimènez De Arêchaga stated that the right of countries to a continental shelf "is non-negotiable — [it is] an inherent right."\textsuperscript{134} The Netherlands is making a claim to its right to have its tax jurisdiction extended to its continental shelf area by enacting the Dutch Bill.\textsuperscript{135}

As far back as 1967, the Netherlands controlled its continental shelf area from a dispute with Denmark resolved before the ICJ.\textsuperscript{136} According to Amin, "it is accepted that although the unilateral act of states does not in itself create any new rules of international law, the currently well-known legal regime of the continental shelf was originated in consequence of the unilateral acts of states from the 1940s onward."\textsuperscript{137} The Netherlands is following this developing international law together with the United Kingdom, Norway and Canada.

One commentator, S.H. Amin, concluded that "[t]he principle of

\textsuperscript{127} Beaglehole, \textit{The Equitable Delimitation of the Continental Shelf}, 14 \textsc{Victoria Univ. of Wellington} L. \textsc{Rev.} 415, 428 (1984).


\textsuperscript{129} \textit{Regime of the Sea-Bed}, supra note 128, at 70.

\textsuperscript{130} Ijistra, supra note 42, at 193.

\textsuperscript{131} van Raad, supra note 51, at 247; U.S.-Netherlands Tax Treaty, supra note 18, at art. 2(2).

\textsuperscript{132} Continental Shelf (Tunisia v. Libya), 1982 I.C.J. 18.

\textsuperscript{133} Id.

\textsuperscript{134} Beaglehole, supra note 127, at 428.

\textsuperscript{135} The IADC, specifically, within the United States is objecting to this assertion. But there does not appear to be any other opposition to the Netherlands exercising this inherent right.

\textsuperscript{136} \textit{Regime of the Sea-Bed}, supra note 128, at 66.

\textsuperscript{137} Id. at 63 (citing Andrassy, \textit{International Law and Exploitation of Natural Resources of the Seabed and Subsoil}, 6 \textsc{Polmark} 249 (1968)).
‘natural prolongation of the land territory’ is the main legal basis upon
which the doctrine of the continental shelf rests.”138 This principle sup-
ports state territorial claims,139 and is supported by the inherent right of
sovereignty of the coastal states over the continental shelf area.140 Amin
also wrote in 1980 that political bloc orientation141 is not used to shape
policies governing the continental shelf area.142 National interests are
the dominating factors.143 These national interests coincide with the sov-
ereign and inherent rights to control proportionate areas of the continen-
tal shelf, the “natural prolongation” of the territory.144

Even if there is not a developing international practice, the Nether-
lands still has inherent sovereignty rights to tax its continental shelf area.

Oil and gas exploitation take place within the sovereign power of the
coastal state (Art. 2(1), 1958 Continental Shelf Convention; Art. 77
LOSC). This implies that the coastal state is only marginally limited
by the rules of international law in the exercise of its sovereign rights
over the continental shelf. Hence the regulation of exploitation of the
continental shelf takes place to a vary large extent within the frame-
work of the national legislation of the coastal state.145

The Netherlands is exercising such rights over its continental shelf by
enacting the Dutch Bill. The only apparent restrictions on such legisla-
tion as the Dutch Bill are maritime safety146 and the rights and freedoms
of other States within the area.147 These are not problems for the Dutch
Bill, because this is tax legislation and not legislation which regulates
licensing or other use-oriented activities within the continental shelf.

Since the United States does not have any sovereignty rights within
the North Sea area, the only rights given to the United States are given
through licenses approved by the Netherlands or other countries where
the United States may locate ships and platforms within the North
Sea.148

139 Id. at 70.
140 Id. This statement is also “supported by the ILC [(International Law Commission)] (1956)
and ICI [(International Court of Justice)] (1969) and UNCLOS III [(Third United Nations Confer-
ence on the Law of the Sea)] (1973-1981).” Id.
141 Amin, supra note 79. Political bloc orientation is the formation of political groups of states
to attain common goals. Id.
142 Id.
143 Id.
144 Amin, supra note 128, at 70-72.
145 Ijistra, supra note 42, at 193.
146 Id.
147 Id.
148 See Oudshoorn, supra note 60, at 418.
Another commentator addresses an override feature within a constitution and treaties. He states that when there is a conflict between a state statute and a treaty, the treaty prevails. In order to avoid overriding the treaty provision, he suggests that a penalty clause be incorporated into the treaty to give the opposing country an enforcement mechanism. Such a provision will deter casual instances where statutes may be in conflict with existing treaties, because it may make a country hesitate before enacting legislation which conflicts with a treaty. It appears that this is not a majority position since this penalty or enforcement provision is not present in the U.S.-Netherlands treaty. Therefore, the Netherlands is not encouraged to remain faithful to the treaty. The United States can only negotiate with the Netherlands to impose some regulations on the Netherlands Government to comply with the treaty. Beyond this, the Netherlands has every right to enact the Dutch Bill.

VII. Conclusion

The Dutch Bill is merely the codification of an international practice and sovereign right. The Dutch Bill will not be applied beyond its sovereign territory. It will be applied to the continental shelf area over which the Netherlands has sovereign rights. Any burdens that the Bill might generate are already imposed by other countries through domestic legislation or treaties. The Dutch Bill is using the Netherlands inherent right to extend its jurisdiction to its continental shelf area. Countries have been exercising such rights since the 1940s. This inherent right is also a right of sovereignty which cannot be hindered by other countries or even by international rules of law. Thus, the Netherlands will be within its authority when it enacts this Bill in January of 1990.

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150 van Raad, *supra* note 51, at 247.
151 *Id.* at 248.
152 *Id.*

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