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Tax alert – Belgian withholding tax planning

In private equity, holding companies established in Belgium are often used to benefit from the attractive capital gains tax treatment in that jurisdiction. In Belgium, capital gains on "normally" taxed participations (EU and non-EU) are exempt from corporate tax. To benefit from the exemption, no minimum investment holding period is required, nor a minimum invested amount. Additionally, the combination of a Belgian holding company held by a Luxembourg company (double holding structure), makes it possible to upstream the return on investment completely free of tax (neither Belgian nor Luxembourg withholding tax is due) – see immediately below.

25 or 15% withholding tax in Belgium

In Belgium, dividend distributions (in the course of business and/or at the moment of liquidation[1]), are generally subject to a 25 or 15% withholding tax, in contrast to the full exemption of capital gains on alienation of a participation. Therefore, additional withholding tax planning may be needed. This is especially true for small investments (meaning participations below a 10% threshold) and investments made by corporations and individuals established in a country that has no double tax treaty with Belgium.

Most withholding tax planning is based on the Belgian domestic law provisions that state that distributions made to "normally" taxed corporations, having a participation of at least 10% and established in the EU or established in a "good" treaty country[2], are exempt from withholding tax (implementation of the so called parent-subsidiary directive + internal law extension of the benefit of the directive to corporations established in a "good" treaty country).

For this reason, the combination of a Belgian holding company, held in turn by a Luxembourg company, is often used. No Belgian withholding tax will be due on dividend distributions made to a qualifying Luxembourg parent (holding) company. Furthermore, (re)distributions made at the time of liquidation of the Luxembourg parent company are not subject either to withholding tax in Luxembourg. The Belgian capital gain exemption remains of course equally applicable.

Risk of recharacterization (art. 344 §1 BITC)

The Belgian rulings commission generally accepts that distributions made by (Belgian) target companies to an interposed "normally" taxed holding company cannot be disregarded and recharacterized as distributions made directly to the investors. This however on the conditions that:

- substance is respected and that
- legal title of the (Belgian) target shares is effectively owned by the interposed company[3].

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[1] In Belgium, liquidation proceeds are qualified as dividends

[2] I.e. a country with a DTT with Belgium that contains exchange-of-information clauses.

[3] Implying that the income received is recorded in the accounts of the interposed company; hence included in its taxable base. Furthermore, it is stated towards the Belgian rulings commission that the interposed company has free disposal of the cash received (banc deposit, reinvestment, redistribution etc.)

- The last element (respect of legal title) clearly shows that, in contrast to other jurisdictions (e.g. France), the Belgian rulings commission does not use a substance-over-form approach but respects the “legal reality” of the holding structure, which is in line with the strict interpretation of the Belgian general anti-abuse provision, as set forward by the Belgian Supreme Court.

A Brussels tribunal however judged very recently that the existence of a sound business purpose (other than tax planning motives) is decisive in determining whether an interposed (Luxembourg holding) company can be disregarded or not. Hence, it is assumed (though this is not made entirely explicit in the judgment) that according to the Brussels tribunal the general anti-abuse provision (art. 344 of the Belgian income tax code) can still be invoked, unless solid business needs exist.

In the case judged by the Brussels tribunal, the double holding company structure was justified for the following (investor) business reasons:

- the need to shield personal liability (so warranties at investor level could be avoided)[4];
- the need to ensure the liquidity and flexibility of the investment by having the possibility to transfer the shares and financing (bonds) to third parties[5]; and
- the need to ensure that no investor could block the sale of the (Belgian) target. The possibility to sell the target shares was also vital for the financing bank.

Conclusion

Businesses having an interposed holding company to prevent Belgian withholding tax are advised to carefully check, on a case-by-case basis, the implications of the above mentioned judgment on their tax position. Furthermore, as far as future deal planning is concerned, the use of holding companies to prevent Belgian withholding tax should be carefully structured so the sound business reasons are apparent. In this light, the use of an investment company subject to a specific regime, such as the Belgian Private Pricaf, may be advisable, because the sound business reasons (investment objectives) are easier to demonstrate when investors make use of this dedicated type of entity. Furthermore dividends distributed during the lifespan of the Private Pricaf, stemming from capital gains on shares, are not subject to withholding tax. Moreover, distributions made by liquidation or share by back, are not subject to any withholding tax in Belgium.

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[4] For banc financing and the conditions thereof, it was –in the case at hand- vital that the Luxembourg investment vehicle granted warranties. Furthermore it was proved that indeed no warranties were granted at investor’s level. Moreover, parties stated that the investment would not be made if personal liabilities could not be shielded.

[5] The element that two investors indeed transferred part of their shares in the Luxembourg investment vehicle (and bonds held) to an independent party sustained this sufficiently.