

Belgium in international tax planning

Presented by Bernard Peeters and Mieke Van Zandweghe, tax division at Tiberghien

Belgium has improved its tax climate considerably in recent years. This may be illustrated by an improvement of its domestic tax legislation, an extension of its tax treaty network and well established ruling practice. Below we summarize Belgium's main tax features.

1. Notional interest deduction:

In 2006, a new and revolutionary tax regime has been introduced, the so-called risk capital deduction or notional interest deduction, as it is more commonly known. It has been introduced by the Belgian government as an alternative to the Belgian co-ordination centre tax regime, which, after more than 20 years of existence, has now almost come to an end under EU pressure.

The notional interest deduction is open to all companies doing business in Belgium, even to foreign companies only having a permanent establishment in Belgium or real estate investments. In fact, it is open to existing, as well as to newly started, operations, irrespective of the business sector the company is active in and also irrespective of the size of the company.

According to this new tax regime, businesses will be able to deduct, each year, the cost of their equity from their taxable income, just as they currently do in relation to interest charges incurred in order to finance their business activities. Any deduction which cannot be used in a given year can be carried forward for a period of seven years.

The cost of equity is currently calculated by applying the interest rate on linear long-term Belgian gilts (the 10-year OLO rate) to the company's accounting equity. The company's accounting equity, as determined in accordance with Belgian Generally Accepted Accounting Principles (GAAP), is shown in the (unconsolidated) annual accounts of the previous financial year. The interest rate applicable for income year 2009 amounts to 4.473%. For small- and medium-sized businesses, the rate amounts to 4.973%. During the budget negotiations for year 2010 however, the government announced to introduce a cap of 3,8%.

In calculating the accounting equity, some items are, however, not taken into account: capital subsidies, re-evaluation gains and the net book value of its own shares and financial fixed assets that consist of holdings and other shares. A number of special rules apply in order to counter abuse. Special rules also apply in the case of changes to the accounting equity in the course of the financial year. The same counts in case a company's accounting year is compromised by more or less than 12 months or for a company's first financial year.

The notional interest deduction is only granted in relation to the equity of a company that is deemed to generate taxable income in Belgium. Hence, the following items are excluded and deducted accordingly in order to calculate the accounting equity:

- for companies with a permanent establishment in a country with which Belgium has entered into a tax treaty under which any such income is exempted in Belgium: the accounting net assets of the foreign establishment;
- for companies with real estate situated abroad from which any income is exempted under a tax treaty: the excess net book value of these assets over the total liability items that are attributable to such real estate.

Proper tax planning around the notional interest deduction may help to reduce Belgian corporate tax liability considerably. It may also contribute to reduce overall tax liability for multinational groups, especially where a Belgian finance company is established as an alternative for the well-known Belgian co-ordination centres. A Belgian investment cq. portfolio company may also be of interest as an alternative for (foreign e.g. Luxembourg) companies paying a substantial amount of net wealth tax. By contributing the portfolio into a Belgian subsidiary, the notional interest deduction is being used without paying net wealth tax¹.

2. Tax ruling practice:

In year 2005, the Belgian ruling procedure has been renewed. Since then, the ruling practice has played an important role in putting Belgium back at the forefront of countries where businesses can get legal certainty on the tax treatment of their operations. Businesses may in principle submit a ruling request on any tax issue to the commission. This may be done from the outset in a formal way. It is also possible to start discussions with the commission on an informal basis during so-called pre-filing meetings. When a ruling request is being introduced, one can normally expect to receive an answer within a period of three months, sometimes much sooner.

Currently business reorganizations as well as transfer pricing issues are the most popular amongst the issues submitted. The commission has also issued some interesting decisions on tax transparency issues e. g. regarding US general partnerships, UK LLP's, German KGs etc.. Finally, decisions have been granted on the so called tax shelter for movies and on the Belgian tax regime for the shipping industry. Following decisions may illustrate Belgium's attractive tax climate:

¹ Qualifying participations are exempt of Luxembourg net wealth tax

2.1. Hybrid financial instruments: Profit participating loans

In Belgium, real estate certificates, convertible bonds and subordinated loans are commonly used as hybrid financial instrument. Moreover, the Belgian ruling commission confirmed the use of so called profit participating loans (PPL) and accepted the deductibility of the interest in the hands of the Belgian corporate issuer, knowing that the interest is not taxed in the hands of the Luxembourg creditor by application of the participation exemption. From the case presented to the Belgian ruling commission, the following characteristics can be deducted:

- The PPL is convertible into shares in accordance with the provisions of the Belgian Code of Companies. The conversion can be decided upon by any party at any time.
- The PPL is a registered bond or a loan.
- The PPL has a maturity of 10 years, renewable for another 10 year period unless otherwise agreed upon and renewable for a further 10 year period upon explicit consent.
- The PPL is subordinated.
- The PPL interest is profit linked and depends on the profit generated by the activities which have been financed by the PPL.
- The ruling is based on the fact that the margin earned by the Belgian company adequately reflects its executed functions and incurred risks (no currency or other risk for the Belgian issuer).

2.2. Excess profit ruling: opportunities for multinational groups to reorganize their business

In 2004 Belgium introduced into Belgian domestic law a new arm's length provision which is modelled on article 9 of the OECD Model treaty. The provision makes it possible for multinational enterprises to obtain an advance ruling on the allocation of profits and/or on the at arm's length character of pricing arrangements in the framework of cross border (related) party relations. The provision however also allows Belgium to unilaterally grant an advance ruling for downward adjustments e.g. for profits that are shifted from abroad to Belgium and would not have been realized if it were a stand alone enterprise. The "excess profit" (being that part of the profit exceeding the profit that could have been realized by the Belgian company under arm's length conditions and which is a result of group synergies) will be excluded from the taxable basis of the Belgian company. Appropriate transfer pricing documentation has to be submitted in order to determine the arm's length profit that should have been realized by the Belgian company. The conditions and calculation of the arm's length profit for the Belgian company are then fixed in a so called "excess-profit" ruling. An application can be found in a recently published ruling on a case where a multinational group intended to transfer from abroad to Belgium its central entrepreneur functions and risks. This approach may offer opportunities to multinational groups while concentrating e.g. central entrepreneur functions and risks in one single location in Europe.

3. Patent income deduction (PID)

As from tax year 2008 (financial year on 31 December 2007 or later) Belgian companies and Belgian branches of foreign companies are entitled to apply a tax deduction for qualifying patent income, provided certain conditions are respected. Hence, 80% of the patent income becomes deductible from the taxable basis giving rise to a tax burden of the qualifying royalty income of only 6,8%. The PID more specifically covers:

- patents or extended patent certificates owned by a Belgian company or Belgian branch as a result of its own patent-development activities in research and development centres in Belgium or abroad and
- patents or extended patent certificates acquired by a Belgian company or establishment provided it has further developed the patented products or processes in the company's research centres in Belgium or abroad. To benefit from the deduction, the research centre should qualify as a so-called "line of business". In essence, it should be an entity or a division of an entity that is capable of operating autonomously.

The Belgian company or Belgian branch can use the patents – owned by it or licensed to it – to manufacture patented products or have them manufactured on its behalf. Alternatively, it can license the patents to other parties. Combined with other measures (like for example the notional interest deduction), the PID may result in a substantially reduced tax burden.

4. Withholding tax exemptions on interest payments

Belgium domestic law foresees several withholding tax exemptions on interest payments. Exemptions that are regularly used are:

- interest paid to *qualifying group companies*. Latter exemption is based on the European Interest & Royalty directive where Belgium extended the exemption to *indirect* holdings of at least 25%;
- interest paid to *banks* established in the E.E.A. or in a "tax treaty country";
- interest paid by a Belgian *eligible quoted company* or an eligible *intra-group finance company*;
- interest from *registered bonds* issued by Belgian companies/branches.

The domestic withholding tax rate (15%) may also be reduced by application of a double tax treaty (subject to the conditions off course of the treaty). Hence, interest payments to for example the Netherlands, Luxembourg and the US may be exempt of withholding tax.

5. Withholding tax ('WHT') exemption on dividend distributions

Dividend up streams are not subject to withholding tax under the conditions of the EU Parent-Subsidiary Directive. Additionally, no WHT is due on dividends paid to companies located in a tax treaty country (provided the treaty contains an exchange of information clause). The latter relief will apply if the parent company: (i) is a *resident* of a country with which Belgium has a tax treaty; (ii) is subject to corporation tax or to a similar tax; (iii) is not subject to a tax regime which deviates from the common tax regime; (iv) holds a *minimum shareholding* of 10% in the distributing company for a *minimum period* of one year; and (v) has a *legal form* similar to the forms entitling a company to benefit from the Parent Subsidiary Directive. The latter withholding tax exemption provides an additional international tax planning tool; especially knowing that Belgium has a quite extensive tax treaty network (e.g. with US, Singapore, Hong Kong etc.) and is currently involved in negotiations with several states.

6. International competitive holding regime

Profits realized by a Belgian company are subject to 33.99% taxation. Dividend income and capital gains on shares may however benefit from a favourable tax treatment.

Under the following conditions, a Belgian company can benefit from the participation exemption up to 95% of the *dividends* received:

- the Belgian company shareholder must hold in full ownership during an uninterrupted period of one year a minimum participation of at least 10% or a participation with an acquisition value of at least 1.2 million EUR.
- the participation has to qualify under Belgian accounting law as a fixed financial asset, and
- the subsidiary distributing the dividend must be subject to Belgian corporate income tax or a similar foreign tax (taxation requirement). Special rules apply for offshore companies, investment companies and/or finance companies.

When comparing Belgium as a holding jurisdiction to other European countries, the main attractiveness of Belgium's holding regime is the full exemption of *capital gains on qualifying shares* (i.e. participations that meet the taxation requirement) without any threshold or holding period requirement.

As a general rule, interest payments made or charges incurred by a Belgian company in relation to a bank debt or a shareholders loan, are in principle tax deductible provided they are made (incurred) in order to acquire or preserve taxable income. Recent Belgian case law however shows that the Belgian tax authorities are more and more rigid when applying this test. A combination with the notional interest deduction may nevertheless still result in successful tax planning.

7. VAT Grouping

As from 1 April 2007 taxable persons established in Belgium that are closely related through financial, economic and organizational links, are entitled to opt for VAT grouping. The new measure may contribute to reduce considerably irrecoverable VAT. It may also contribute to reduce overall compliance costs. Main characteristics of the regime are:

- supplies of goods and services between members of the group will no longer fall within the scope of VAT;
- each member of the VAT group is jointly liable for the VAT debts incurred by the VAT group as a whole;
- it is an optional regime though VAT payers must remain a member of that VAT group until at least December 31 of the third year following the year during which the application was filed;
- deduction and recapture of input VAT will depend on the use of the goods or services by the members of the VAT group.

8. “Tailor-made” investment vehicles

8.1. Belgian Private Privak (Pricaf)

In 2003 the Belgian legislator introduced an investment vehicle for private equity investments called the Private Privak (Pricaf). As the original legislation was perceived as being quite stringent, new amendments were introduced in 2008 with the aim to make the Private Privak a much more flexible entity. The main advantage of the Belgian Private Privak is a combination of having separate legal personality with transparency for tax purposes. According to the Private Privak regime Belgian and foreign investors can, provided certain conditions are fulfilled, receive dividends, liquidation proceeds or share buy back distributions free from withholding tax. The Private Privak itself benefits from a limited tax basis under which capital gains and dividends in principle are fully tax exempt. In practice, the Private Privak is mainly used for private equity investments and exit route structuring.

8.2. Pan European pension fund (OFP)

In 2006, Belgium adopted the so called IORP directive by adopting a comprehensive legal, prudential and fiscal framework for multinationals that have the aim to create pan-European and international pension funds. The legal framework is based on the principles of flexibility and contractual freedom: parties setting up the fund can structure according to their own needs and wishes provided an appropriate division of operational responsibilities (board of directors) and supervision responsibilities (general assembly) is ensured. The pension fund in Belgium takes the legal form of an OFP and may, when authorized by the CBFA, start operating several pension plans providing for retirement benefits. Belgian law is not requiring that one or more sponsor undertakings is located in Belgium, nor that at least one pension plan which the OFP operates applies to

workers in Belgium. The prudential framework is mainly focused on qualitative, rather than quantitative rules, both for the determination of the technical provisions and for the investments (prudent person principle). In addition to the advantageous legal and prudential framework, the OFP is benefiting from a favorable tax regime in principle resulting in a zero corporate taxation. Knowing furthermore that the OFP is benefiting from a favorable indirect tax treatment (VAT), and (as an entity being subject to corporate income tax) should be able to claim double tax treaty benefits, Belgium definitely should be a prime location for international and pan-European funds.