Notional Interest Deduction: the Belgian experience

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What is it?
Notional Interest Deduction

- A deduction of a fictitious interest equal to a certain percentage of the equity of any Belgian or foreign company subject to tax in Belgium:
  - Applicable as from tax year 2007;
  - Interest rate applicable for tax year 2012: 3.492% (+ 0.5% for SME’s)
Objectives anno 2005
Notional Interest Deduction

- Lowering the nominal and effective corporate tax rate;
- Enhance and increase the equity of Belgian companies;
- Keep the remaining coordination centers in Belgium;
- Reduce the gap in the tax treatment of interest payments and dividends;
- Promote capital-intensive investments in Belgium;
Lowering corporate tax rate

- Despite of the tax reform of 2002 with a drastic reduction of the nominal corporate tax rate from 41.07% to 33.99%, Belgium had in 2005 still one of highest nominal and effective corporate tax rates within Europe;
Lowering corporate tax rate

Nominal corporate tax rates (anno 2006) *(source: Economisch Tijdschrift 2007)*
Lowering corporate tax rates

Average effective corporate tax rates (anno 2006) (source: Economisch Tijdschrift June 2007)
Lowering corporate tax rates

Evolution nominal corporate tax rates (source: Nationale Bank van België)
Enhancing equity of Belgian companies

Evolution of equity of Belgian companies *(in billion euro’s – source: NBB)*

![Graph showing the evolution of equity of Belgian companies](image)
Reducing debt of Belgian companies

Evolution of debt of non-financial Belgian companies (source: NBB)
Keeping remaining CC’s in Belgium

- In June 2005 Belgium still had 121 coordination centers;
- More than 100 stayed in Belgium making use of the NID;
How does it work?
The NID legislation

- Law of June 22, 2005
- Prepatory works:
  - "The NID is the only credible and competitive alternative which is available for maintaining decision and coordination centers in Belgium and all professional activity linked to it, and for which Belgium has gained in the past 20 years a know how which is unique in the world."
The NID legislation

- The proposed deduction will be applicable to all Belgian companies and foreign companies taxable in Belgium, except those benefiting from a special tax regime. The NID deduction is further fully compliant with European and Belgian constitutional provisions.”
The NID legislation

- Most important features:
  - Tax deduction calculated as a percentage of equity;
  - Applicable to all Belgian companies and foreign companies subject to the standard Belgian corporate tax regime;
  - NID deduction = % of slightly corrected equity of the previous book year as it appears from the annual accounts;
  - % equal to the annual average of the monthly published interest rates for 10-year linear Belgian government bonds («OLOs») \( \Rightarrow \) 3,492 % for tax year 2012 (+ 0,5 % for SME’s)
The NID legislation

- Variations in equity in the course of the book year (such as dividend distributions, redemptions of capital, etc...) are taken into account;
- Financial fixed assets (participations) should be excluded from the basis;
- As well as the net equity assigned to foreign permanent establishments or real estate property or rights located in countries with which Belgium has a DTT;
The NID legislation

- As well as tax-free revaluation gains and capital subsidies;
- A limited number of anti-abuse provisions;
- If the company makes insufficient profit, the deduction can be carried forward to the following seven years;
The European context
EU context

- Belgium is convinced that the NID legislation is state aid proof (art. 107 TFEU) and did not notify the EU Commission:
  - No selectivity or specificity: see Commission notice 98 C-384/03
EU context

- Nevertheless action of the EU Commission in February 2009 but not on potential state aid issue:
  - Exclusion of foreign p.e’s and foreign real property located in DTT countries, is considered to be an infringement of art. 49 and 63 TFEU;
How much does it cost?
How much does it cost?

Budgetary evolution Belgian corporate taxes (2000 = 100; source EC/FEB)
### How much does it cost?

<table>
<thead>
<tr>
<th>Year</th>
<th>Voorafbetalingen</th>
<th>Kohier</th>
<th>totaal</th>
<th>toeename</th>
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</thead>
<tbody>
<tr>
<td>2000</td>
<td>9,236,428</td>
<td>144,101</td>
<td>9,380,529</td>
<td>4,1%</td>
</tr>
<tr>
<td>2001</td>
<td>9,208,481</td>
<td>440,750</td>
<td>9,649,231</td>
<td>2,9%</td>
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<tr>
<td>2002</td>
<td>8,618,702</td>
<td>806,516</td>
<td>9,425,218</td>
<td>-2,3%</td>
</tr>
<tr>
<td>2003</td>
<td>8,546,256</td>
<td>754,583</td>
<td>9,300,839</td>
<td>-1,3%</td>
</tr>
<tr>
<td>2004</td>
<td>9,724,017</td>
<td>726,155</td>
<td>10,450,172</td>
<td>12,4%</td>
</tr>
<tr>
<td>2005</td>
<td>10,276,923</td>
<td>841,860</td>
<td>11,118,783</td>
<td>6,4%</td>
</tr>
<tr>
<td>2006</td>
<td>10,845,123</td>
<td>1,043,994</td>
<td>11,889,117</td>
<td>6,9%</td>
</tr>
<tr>
<td>2007</td>
<td>11,546,570</td>
<td>1,340,205</td>
<td>12,886,775</td>
<td>8,4%</td>
</tr>
<tr>
<td>2008</td>
<td>11,353,608</td>
<td>1,532,977</td>
<td>12,886,584</td>
<td>0,0%</td>
</tr>
<tr>
<td>2009</td>
<td>8,393,546</td>
<td>794,213</td>
<td>9,187,760</td>
<td>-28,7%</td>
</tr>
<tr>
<td>2010</td>
<td>9,318,625</td>
<td>1,209,304</td>
<td>10,527,929</td>
<td>14,6%</td>
</tr>
</tbody>
</table>

*In thousands euro

How much does it cost?

- Intensive debate in Belgium:
  - Gross cost relatively easy to calculate;
  - Net cost however highly debated (large deviations even between official authorities such as tax authorities vs. National Bank);
  - Discussions due to difficulty in calculating a.o. the effect the following issues:
    - Compensating measures introduced at the occasion of the NID;
    - Economic return?
How much does it cost?

- Effect of capital inflow in Belgium from abroad which wouldn’t have occurred without NID;
- Substitution of effective interest payments with notional interests (debt vs. equity);
- Substitution of CC- legislation by NID deduction;
- Deferral of use of NOL’s;
- Etc...

- Belgian National Bank arrived for the year of 2008 at a net cost between 280 to 770 Mio € but warms that calculation is very difficult;
How much does it cost?

- Anyhow, in the course of 2008 Belgian tax authorities start to react to alleged abuses:
  - So called ‘double dipping’;
  - Artificial increase of equity;
Reactions

“Double dip”

Parent Co

Bel Co I

Bank loan

Cap.

Bel Co

Fr Co

Bel Co

ForeignCo

Dutch Co III
Reactions

Intragroup transfer of participations with realization of capital gains

- Sale of participations to either Bel Co II or Foreign Co:
  - NID Basis improves for Bel Co I (is worsening for Bel Co II if the latter is the purchaser);
Reactions

- Creation of a task force in 2008;
- Administrative anti-abuse circular of April 2008;
- Creation of a specific anti-abuse team at the Central Tax Authorities;
  - Data mining:
    - Important increase of equity;
    - Realization of important capital gains;
    - Important reduction of participations;
- Reaction of advance ruling commission

→ effect all by all (very) limited