Tax amnesty

Was it just the silly season ? Since the Government decided that there would be a fiscal amnesty, no day passes without someone having a say about it.

One of the reasons was the adoption of the EU Savings Directive. As of 2005 each EU Member State will inform the others how much income their residents have collected on their savings. If the system can be organised in time, Belgium will then know exactly how much interest income each of us has collected abroad. Interestingly enough, Belgium values its own banking secrecy rules too much to join in, at least for the immediate future. Together with Austria and Luxembourg, Belgium will withhold tax at 15 % on interest (between 2005 and 2007), then at 20 % (2008-2010), and finally at 35%.

Many Belgians have their investments on Luxembourg bank accounts or travel to Luxembourg regularly to cash the interest on their bearer bonds and cash certificates. Because 15% in Luxembourg is as much as the 15% tax in Belgium, the Government hopes that some of us are willing to pay a small penalty to get a complete amnesty for their tax evasion in the past.

It is still early days, but Minister Reynders proposed that one could get an amnesty by paying 10 % of the capital, anonymously. The bank would then deliver a certificate. If the money is invested in an investment fund or a Belgian company, the penalty would be 6 % or even 3 %. The debate is only starting, but it is clear what the main concerns are.

The first is an ethical question. Is it acceptable that those that cheat pay so little if earnings are taxed at rates going up to 50 %. The Government seems to assume that most of us are guilty to some degree, and will only welcome the amnesty ?

Another issue is that the amnesty should only benefit grey and not black money. Black money stands for the proceeds of criminal activities or for hidden funds that have never been declared or taxed. Because the capital is black, the interest was never declared and is just as black Grey money was white to start with. It comes from earnings which have been taxed, or an inheritance which has been declared, but the interest or dividends have never been declared since then. A large part of the billions held on foreign bank accounts is not black ; most are not in a position to earn money in the black but they have just forgotten to declare the tax on the interest. These proceeds in the black have muddled the white money, and the longer it stays abroad, the greyer it becomes. But black money can also get grey ; after about 7 years, the taxman's claim is tax barred and he cannot come back on it. The black capital is white but the interest is still black.

The penalty cannot be too high either. There is already some sort of fiscal amnesty for repentant taxpayers with grey money. If a taxpayer has hidden 100.000 euro on a Luxembourg account in 1996 and invested it at a rate of say 5%, the tax authorities cannot question the origin of the capital anymore. Come 2003, all he can do is tax the accumulated interest of the last five years. That is [(100,000 x $(1.05)^5$) - 100,000] at a rate of 15 %, plus a penalty of 50 %, or in total € 8,288, not even 6.50 % of the capital and interest. Quite often, the penalty is reduced to 10 or 20 %, or even waived. The total cost is then not even 4.50 %. An amnesty at 10 % does not convince a repentant taxpayer if he can redeem himself for less than 4.50 % of his accumulated grey money, admittedly he will have to take account of the fee his tax adviser will charge him for negotiating the deal.

Belgium is not the first EU Member State to offer tax amnesties. Ireland started the trend in 1988 with a penalty of 15 % and over € 650 million was repatriated, fifteen times what was anticipated. It has repeated the amnesty twice. Italy introduced an amnesty last year at a penalty rate of 2.5 % (with the possibility of a lower rate if the taxpayer invested the funds). The amnesty does not end until 16 October, but the proceeds already exceed the expectations by nearly 2 billion euro. Germany has also announced a tax amnesty for 2004 ; even if the penalty is 25 %, the government expects to recover € 100 billion.

The success of an amnesty does not only depends on the pool of savings hidden abroad and the level of the penalty. More important are the anonymity offered, the availability of alternative locations or investments, the credibility of the government not to repeat the operation in the future and not to abuse the information gathered. 20 years ago, a similar operation failed as the opposition was threatening to use the information to record the information in a a register of all assets held by Belgians.

To make a success of it, the government would need to convince us that unrepentant taxpayers will get caught and treated more harshly than the KB Lux clients who got off quite lightly, and offer a tax scheme that makes it particularly advantageous to invest in the Belgian economy. The Government only anticipates recovering 10 % of the € 174 million hidden in foreign bank accounts.

Most non Belgians living in Belgium will face the same dilemma. In principle, they have to declare the interest and dividend on their savings even if they left them at home. The taxman at home will only inform his Belgian colleague who will know and tax his exact savings income. And once the Belgian tax man knows, the savings income will have to be declared, and it might attract inheritance tax. For those with expatriate tax status, the foreign savings income will remain tax exempt in Belgium though.

The loopholes in the Savings Directive leave a lot of opportunities.

Bonds issued before 1 March 2001 will continue to be exempt of the withholding tax for a number of years. Certain low yield bonds (e.g. convertible bonds) may be liable to (a little) withholding tax but capital gains they generate remain tax exempt. Investments in stock and investment in UCITS which have invested at least 60 % of their assets in stock are exempt. The investments are guaranteed in certain funds, such as click funds. And Belgium can not at the same time exempt its own capitalization SICAVs and tax Luxembourg SICAVs.

As the Directive only applies to individuals, some will propose trusts and companies in a tax paradise for holding bank accounts within the EU. And finally, insurance companies will promote their life insurance policies linked to investment funds.

Indeed, life insurance contracts offer a simple and valid alternative to paying withholding tax. No withholding tax is due on the proceeds from a life insurance policy unless it guarantees that the capital will be maintained and that the capital will general a minimum in income. And if it offers such guarantee, the withholding tax can be avoided if the guarantee is limited to 130 % or has a duration of more than 8 years. These life insurance contracts, called "branch 23" policies in Belgium, are usually linked to funds investing in stock or bonds. In Belgium they can only be set up as units or shares in investment funds and SICAVs, but for a dedicated fund, one has to look over the border. Foreign investment funds are also more flexible if one wants to receive a regular income but also part of the capital, or if one wishes to take bonds or stock out of the policy.

The issue as always is to see where the opportunities end and where they become tax avoidance.

The structures may not be in place by 2005. Even the U.K. anticipates problems in setting up an effective information system. It remains to be seen how well other Member States will comply. Not all are as enthusiastic as the U.K. And then there are also the matter of the ten accession States who will join on 1 May 2004. And in the negotiations with the US, the US are using delaying tactics by negotiating with each Member State separately.

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