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Are M&As Easier in Belgium?
Understanding the Impact of a New ECJ Ruling

BY MARC QUAGHEBEUR
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This article examines the impact of a new European court ruling on certain mergers and acquisitions under Belgian law, which involve both Belgian and non-Belgian companies.

A decision of the Court of Justice of the European Communities (*i.e.*, the European Court of Justice or, simply, the "ECJ") of June 8, 2004 should make the mergers and acquisitions of Belgian companies easier and possibly cheaper.

Background

One of the principles of Belgian income tax is that capital gains on an individual's private assets (securities, tangible assets, or real estate) are tax exempt if these gains are realized on transactions that are within the limits of the "normal management of a private estate" (Article 90, 1° Income Tax Code ("ITC") 1992).

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Obtaining Advanced Tax Rulings in the Netherlands
Updated Procedures for Enhancing Planning Certainty

BY JOHANN MÜLLER
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In this article, the author walks us through a number of important changes in Dutch tax practice, which affect the ability to obtain advance rulings from the Dutch authorities and thereby enhance the "certainty" of your tax planning activities.

After having worked (well) for many years with standard rulings that were issued in the 1990s, Dutch ruling practice received a thorough overhaul in 2001, in large part because of criticisms of the practice in the "Primarolo Report" on European Union ("EU") efforts to curtail harmful tax competition. The basis of current Dutch ruling practice is now set forth in eight decrees from the Dutch State Secretary of Finance, dated 30 March 2001. Those decrees cover:

- jurisdiction within the tax department with regard to rulings;

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Mergers & Acquisitions
We begin with an article about a recent ruling from the European Court of Justice, which has significant implications for M&A transactions in Europe. The ruling and the Belgian tax authorities' response to it have particular consequences for Belgian companies and their foreign buyers. *Page 1.*

Tax Procedure
Obtaining advance tax rulings and advance pricing agreements in the Netherlands can be valuable tools in a European or multinational groups' tax planning program. *Practical Strategies* brings you up to date on a number of recent critical changes in Dutch advance rulings practice. *Page 1.*

Country Focus
In this month's issue, the focus is on Belgium. Along with our lead article, we also offer an analysis of two new transfer pricing developments there -- one that is likely to attract foreign investors and the other that could result in closer scrutiny of their activities and compliance practices. *Page 3.*

Intangibles
Part III of our multi-part series on the development of intangibles and valuation of marketing-related intangibles from a transfer pricing perspective discusses the legal protections for intangibles in Europe and certain key tax planning principles in the start-up phase of development. *Page 7.*

Transfer Pricing
Finland has adopted tax "reforms" that limit the ability of domestic (Finnish) companies to give "economic support" to their foreign (non-Finnish) subsidiaries. This affects support provided in anticipation of future earnings, growth of market share, and other circumstances. We explain the new regime. *Page 15.*

Snapshots
Pages 14, 16, and 20.

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The courts have explained this notion of "normal management" as a conservative, risk-averse, and unsophisticated approach to the ownership of a private estate. If these conditions are not met -- and the capital gain is the result of speculation -- gains on an individual's private assets are liable to income tax at a flat rate of 33 percent (Article 171, l° a, ITC 1992).

A sale of shares of a privately-owned company is usually "normal management" and capital gains are therefore generally tax-free. However, recent tax audits show that the Belgian tax authorities are now taking the view that the transfer of shares to a controlled company may not qualify as "normal management."

Taxing Substantial Shareholdings

On the other hand, capital gains realized on a "substantial shareholding" in a Belgian company are taxed at a rate of 16.5 percent if they are transferred to a foreign entity (Articles 90, 9°, and 171, 4° e, ITC 1992) even if the disposal of the shares was "in the course of the normal management." (On top of the 16.5-percent capital gains tax, the taxpayer also must pay about six to nine percent tax to the local authorities, bringing the total tax bill to about 18 percent.)

A "substantial shareholding" in a Belgian company is any participation of more than 25 percent, which is held directly or indirectly by an individual vendor and his or her close relatives at any time during the five years prior to the sale. Even the sale of a single share may trigger the 16.5-percent tax if that share was part of a "substantial shareholding" during the last five years. In any event, the capital gain is only taxed when it is actually realized.

A specific anti-avoidance clause has been tagged on to this provision. Even if the conditions are met and the shares of the company are sold to a Belgian entity, the tax still becomes due if the purchaser transfers the shares to a foreign entity within twelve months following the initial sale (Article 94, ITC 1992).

This tax applies to both Belgian vendors and foreign (individual) vendors (Article 228, §2, 9°, h, ITC 1992). Nevertheless, they can usually invoke the provisions of a double taxation treaty to prevent Belgium from taxing the capital gains they realize on shares if they are not Belgian residents. However, the treaties with Mexico and Canada allow Belgium to tax Mexican or Canadian resident individuals on their capital gains on Belgian "substantial shareholdings."

What is remarkable is that the capital gain is only taxed if a "substantial shareholding" in a Belgian company is transferred to a foreign company, institution, or association. This was the case when the De Baeck family sold its participation in the insurance company Antverpia for €45 million to the French Sociéte Européenne de Finances et d'Assurances ("SEFA") in March 1989. The taxman sent the vendors a tax bill for the capital gains tax, which they contested.

One of the arguments submitted was that this provision was archaic, and could not be justified anymore within the European Union (the "EU"). It discriminates shareholders who sell their shareholdings to a Belgian company from shareholders who sell their shareholdings to a company established in another EU member state.

Any M&A lawyer worth his or her salt knows that a share purchase agreement needs to include an undertaking that the Belgian company purchasing the shares will not transfer the shares to a foreign entity for at least 12 months after the original transfer.

In particular, this would be contrary to the EU principle of freedom of establishment. In other words, a Belgian entity purchasing a participation in a Belgian company has a serious advantage over a foreign group that will have to fork out an additional 18 percent on top of the purchase price.

De Baeck v. Belgium

In *De Baeck v. Belgium*, Case No. C-268/03, the court of first instance of Antwerp stayed proceedings and referred a question to the European Court of Justice. This court confirmed that the difference in treatment to the detriment of a taxpayer who assigns his or her shareholding to a taxpayer established in another EU member state constitutes a restriction on the taxpayer's freedom of establishment (Articles 43 EC and 48 EC).

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Foreign enterprises were liable to be restricted in the exercise of their right of establishment, provided that they take a shareholding that gives its holder definite influence over the company's decisions and allows him or her to determine its activities. Further, if the foreign purchaser does not acquire a major shareholding, the difference of treatment must be regarded as a restriction on the freed movement of capital (Article 56 EC).

The decision was to be anticipated and the ECJ confirms that this reply followed its case law. It is noteworthy that the court states that the reply to this question could be clearly deduced from its case law, and that this observation allowed the court to give its decision by reasoned order under a new accelerated procedure.

Relevance

Because only the sale of a Belgian company to a foreign company or legal entity was liable for capital gains tax, it became common practice for a foreign group to acquire a family-owned company via a Belgian company incorporated for that purpose. The Belgian tax authorities have only successfully attacked this avoidance technique once (Court of First Instance Brussels, February 18, 2004), and it would appear that they cannot invoke the general anti-avoidance rule of Article 344 §1, ITC 1992, against this construction because the law specifically permits it.

We can only wait and see how the Belgian government will react. We do not exclude the possibility that, rather than exempting all capital gain from the tax on substantial shareholdings, the government will extend the tax to all gain on substantial shareholdings, irrespective of whether the purchaser is a Belgian company or a foreign company.

Moreover, any M&A lawyer worth his or her salt knows that a share purchase agreement needs to include an undertaking that the Belgian company purchasing the shares will not transfer the shares to a foreign entity for at least 12 months after the original transfer.

However, this construction cannot be used at the time of an IPO where the investors are likely to be foreign entities or investment companies. This was the situation in the case of Artwork Systems (Court of First Instance, Ghent, November 14, 2002), a company that was listed on Easdaq (later Nasdaq Europe) in 1996.

To avoid the 16.5-percent capital gains tax, the founders set up a special purpose company held by a complex string of offshore companies to which they sold their stock at cost. However, for purposes of the IPO, they had announced that the IPO company had a market value that was 20 times higher.

The tax authorities did not tax the capital gain realized by the shareholders, but they assessed the company on the difference between the market value and the purchase price of the company. For the market value they referred to the first listing of the shares on Easdaq.

Further, vendors occasionally are not able to convince buyers to acquire the shareholdings via a Belgian company. This was the case for the De Baeck family.

It is correct that the capital gains tax on a substantial shareholding was not justifiable anymore. Foreign purchasers were being discriminated against. When they were bidding against a potential Belgian purchaser, they had to offer about 22 percent more than a Belgian bidder. Even after incorporating the administrative costs of operating a Belgian special purpose vehicle, foreign purchasers were still at a comparative disadvantage.

The ECJ's decision should have a major effect on the negotiation of mergers and acquisitions and the listing of Belgian companies. In the first place, it will give an argument to foreign purchasers to refuse to set up a Belgian company to acquire the target company.

We can only wait and see what will be the reaction of the Belgian government. We do not exclude the possibility that, rather than exempting all capital gains from the tax on substantial shareholdings, the government will chose to extend the tax to all capital gains on substantial shareholdings, irrespective of whether the purchaser is a Belgian company or a foreign company. ❑

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