The statutory general anti avoidance rule: the first case law in Belgium.

In 1993 a general anti avoidance rule was introduced in the Belgian Income Tax Code (Article 344 § 1 ITC 1992) to give the Tax Authorities more scope to disregard certain transactions which are only set up to avoid taxation.

This general anti avoidance rule allows the Tax Authorities to disregard the legal qualification given to a transaction, when they can prove that parties have given this particular legal qualification to the transaction instead of another for the sole purpose of avoiding income tax. If they can establish this, the Tax Authorities can disregard the legal qualification give by the parties and give the operation the (less tax efficient) qualification in order to assess the tax on this basis. However, the taxpayer can prove that this qualification meets lawful financial or economic requirements ("*répond à des besoins légitimes de caractère financier ou économique*").

The general anti avoidance rule can also be used when the Tax Authorities can evidence that parties have split up one single legal act into separate legal acts realising a same transaction for income tax reasons only. The Tax Authorities can then disregard the separate steps and treat them as one single operation. This is inspired by the Anglo-Saxon step transaction doctrine.

The general anti avoidance rule has been commented upon by many tax lawyers, but it is only in the last couple of months that the courts have rendered decisions in which they give their interpretation of this rule.

The following is a short analysis of this recent case law.

Redemption of shares

The case law has been favourable for the taxpayer in situations where a company redeemed its shares. Until 2001, a company was able to pay out its reserves without any obligation to withhold tax at source by redeeming its shares. This was more tax efficient than paying out a dividend, on which withholding tax was due, although, from an economic point of view, this would not be the common manner of paying out reserves. This is why the Tax Authorities apply the general anti avoidance rule to disregard the qualification of redemption of shares and to qualify the transaction as a payment of interest, and to charge the company with the tax which they should have withheld at source.

This was rejected first by the Court of First Instance of Antwerp on 26 October 2001. The company was a Dutch one-man company which had moved its registered office to Belgium and had paid out a reserve for 200.000 EUR by redeeming its own shares. The court decided that the Tax Authorities had to evidence that the transaction had been qualified as a redemption of shares in order to avoid income tax, but that they had failed to do so in this case.

On 9 January 2002, the Court of First Instance of Hasselt examined a case where one of the two partners in an architects' company got ill and sold his shares to the company shortly before dying. The court considered that the company had established lawful financial or economic requirements for the transaction.

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Sale of a life interest ('usufruit')

The Court of First Instance of Antwerp decided on 19 June 2002 in favour of the tax payer who had purchased a property for 450,000 EUR and had sold a life interest in the building for a period of 15 years to a company which he controlled. As the price paid for the a life interest (325.000 EUR) is not taxable income, the Tax Authorities considered that the transaction was in fact a rental agreement even though the rent had been paid in full in advance.

The court decided that the Tax Authorities did not prove that the transaction had been qualified as a sale of life interest in order to avoid income tax: the fact that the price for the life interest was disproportionate to the purchase price was not sufficient evidence. Moreover, the court considered that the taxpayer had established lawful financial or economic requirements, i.e. the possibility to dispose immediately of the proceeds of the sale of the life interest.

However, on 6 January 2003, the same court came to the opposite conclusion in a situation that was not a bit more complex. A couple had contributed their house with its contents to their company. A couple of years later, the same company had purchased the life interest for a period of 27 years of another house, while the couple and their children purchased the bare ownership rights. The company had to take out a loan to finance the acquisition of the life interest. It then let out the second property to the husband with the exception of half of the driveway, half of the garage, of the entrance hall and the toilet, an office at the back of the first floor and the attic which was used for storage.

The Tax Authorities considered that the combination of three contracts in order to provide accommodation for the company director does not meet lawful economic or financial requirements, and it requalified the transaction as a rental agreement between the couple as the landlord and the company as the tenant. The rent which the company should have paid was taxable income for the couple and part of it would even qualify as earned income for the husband who was the company's director.

The court agrees with the Tax Authorities that the combination of three contracts cannot be invoked against the Tax Authorities. However, the court has given the taxpayers an opportunity to establish that they had lawful economic or financial reasons to set up this construction.

Subletting

There is a big difference for the owner of a property when he lets out his property to an individual for private use as compared to the situation where his tenant is a company or a individual who will use the property for a professional use. In the first case, the taxable income is 140 % of the *cadastral revenue* (the *cadastral revenue* is a very low notional rental value of the property), while in the second situation; the landlord will pay tax on the net rental income he receives. Moreover, if the landlord is at the same time the director of the company, part of the rent paid by the company can constitute earned income for the landlord.

The practical solution which has been used frequently was to split up the rental agreement into two rental agreements. The property is first let out to an individual who then lets it out to the company. The landlord enjoys the favourable tax regime (140 % of the *cadastral revenue*), while the intermediary pays tax at a rate of 33 % on the profit he makes.

When the Tax Authorities disregarded the rental agreements between the owner of a property and her husband, and the subsequent rental agreement between the husband and the company

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in which he is a director, and considered that there was only one rental agreement between the owner and her husband's company; so that she was liable to pay tax on the net income paid out by the company.

The court of first instance of Brussels accepted this first application of the step transaction doctrine (Brussels, 7 March 2002).

However, it appears that the court did not only disregard the legal qualification given by the parties, but also the mutual rights and obligations of the parties under the two agreements as well as the existence of an intermediary, and this seems to be one step to far. If the Tax Authorities disregard the legal qualification given by the parties, they must replace it by another qualification which fits the facts and which has the same effect between the same parties.

Can the court apply the general anti avoidance rule?

The court of first instance of Mons gave an interesting turn to the general anti avoidance rule in its decision of 16 October 2002.

The case related to the director (and majority shareholder) of a Belgian company who invoiced his services via a Luxembourg company for the work done in the Belgian company for other companies. He received a salary from the Luxembourg company but not from the Belgian company The Tax Authorities applied the general transfer pricing rule (article 26 ITC) but the court considered that the conditions were not met.

However, the court decided that as tax law is of public order, it could apply the general anti avoidance rule even if the Tax Authorities had not applied it. Consequently, the court decided that the director was in fact working for the Belgian company and any payments made to the Luxembourg company were disallowed expenses.

Conclusion

It is too early to draw any major conclusions from this limited case law.

The six decisions have been rendered by four of the tax chambers which were set up in 1999 in ten courts of first instance all over Belgium. The judges are relatively new, and sometimes maybe over eager. Each of these decisions is open to appeal with the tax chambers of one of the five Courts of Appeal, which have traditionally been dealing with tax matters.

Where the situation is straightforward, the courts are favourable to the taxpayer (see redemption of shares and sale of life interest). However, where a structure has been set up that seems too complex to have been dreamt up by the taxpayer himself, and that does not seem to have any economic reason, the courts are less understanding (see the decision of Antwerp 6 January 2003, where the court has asked the taxpayers to explain their lawful economic or financial reasons).

The question which has always intrigued Belgian tax lawyers is whether the general anti avoidance rule can be applied when the new qualification given by the Tax Authorities disregards the existence of a third party or the economic effects and consequences of the old qualification. They have always held that a limitation of the general anti avoidance rule was that the new qualification given had to maintain the same economic effects and consequences of the qualification that was disregarded. If an appeal is lodged against the subletting case, the Brussels Court of Appeal will have to address this issue.

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It will also be interesting to see how the Court of Appeal of Mons will judge the initiative of the court of first instance to apply the general anti avoidance rule where the Tax Authorities had not even referred to it.

Marc Quaghebeur, 4 February 2003

Belgium's Antiavoidance Rule : The First Case Law , Tax Notes Int'l, 24 February 2003, p. 775.

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