



Taxation of Convertible Profit Shares

The Court of Appeal of Brussels has applied the rules laid down by the Belgian Supreme Court to convertible profit shares.

The facts relate to a Belgian public limited company that issued convertible profit shares to its directors in 1989. A year later the company incorporated its retained earnings into its share capital, and subsequently the directors asked for their profit shares to be converted in stock.

The tax authorities considered that the conversion of the profit shares into stock constituted a fringe benefit for the directors. The latter refuted. By way of a subsidiary argument, they argued that even if there was a fringe benefit, this had been granted in 1989, at the time the profit shares were granted, and not at the time of their conversion.

The Brussels Court of Appeal rejected their first argument. The minutes of the extraordinary general shareholders' meeting explicitly mentioned that the profit shares were granted in compensation for their special efforts in developing the activities of the company; that was sufficient to qualify the grant of profit shares as a fringe benefit that was subject to income tax in the same way as earnings.

The Court refers to the decision of the Supreme Court of 16 January 2003 to uphold the second argument. In this decision the Supreme Court had settled the old dispute relating to stock options granted before the 1999 tax regime for stock options entered into force.

The 1984 stock option tax regime gave an exemption for notified stock option plans, but it was never clear on what legal basis or at what time tax would be due. On 16 January 2003, the *Cour de Cassation* decided that in order to determine whether the beneficiary of a stock option plan receives a taxable fringe benefit, one should place oneself at the time the option is granted. It also confirmed that the capital gains realized when the option itself is exercised is not compensation for work, but is the result of the fluctuation of the shares. Such capital gain is not liable to income tax (for prior coverage, see 2003-2614).

The Brussels Court of Appeal now considers that the same rules apply to profit shares. As soon as they are granted, they become the private property of the beneficiary. Consequently, a dividend paid out to the holder of the profit share does not constitute remuneration but must be taxed as investment income. For the same reason, stock issued to the holders of converted profit shares is not remuneration.

The tax authorities could have taxed a fringe benefit in the hands of the directors at the time of the granting of the profit shares in 1989, but not when the latter converted the shares into stock.

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