

## Belgium Confirms Tax-Free Status of Cross-Border Lease

by Marc Quaghebeur

**B**elgian Minister of Finance Didier Reynders recently announced that the ministry's ruling committee has confirmed the tax-exempt status of cross-border leasing agreements that the municipalities of Sint-Niklaas, Dendermonde, and Hamme plan to sign with the Fifth Third Leasing Co. of the United States.

### Cross-Border Leasing

Cross-border lease transactions generate a tax shelter for U.S. corporate investors. The U.S. corporation leases infrastructure from the municipalities for a period of 99 years (the head lease) and sublets it back to the municipality in Belgium under a sublease for a shorter period of time (25 or 32 years), with an option to redeem the lease agreement at the end of the sublease.<sup>1</sup>

Those investors look for foreign governmental units, such as municipalities, that are not subject to taxes but have control over large, immovable infrastructure assets with long, useful lives. Infrastruc-

ture assets have a more stable value over time, and the fact that the governmental units are not subject to tax means they do not need their own depreciation deduction for those assets. The interest for the U.S. investors is that they acquire a right of use that is sufficient to depreciate the foreign assets and to claim U.S. depreciation deductions over the life of the lease, and sometimes over a much shorter time period. Part of those tax benefits is retroceded to the municipalities.

In particular, the municipalities are paid a large, upfront fee to enter into a long-term lease of their sewerage systems. The fee due under the sublease is equal to the fee due under the head lease, less the upfront payment received by the municipality. The municipalities remain in control of their infrastructure and retain responsibility for operating and servicing it over the lease term. At the end of the lease term the assets of the infrastructure revert back to the municipality.

To allow both the investors and the municipalities to avoid the credit or ownership risk, the transaction is secured with an equity payment undertaking agreement and a debt equity payment undertaking agreement.

### Cross-Border Leasing in Belgium

There have been 10 to 15 U.S. cross-border leases in Belgium. The technique has been used for the rolling stock of the SNCB (the Belgian public railway company), the combustion furnaces of the Indaver waste processing company, the *Liefkenshoektunnel*, and the Ferraris building occupied by the Flemish re-

<sup>1</sup>S. 1637, legislation approved by the U.S. Senate Finance Committee in October 2003 that would repeal the U.S. FSC Repeal and Extraterritorial Income Exclusion Act, would combat the use of these leasing transactions as tax shelters. Senate Finance Committee Chair Charles E. Grassley, R-Iowa, has since announced that he will change the effective date of the leasing provision to 18 November 2003, "instead of the date of enactment, to dissuade a rush to market of last-minute deals designed to beat the legislation's effective date." (For text of a related release, see 2004 WTD 33-14 or Doc 2004-3326 (2 original pages).) The fiscal year 2005 budget presented by President George W. Bush included similar provisions to end lease tax advantages.

gional authorities. Municipalities have been slower to follow the trend. Nürnberg in Germany was the first municipality to sign a cross-border lease for its sewerage system, while Dutch municipalities were banned from entering into the transactions for their sewerage infrastructure, even if they had used cross-border leasing for other utilities.

Two years ago some Belgian municipalities saw the potential of cross-border leasing transactions to boost their finances. However, many local authorities were waiting until the tax regime for cross-border leasing transactions was clarified. The municipalities asked the finance minister to confirm that cross-border leasing transactions would not be subject to taxation, as a withholding tax of 15 percent on an estimated return of 5.5 percent would wipe out the benefit of the transaction. However, Reynders was reluctant to give a positive ruling and referred the issue, as one of money laundering, to the minister of justice.

In December 2003 representatives of the aforementioned cities traveled to the United States to sign the agreements, hoping to receive the ruling while they were engaged in the final discussions. It was essential for the Fifth Third Leasing Co. that the deals

be signed in 2003, as its accounting period ended 31 December 2003.

However, the ruling committee only recently confirmed its position under the express reserve that the funds do not qualify under the money-laundering rules. Indemnities paid under the head lease and the sublease are not subject to any income tax, and no tax must be withheld at source on the return of the amounts invested. Also, no registration tax will be due when the agreements are registered, and services rendered under the agreements will be exempt from VAT in Belgium.

Fortunately for the municipalities, the Fifth Third Leasing Co. was still willing to sign the cross-border lease agreements. Sint-Niklaas, Dendermonde, and Hamme hope to collect €7.5 million (approximately US \$9.3 million), €4.5 million (approximately US \$5.6 million) and €2.5 million (approximately US \$3.1 million), respectively. The cities of Leuven, Mechelen, Liège, Genk, and Geraardsbergen are planning similar transactions. ♦

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