

Court Upholds Constitutionality of Antiavoidance Rule

by Marc Quaghebeur

Article 344, section 1 of the Belgian Income Tax Code is a general antiavoidance rule introduced in 1993 to give tax authorities more latitude to disregard transactions that are set up solely to avoid taxation. In its decision of November 24 (in case 188/2004), Belgium's Court of Arbitration rejected a claim that the provision violates the constitutional principle of no taxation without representation.

The General Antiavoidance Rule

Article 344, section 1 allows tax authorities to disregard the legal qualification, or structure, of a transaction if they can prove the parties have chosen that particular legal structure solely to avoid income tax. If that can be established, tax authorities can reclassify the transaction and assess the applicable tax. However, tax authorities must accept the original legal qualification if the taxpayers can prove it meets lawful financial or economic requirements.

The general antiavoidance rule also may be used when tax authorities can prove that parties have divided a single transaction into separate steps to create a certain income tax outcome. Tax authorities can disregard the separate steps and treat them as one operation (step transaction doctrine). (For prior coverage, see *Tax Notes Int'l*, Feb. 24, 2003, p. 775.)

The Court of Arbitration

The Court of Arbitration (Cour d'Arbitrage, Arbitragehof) is Belgium's Constitutional Court, with exclusive jurisdiction to review regulations that have the force of law for compliance with the Belgian Constitution (articles 8-32, 170, 172, and 191), and the division of powers between the federal government and local authorities.

A case can be brought before the Arbitration Court by any authority designated by statute, any person who has a justifiable interest, or by any tribunal, by way of preliminary question.

The Case

Initially appearing before the Court of First Instance of Antwerp, the taxpayers argued that article 344, section 1 of the Income Tax Code violates article 170, section 1 of the Constitution, which provides that no federal tax can be introduced unless it is by law.

The tax authorities had used article 344, section 1 to reclassify various transactions related to real property. In one of those cases, two individuals had terminated a lease agreement they had signed with companies they controlled, and had replaced it with a right *in rem* of usufruct (a life interest). The advantage for the individuals was that they no longer were subject to tax on the leased real property. They also were able to circumvent the specific antiavoidance rule that allows tax authorities to reclassify part of the rent received by a company director as a director's fee. In the cases at issue, the tax authorities simply classified the transactions under the original qualification as rental income.

In two decisions dated October 20, 2003, and January 21, 2004, the Court of First Instance of Antwerp asked the Court of Arbitration to decide whether article 344, section 1 of the Income Tax Code is contrary to article 170, section 1 of the Constitution in that it gives the government the power to determine taxable circumstances. It wanted to know if article 344, section 1 allows the Ministry of Finance to create its own regulations, or gives the Finance Ministry a blank

regulation that it can fill in as it likes, when there is an independent procedure that guarantees a taxpayer's rights of defense.

The Court of Arbitration went back to the first purpose of the general antiavoidance rule: It was introduced for situations in which tax authorities perceive that the transaction has clearly been set up to enable the taxpayer to circumvent taxation. The Parliament wanted to limit the application of the Supreme Court ruling in *Brepols* (June 6, 1961), which limited only those fiscal constructions that are not based on reality.

However, because a taxpayer has the right to opt for the road of least taxation and to set up transactions that have an economic justification, the application of article 344, section 1 is subject to a number of strict conditions.

The first condition is that the legal construction chosen by the parties was selected for avoiding tax. However, the Arbitration Court pointed out that this does not need to be the only aim of the legal structure, as that would be too difficult to prove. The second condition is that the aim of avoiding tax must be evidenced by tax authorities through all means allowed by law.

Furthermore, the application of article 344, section 1 is limited to transactions involving economic activities that result in profits or benefits that, in principle, are subject to taxation. Transactions related to a person's private estate that do not affect any taxable elements are to be disregarded.

And when the taxpayer gives evidence to the contrary, he must show that the legal classification given to the transaction meets lawful financial or economic requirements, and thus demonstrate why he opted for that legal qualification and not for the qualification preferred by tax authorities.

The Court of Arbitration concluded that the reason for article 344, section 1 is to give tax authorities power to base the tax on the normal legal qualification of a transaction. The Court repeated comments

made by the Parliament during its discussion of article 344, section 1, when it was still in the form of a draft bill:

This means: If the operation consists of one transaction which can have more than one legal qualification — which the Court notes appears to be quite exceptional — the tax authorities have the right to choose the qualification which reinstates the taxable base if the sole purpose of the qualification chosen by the parties is to avoid the tax.

If, however, the operation is the result of two or more separate or successive transactions, the tax authorities will be able to levy the tax by giving to the transactions a legal qualification which is not related to the qualification given to each separate transaction if they note that these transactions relate to one and the same operation from an economic point of view. This is the English "step by step" doctrine, whereby a transaction can be viewed as one in one piece by lifting all artificial separate elements so that they only take account of the operations wanted by the parties.

The Court of Arbitration concluded that the Parliament made the application of article 344, section 1 dependent on those stringent conditions to realize a legitimate aim (that is, to fight tax avoidance without harming the principle of the freedom to choose the road of least taxation). Article 344, section 1 is not a general power given to tax authorities to determine the taxable basis, it said, but rather, is merely a means to consider specific situations on an individual basis, possibly under the supervision of a judge.

Therefore, article 344, section 1 does not violate the constitutional principle of no taxation without representation, the Court said. That principle does not require the legislature to define the actual conditions for the application of article 344, section 1, as the nature of the provision does not allow it. ♦

♦ *Marc Quaghebeur, Vandendijk & Partners, Brussels*