www.taxbites.be

Reprinted from *Tax Notes Int'l*, June 20, 2005, p. 1035

taxanalysts
Respectfully disagreeable since 1970.
tax notes international

(C) Tax Analysts 2005. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

News Analysis: Belgian Equity Financing Measure Moves Forward

by Marc Quaghebeur

Belgium's House of Representatives on June 2 adopted a bill that would make investments in equity significantly more attractive. The Senate is not expected to ask to reexamine the bill, so it is possible that King Albert could sign it into law in the coming weeks, well in time for its proposed entry into force.

For most companies, that is January 1, 2006. The timing is perfect, as the Belgian coordination center regime is coming to an end over the next couple of years. However, unlike the coordination center regime, the measure approved on June 2 is creative and simple. The new regime would make Belgian companies even more attractive vehicles for financing multinational groups. (For prior coverage, see *Tax Notes Int'l*, May 16, 2005, p. 547.)

Abolition of the Capital Duty

The law would abolish the 0.5 percent capital duty on contributions to a company's share capital. That duty now is charged at the time of a company's incorporation, or when new share capital is issued. The capital duty generally is seen as an additional burden in comparison with countries that have no capital duty (for example, Denmark, France, Germany, and the United Kingdom). Other countries also are considering abolishing their capital duty. In the neighboring countries, rates vary from 0.5 percent (Ireland) and 0.55 percent (the Netherlands) to 1 percent (Austria, Luxembourg, Spain, and Switzerland).

Under Belgium's new regime, the capital duty would be fixed at €25, effective January 1, 2006, except when a private individual contributes residential property to a company against shares issued by the company. The capital duty then would be charged at the rate for the transfer of real property: 12.5 percent (10 percent in the Flemish region).

Risk Capital Deduction

As of next year, Belgian companies would be entitled to set off a new risk capital deduction against their profits. The deduction is viewed as a first step in creating equality between debt and equity financing. It was conceived as compensation for the economic cost of the use of the company's equity, at a hypothetical interest rate that reflects the cost of long-term, risk-free financing.

Equity

The basis for calculating the risk capital deduction is the company's equity (that is, its share capital plus its retained earnings, as shown in its most recent annual accounts and determined in accordance with Belgian accounting rules).

However, that basis would have to be adjusted to avoid double use or other abuses. The risk capital deduction should not be granted if the income from the equity is tax-exempt (for example, because it is exempted under a tax treaty). The following elements would be excluded from the company's equity:

- the net value of the shares that the company holds in its own share capital;
- the net value of shareholdings that are mere financial fixed assets, rather than participations in affiliated companies (financial fixed assets labeled "participations and other shares" in the company's accounts); in fact,

www.taxbites.be

(C) Tax Analysts 2005. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

in that situation, there is no risk that the company would be entitled to a double deduction, as it is not normally entitled to the participation exemption for those shareholdings;

- the net value of investment companies that are entitled to the participation exemption for dividends received;
- if the company has an overseas permanent establishment with profits that are tax-exempt under a tax treaty, the net book value of the assets of that PE (except for shares already excluded from the equity), less the liabilities that are attributable to the PE and that do not constitute equity;
- if the company owns real property abroad or entitlements to real property that are not held by a PE and that produce income that is tax-exempt in Belgium under a tax treaty, the net book value of that property, less the liabilities that can be attributed to it, unless they constitute equity;
- capital gains recorded in the company's accounts for assets other than those mentioned above (which are not included in the company's taxable basis); and
- capital subsidies.

To discourage taxpayers from inflating the company's equity artificially, the following elements would be taken out of the equity as well:

- the net book value of tangible fixed assets acquired at a cost that unreasonably exceeds the needs of the company;
- the book value of assets that are held as an investment and that, by their nature, are not intended to produce regular taxable income (for example, jewels, precious metals, and so on); and
- the book value of real property or real property entitlements that are used or occupied by the director or receiver of the company, his or her spouse, or dependent children.

The values to be taken into account are those in the most recent set of annual accounts, but certain changes during the accounting year would be taken into account to prevent artificial variations in equity capital to manipulate the risk capital deduction. The principle is that if the value of an element on the balance sheet changes during an accounting year, the value of the equity is adjusted as of the first of the following month.

During the discussion of the bill, Finance Minister Didier Reynders confirmed that the purpose of that provision is to stop companies from manipulating their share capital to increase the value of their equity on the first day of their accounting period. Some representatives were wondering whether companies would have to draft monthly balance sheets to show the monthly variations in their retained earnings and the profit/loss to be carried forward. Reynders indicated that he was not setting his sights on a company's day-to-day profits, but on changes in its assets and the purchase and sale of participations.

Interest Rate

The deduction would be a fixed percentage to be determined by the government based on the interest rate paid by Belgium on the 10-year linear bonds it issues. Currently, it is around 3.5 percent, a historical low, but the average over the past decade has been around 5.5 percent.

The rate for tax year 2007[1] would be determined on December 31, 2005, as the average over the past year. For the following year, the average of 2006 would be taken into account. However, the rate could not vary more than 1 percentage point from one year to the next. The rate generally would be limited to 6.5 percent, but in years of high inflation, the government would be able to raise it over that limit.

Small and medium-size enterprises, as defined in the Belgian company code,[2] would be entitled to opt for a risk capital deduction that is half a percentage point higher. They then would have to abandon the investment reserve to which they are currently entitled (article 194 *quarter*, Income Tax Code 1992, which took effect in tax year 2004).

Conditions

The deduction would not be available to companies enjoying a favorable tax regime, specifically coordination centers or companies in a reconversion zone; open-ended (SICAV) and closed-ended (SICAF) undertakings for collective investment or undertakings for collective investment in receivables; cooperative participation companies set up to allow employees to participate in the profits of their employer; and shipping companies that pay the tonnage tax. Most of those companies are taxed on a cost-plus basis.

Non-Belgian companies would be entitled to the same deduction, but only for the risk capital used for

---

[1]This corresponds to the accounting period 2006 for companies that draft their annual accounts on Dec. 31, 2006; for other companies, this is the accounting period ending on or before Dec. 30, 2007.

[2]These are companies which, on their balance sheet date, do not exceed the limits of the following three criteria: 50 employees, a balance-sheet total of €3,650,000, and a net turnover of €7,300,000 (article 15, section 2, company code, as modified by Royal Decree of May 25, 2005, Belgian state gazette, June 7, 2005).

www.taxbites.be

(C) Tax Analysts 2005. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

their Belgian PEs and for their Belgian real estate or real estate entitlements.

To be entitled to the exemption, the company would have to record and maintain an amount equal to the deduction on a separate account on the liabilities side of its balance sheet during the following three accounting years. Moreover, the tax-exempt profit could not be used as a basis for calculating any remuneration or allocation; that means that the company could not distribute that tax-exempt profit by way of dividend for at least three years.

Carryforward

The part of the capital risk deduction that could not be set off against the profits of the current year could be carried forward for seven years. That should help start-up companies through their lean years.

If control of the company changes, the carryforward of the risk capital deduction could be lost in the same way as the investment deduction and the carryforward of operating losses. However, the company could justify the change of control with financial and economic reasons. That would be the case for a company in financial difficulties that maintains (even partially) its business activities and staffing. That does not restrict an international group from transferring shares or managers.

Compensating Measures

While the risk capital deduction is being introduced, the tax credit (article 289 *bis*, section 2, Income Tax Code 1992) introduced in 1996 and the investment deduction (article 292 *bis*, Income Tax Code 1992) that took effect in tax year 2004 would be abolished. Those measures are limited to SMEs, and they are complicated and usually are one-time operations. Specific investment deductions for research and development to encourage the rationalized use of energy or investments in security would be maintained.

Opportunities

The legislation is expected to be finalized six months before it enters into force. The government wanted to give coordination centers plenty of time to prepare to benefit fully from the new tax regime.

The measure is certainly a valid alternative that could convince multinational groups to maintain the activities of their Belgian coordination centers. Coordination centers provide specific accounting, administrative, and financial services to other companies of their multinational group. Their profits are calculated with the cost-plus method, but not all their costs are taken into account: in particular, finance and personnel costs are not included in coordination centers' taxable base. Moreover, coordination centers are entitled to an exemption from withholding tax on the payment of dividends, interest, and royalties, and an exemption from capital duty.

Although the European Commission approved the coordination center tax regime when it was introduced, it decided in 2003 that the regime is incompatible with EU state aid rules. Belgium agreed to adapt the coordination center regime (Commission Decision 2005/378/EC of Sept. 8, 2004, Official Journal, L 125, May 18, 2005, p. 10) and to abandon it, in stages, by December 31, 2010. Some 88 coordination centers will lose their status by the end of this year.

Forum 187, a federation of coordination, distribution, and service centers, has indicated that for about half of the coordination centers, the risk capital deduction could pass the test in a comparison with the tax regimes offered by Luxembourg and Switzerland (De Tijd, May 21, 2005). Forum 187 expressed regret that the maximum interest rate of 6.5 percent could send the wrong signal to the international community. Moreover, it argued against the obligation to reserve an amount equal to the deduction for three years.

In the meantime, Belgium has acquired an international reputation as an attractive location for finance centers, and similar tax regimes in France, Germany, Luxembourg, and the Netherlands have not tarnished that reputation. In addition to its central location in Europe and multilingual workforce, Belgium's special tax status for expatriate non-Belgian employees, favorable tax regime for Belgian holding companies (without CFC rules), and modernized advance ruling practice — in combination with the risk capital deduction — put Belgium on the map for any international tax planning. ◆

♦ *Marc Quaghebeur is with Vandendijk & Partners in Brussels.*