Belgium Removes Obstacle to Risk Capital Deduction

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Belgian Prime Minister Guy Verhofstadt on November 17 announced that one of the major obstacles to the new risk capital deduction will be lifted. Companies no longer will be barred from distributing the portion of their profits that corresponds to the deduction (also known as the notional interest deduction). Previously, to qualify for the deduction, a company had to retain an amount equal to the amount of the deduction for a period of at least three years. During that time, the amount equal to the deduction could not be distributed by way of a dividend.

Issuing a warning to Belgium's business sector, Verhofstadt said companies should not try to combine the risk capital deduction with a deduction of interest on loans taken out to capitalize their operations. Although coordination centers have been doing that on a large scale for years, Belgian tax authorities now will be looking out for such constructions, and will consider them to be tax fraud, he said. It is not clear what tax authorities will base that assertion on in a purely Belgian situation, but they clearly will not be in a position to deny the tax deduction if a foreign parent company borrowed the funds used to capitalize a Belgian subsidiary.

During a trip through South Korea, Japan, Hong Kong, and Singapore at the beginning of November, Verhofstadt and Finance Minister Didier Reynders promoted Belgium as a gateway to Europe, using the Hong Kong route (for prior coverage, see Tax Notes Int'l, Apr. 18, 2005, p. 201, 2005 WTD 67-3, or Doc 2005-7169) and the new risk capital deduction.

As of January 1, 2006, Belgian companies will be entitled to a tax deduction calculated as a percentage of their equity (share capital plus retained earnings).[1] (For prior coverage, see Tax Notes Int'l, Aug. 15, 2005, p. 590, 2005 WTD 150-5, or Doc 2005-16564.) The percentage of the deduction will be based on the average interest rate paid on 10-year linear government bonds, but it is expected to be about 3.5 percent. While the corporate income tax rate is currently 33.99 percent, the effective tax burden is about 30 percent. The deduction could reduce the effective tax burden to about 26 percent. The new tax regime will replace Belgium's existing coordination center tax regime.

The risk capital deduction is attractive to many investors. The Dutch contract staffing group Randstad Group, for example, recently announced that it will move its corporate treasury center to Belgium. While one of the requirements under the old coordination center regime was a staff of at least 10, the corporate treasury center will have a staff of two.

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[1] Non-Belgian companies will be entitled to the same deduction, but only for the risk capital used for their Belgian permanent establishments and their Belgian real estate or real estate entitlements.