www.taxbites.be

Reprinted from *Tax Notes Int'l*, March 26, 2007, p. 1180

taxanalysts tax notes international

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

Belgium Hopes to Sign Tax Treaty Protocol With France

by Marc Quaghebeur

Belgian tax treaty negotiators are hopeful that they soon will sign a protocol to the current tax treaty with France. However, Belgian and French negotiators first must resolve two issues: a change in the rules on the taxation of cross-border workers, which France has been resisting, and the taxation of inbound dividends from France.

Discussions regarding a new protocol started in 2004 but were suspended several times. Negotiations resumed in December 2006 at France's request, and negotiators held a second meeting on February 14.

The current Belgium-France income tax treaty dates back to March 10, 1964; it was amended by two protocols signed on February 15, 1971, and February 8, 1999. (For the 1964 Belgium-France income tax treaty, see *95 TNI 168-24* or *Doc 95-30323*; for the 1971 protocol, see *95 TNI 168-25* or *Doc 95-30324*; and for the 1999 protocol, see *2000 WTD 16-22* or *Doc 2000-2596*.)

Cross-Border Workers

Belgium wants to eliminate a rule in the current treaty that requires cross-border workers to be taxed in their state of residence. Cross-border workers often reside in the border area of one state and work in the border area of the other state. Currently, French residents working in Belgium are entitled to a 40 percent reduction of their tax burden. Not only does France have a lower tax burden than Belgium, but Belgian net salaries are higher, and Belgian social security contributions paid by employers are less. It is estimated that 30,000 French residents work in Belgium. There are 6,000 Belgian residents working in France who pay higher French social security and higher Belgian income tax.

Belgium would like to tax those workers in Belgium in accordance with the ordinary tax rules under article 15 of the OECD model income tax treaty. French residents would then pay social security and income tax in Belgium. They would only pay income tax in France if they worked fewer than 183 days in Belgium, or if their remuneration was not paid by a Belgian employer or was not borne by a Belgian establishment of their employer.

Belgium has already eliminated the cross-border rule in its bilateral tax treaties with the Netherlands and Germany. Since January 1, 2003, Belgian residents working in the Netherlands pay income tax there. And on January 1, 2004, the cross-border worker provision was eliminated from the Belgium-Germany tax treaty. The 1970 Belgium-Luxembourg tax treaty also omits the rule.

French tax authorities and Belgian employers oppose eliminating the cross-border worker provision in the current Belgium-France treaty. The French border area, including the departments of Nord-Pas de Calais and Champagne-Ardenne, has high rates of unemployment and as recently as 2004, the then-minister delegate for industry stated that she expected to maintain the tax regime for at least 15 years and promised that no decision would be made without entering into a dialogue with local elected officials. Employers on the Belgian side of the border have emphasized that they need the border workers because they have found it difficult to find qualified workers in Belgium.

However, in recent months, there have been complaints from French residents that the Belgian tax authorities are now applying the cross-border rule too strictly. When Belgium and France signed the 1999 protocol, Belgium abandoned the allowance under which cross-border workers could occasionally work outside the border area (up to a maximum of 45 days) without losing their tax status. In two

www.taxbites.be

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

administrative notes,[1] the Belgian tax authorities explained that even one day's work or training outside the border area will result in the French resident losing the benefit of the cross-border rule.

Many French taxpayers were audited and received hefty tax bills for which mutual agreement procedures were instituted under article 24 of the Belgium-France tax treaty. French negotiators resumed discussions with Belgian negotiators to ensure that Belgium would respect the spirit of the treaty.

Belgian Finance Minster Didier Reynders has declared that he is willing to consider a transitory period during which the cross-border workers' rule would be phased out with financial compensation for the budgetary loss. His office confirmed on March 14 that the cross-border rule will be maintained for French residents for a period of 25 years, beginning from January 1, 2007. Moreover, Belgium will reintroduce the allowance of 30 days per year for working or following a course outside the border area. Belgian residents working in France will become subject to French income tax with effect from January 1, 2007.

The compensation to be paid by France will be in line with the compensation paid by other countries for abolishing the cross-border rule. Under the 2002 tax treaty protocol with Germany, Belgium receives financial compensation for the budgetary loss resulting from the abolition of the cross-border rule. Germany is paying €18 million per year for six years. It is reported that France would pay €20 million in compensation.

Double Taxation

Belgium and France also need to address the double taxation of inbound French dividends. (For prior coverage, see *Tax Notes Int'l*, Sept. 19, 2005, p. 1068). A dividend received by a Belgian resident individual is subject to withholding tax at a rate of 25 percent. That withholding tax is the final tax. Only if tax has not been withheld at source must the taxpayer declare a dividend and pay income tax at a rate of 25 percent. The same rule applies to dividends received from foreign companies.

However, the foreign company must generally withhold tax at source as well, even if the withholding tax is mitigated under the relevant tax treaty. A French company must withhold at a tax rate of 25 percent at source in France. Under the Belgium-France tax treaty, the withholding tax rate is limited to 15 percent. The Belgian withholding tax is then calculated on the net dividend after deducting the French withholding tax.

Until 2004 the French withholding tax was not a significant problem for Belgian residents because they were entitled to the avoir fiscal, a French tax credit of 50 percent that was credited by the French tax authorities in the year following the payment of the dividend. The avoir fiscal reduced the effective tax rate to 3.375 percent. Last year France limited the impact of the tax credit and Belgian residents saw their tax liability on French dividends rise to 36.25 percent (a 15 percent tax rate in France and a 25 percent tax rate in Belgium on the net dividend).

In 2005 the Belgian and French finance ministers agreed to examine whether they should modify the taxation of inbound French dividends under the tax treaty. However, they did not reach an agreement on the issue.

In *Kerckhaert-Morres* (C-513/04), the European Court of Justice decided that Belgium does not have to give taxpayers a tax credit for inbound dividends to set off the withholding tax levied by France. (For the judgment in *Kerckhaert-Morres*, see *2006 WTD 220-10* or *Doc 2006-23075*.)

Subsequently, the ECJ rejected the French taxation of outbound dividends in *Denkavit II* (C-170/05). (For the *Denkavit II* judgment, see *2006 WTD 241-13* or *Doc 2006-24958*.) The case related to tax withheld at source on intercompany dividends paid before the EU parent-subsidiary directive came into force in 1992. The ECJ decided that even though the case predated the directive, France's refusal to extend to nonresident parent companies the exemption of withholding tax granted to resident parent companies was a discriminatory measure incompatible with article 43 of the EC Treaty. *Denkavit II* may well have more far-reaching effects beyond parent companies; even portfolio investors or individual shareholders may be able to use it to overcome the French withholding tax.

The effect of *Denkavit II* is likely to be more far-reaching than a first reading would indicate. If a member state of source maintains the exemption for resident shareholders and investors, it will not be able to maintain the withholding tax on dividends, whether they are paid to parent companies, portfolio investors, or even to individual shareholders. Moreover, the ECJ decided that the member state of source cannot rely on the existence of a tax treaty to avoid its obligations under the EC Treaty, but contrary to the EFTA Court in *Fokus Bank*, the ECJ added a proviso "whereas a parent company is unable to set off tax in that other Member State [that is, the member state of residence], in the manner provided for by that convention." (For prior

[1]Ci.R.9 F/554.009 of January 14, 2004, and AFZ/2005/652 of May 25, 2005.

www.taxbites.be

(C) Tax Analysts 2007. All rights reserved. Tax Analysts does not claim copyright in any public domain or third party content.

coverage of the EFTA Court's ruling in *Fokus Bank* (E-1/04), see *Tax Notes Int'l*, Dec. 6, 2004, p. 840.)

Denkavit II will require member states to adopt legislation to prevent discriminatory treatment of distributed profits. But in practice, that will prove untenable. It would mean that the member state of source will have to extend the exemption of withholding tax to all parent companies, except when the parent company is entitled to a tax credit at home and is effectively able to set off the credit against its tax liability.

Under the current tax treaty between Belgium and France, a Belgian resident is entitled to a tax credit for the French withholding tax (article 19(A)(1)), but the provision has become ineffective. Until 1988 the individual shareholder was entitled to a foreign tax credit that was calculated on the assumption that the tax collected at source was levied at a 15 percent rate, regardless of the level of tax withheld abroad. The FTC was abolished on December 7, 1988, for private individuals holding shares outside a professional activity.

The Belgium-France treaty has provisions similar to the Dutch and German treaties. It provides that the Belgian tax due on the net dividend amount (net of the withholding tax) "will be reduced by . . . a fixed quota of foreign tax that is deductible in conditions fixed by Belgian law," but the major difference is that the Belgium-France treaty provides "that the quota may not be less than 15% of this net amount."

Legislation that makes a withholding tax dependent on the ability to impute the tax in the member state of residence is unworkable. How does one objectively define which parent companies in which member states are able to set off the withholding tax in the manner provided for by the tax treaty? Member states may consider resorting to an alternative test and continue to withhold tax at source to require parent companies to claim back the tax if they can prove that they have not been able to set off the tax at home. This may sound like a practical solution, but it risks creating a cash-flow disadvantage that the ECJ (in *Test Claimants* (C-524/04)), has already condemned as contrary to the freedom to provide services or the free movement of capital. (For the ECJ judgment in *Test Claimants*, see *2007 WTD 50-9* or *Doc 2007-6302*.) ◆

♦ *Marc Quaghebeur, Vandendijk & Partners, Brussels*