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News Analysis: Belgian Parliament Ratifies Belgium-U.S. Tax Treaty

by Marc Quaghebeur

In one of its last sessions before the Belgian Parliament will be dissolved by King Albert II in advance of the federal elections to be held on June 10, 2007, the Belgian Chamber of Deputies adopted the law ratifying the double tax treaty between Belgium and the U.S.

The treaty may well qualify for the *Guinness Book of Records* as the fastest negotiation and ratification process of a double tax treaty ever. Negotiations started only after Belgian Prime Minister Guy Verhofstadt and Finance Minister Didier Reynders met with U.S. President George W. Bush in January 2006, and the treaty was signed on November 27, 2006, together with a protocol. (For the full text of the treaty, see *Doc 2006-23900* or *2006 WTD 229-7*.) The bill ratifying the treaty and the protocol was adopted by the Senate on March 29, and now by the Chamber of Deputies on April 19, 2007. The bill should be signed into law by King Albert II in the coming weeks.

Reynders has made good on his promises; having this treaty signed and ratified is the crowning achievement of his eight-year tenure. As we have described in previous contributions, most of the tax measures make Belgium an attractive location for holding companies and group financing companies (for prior coverage, see *Tax Notes Int'l*, Mar. 19, 2007, p. 1055), pension funds, and research and development facilities (for prior coverage, see *Tax Notes Int'l*, Apr. 30, 2007, p. 423).

Background

The current income tax treaty was signed on July 9, 1970, and went into effect on October 13, 1972. A protocol to the treaty was concluded on December 31, 1987; that protocol reduced the withholding tax on dividends on qualifying shareholdings from 15 percent to 5 percent and introduced a limitation on benefits provision.

Negotiations in 1988 failed because of technical issues that could not be resolved. The time was ripe for an update of the treaty to take account of significant changes in U.S. and Belgian tax law and business practices, as well as of developments in the international tax world. With input from the business communities in both countries, the U.S. Treasury and the Belgian Ministry of Finance officials negotiated a completely revised treaty that addresses many different issues. At the same time, a protocol was signed to clarify some technical details.

The most significant changes are the zero rate withholding tax, the tightening of the LOB provision, and the introduction of a mandatory binding arbitration, but there are some other important changes, generally in line with recent U.S. treaty practice. The treaty addresses cross-border pension issues and includes now-standard U.S. provisions dealing with hybrid entities, regulated investment companies, real estate investment trusts, and exchange of information. In particular, the exchange of information provisions raised quite a few eyebrows in Belgium.

The text of the treaty is based on the 2005 OECD model as well as on the most recent treaties signed by both parties, in particular the U.S. model tax treaty published in November last year. (For the full text of the U.S. model tax treaty, see *Doc 2006-23239* or *2006 WTD 221-12*.)

I. Residence — Hybrid Entities

The new treaty contains a specific provision in connection with hybrid entities. Article 1(6) provides that income, profit, or gain derived though a fiscally transparent entity in either state will be deemed to be derived by a resident of a state to the extent that the item is treated for purposes of the taxation law of such contracting state as the income, profit, or gain of a resident.

This means that if a U.S. limited liability company or limited liability partnership holds shares in a Belgian company and receives dividends, Belgium will acknowledge that the LLC or LLP is transparent and that the income is derived directly by a U.S. resident unless the income is not treated as income of a resident in the U.S. This provision will ensure that Belgium grants the participation exemption for dividends derived from shares in a fiscally transparent entity in the United States. This has been a bone of contention for a long time, as the Belgian tax authorities refused the benefit of the participation exemption because the dividends did not qualify under the condition that the dividends must have been subject to a tax of the same nature as the (Belgian) corporate income tax. (See also Section XII below.)

II. Business Profits

Permanent Establishment

The warehousing exemption in article 5(3) has been brought in line with treaty practice, thereby ending the abnormality that the permanent establishment exemption was not available when goods held by a U.S. person in a Belgian warehouse are sold in Belgium (article 5(4) of the current treaty.

B. Profits Attributable to a PE

One of the provisions in the new protocol requires that the principles of the OECD transfer pricing guidelines be used in determining the profits attributable to a PE. Given the consternation that has been caused by the OECD's ongoing project on the attribution of profits to a PE, some taxpayers may find this provision a point of concern.

C. Associated Enterprises

The new treaty introduces a correlative adjustment provision that should be in article 9(2). When one state adjusts the taxable income and tax liability of an enterprise, and the other state agrees that the adjustment is appropriate, the latter is obliged to make a correlative adjustment to the tax liability of the related enterprise that is a resident of that state.

III. Subsidiary-Parent Dividends

The withholding tax on dividends cannot exceed 15 percent (5 percent if the parent company owns directly at least 10 percent of the voting stock of the company paying the dividends). The treaty provides a zero rate for dividends paid to a Belgian parent company that has owned directly or indirectly shares representing 80 percent of the voting power in the U.S. subsidiary for the last 12 months with strict limitation on benefit conditions. However, a U.S. parent company will need only a 10 percent participation in the capital of a Belgian subsidiary.

A. Belgium-Bound Dividends

The U.S. has insisted on maintaining the 80 percent threshold on dividends paid out by U.S. companies, mirroring the threshold in the treaties and protocols that the U.S. has signed recently with the U.K., the Netherlands, Sweden, or Germany.

The zero rate withholding tax provision does not figure in the U.S. model treaty. It is only granted under the strictest conditions. At the beginning of last year, the Treasury Department made clear its decision to link the zero rate on dividends to the LOB and information exchange provisions meeting the highest standards, and the overall balance of the agreement being appropriate. (For testimony of U.S. Treasury Deputy International Tax Counsel Patricia Brown on U.S. treaties, see *Doc 2006-2092* or *2006 WTD 23-7*.)

This provision must be read in conjunction with the LOB provision (see Section X below) and the exchange of information provision (article 25; see Section XIV below). It is clear that the U.S. Treasury has put Belgium on probation (paragraph 10). The zero rate will, indeed, be discontinued after five years, unless the U.S. Senate is satisfied that Belgium has satisfactorily complied with its obligations under article 25. Moreover, the U.S. may terminate the convention if it finds that Belgium's actions regarding articles 24 (mutual agreement procedure) and 25 have materially altered the balance of benefits of the convention.

B. U.S.-Bound Dividends

A 10 percent threshold on U.S.-bound dividends is a significant signal from Belgium to U.S. investors. It is a recent trend for Belgium to agree to zero rate dividend provisions in its tax treaties (for prior coverage, see *Tax Notes Int'l*, Apr. 18, 2005, p. 201), but it participates in the intra-European zero rate under the parent-subsidiary directive.[1] Within Europe it does not withhold tax on dividends paid to an EU parent company that has held a 15 percent participation in a Belgium subsidiary (10 percent as of 2009) for a period of one year.

In extending the zero rate to the United States, Belgian negotiators were aware that a U.S. parent company may already effectively obtain the benefits of the EU zero rate in connection with direct investment in Belgium, by holding a Belgian subsidiary through a holding company in another EU country with which the United States has a zero rate (for example, the Netherlands). This is not a major concession, since Belgium has recently extended the

[1]Council Directive 90/435/EEC of July 23, 1990, on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states (OJ L 225, Aug. 20, 1990, p. 6).

zero rate under the EU parent-subsidiary directive[2] to parent companies established in a country that is a double tax treaty partner. (For prior coverage, see *Tax Notes Int'l*, June 20, 2005, p. 1035.) And one should not overlook that the only LOB provision under the EU parent-subsidiary directive is that the parent company must be liable to corporate income tax and not enjoy a tax regime that substantially departs from the ordinary tax regime.

C. Pension Funds and Conduit Companies

The withholding tax for dividends paid to *pension funds* is zero rated. The Belgian negotiators were particularly keen on this provision because Belgium is attempting to attract pan-European pension funds. When implementing the so-called IORP Directive[3] in the Act of October 27, 2006, on the Supervision of Institutions for Occupational Retirement Provision,[4] Belgium adopted a new and transparent flexible legal framework, which must promote Belgium as prime location for international and pan-European pension funds. Part of this strategy is to offer pension funds a *de facto* exemption of Belgian corporate income tax and one of the most extensive networks of double tax treaties. The double tax treaty with the U.S. figures prominently in the government's promotion. (See also Section VIII below for other forms of relief.)

Conduit rules are included to prevent the use of a U.S. RIC to transform portfolio dividends into direct investment dividends or the use of a U.S. REIT to transform income from the sale of real estate into dividend income from the REIT. That is why dividends paid out by a RIC or a REIT are excluded from the 5 percent withholding tax rate. The maximum withholding tax in the U.S. will be 15 percent except if a RIC pays out a dividend to a pension fund, in which case it is zero.

The withholding tax on dividends paid out by a REIT is reduced from the standard 30 percent to 15 percent in three situations:

- The beneficial owner of the dividend is an individual holding an interest of not more than 10 percent in the REIT.
- The dividend is paid regarding a class of stock that is publicly traded, and the beneficial owner of the dividend is a person holding an interest of not more than 5 percent of any class of the REIT's shares.
- The beneficial owner of the dividend holds an interest of not more than 10 percent of a "diversified" REIT. A REIT is diversified if the gross value of no single interest in real property held by the REIT exceeds 10 percent of the gross value of the REIT's total interest in real property. Foreclosure property is not considered an interest in real property, and a REIT holding a partnership interest is treated as owning its proportionate share of any interest in real property held by the partnership.

Dividends paid by a REIT beneficially owned by a pension fund are zero rated if the pension fund holds an interest of not more than 10 percent in the REIT.

D. U.S. Branch Profits Tax

The treaty also introduces a U.S. "branch profits" provision. In addition to the tax imposed on the taxable income of a foreign corporation, a foreign corporation also pays a tax of 30 percent of the dividend equivalent amount for the tax year. The new treaty limits this U.S. branch profits tax to 5 percent in accordance with the withholding tax rules. It may, however, be eliminated on investments in a U.S. branch or partnership provided it meets the necessary LOB requirements. (See Section X below.)

IV. Interest

The withholding tax rate on interest is eliminated subject to the LOB test. (See article 22, described in Section X below.) This follows the current practice to eliminate withholding tax on cross-border payments of interest. Within Europe, Belgium is surrounded by countries that, as a matter of domestic tax law, do not levy withholding tax on interest (the Netherlands, Germany, Luxembourg). Moreover, EU Directive 2003/49/EC[5] provides for a zero withholding tax rate on interest. In recent income tax treaties, the United States has also called for a zero rate of withholding.

There are, however, specific antiabuse exceptions for contingent interest when the source state can withhold 15 percent tax and for excess inclusions regarding a real estate mortgage investment conduit

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[2]Council Directive 90/435/EEC of July 23, 1990, on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states (OJ L 225, Aug. 20, 1990, pp. 6-9), as amended by Council Directive 2003/123/EC of Dec. 22, 2003 (OJ L 7, Jan. 13, 2004, pp. 41-44); see http://www.europa.eu/scadplus/leg/en/lvb/l26037.htm.

[3]Directive 2003/41/EC of the European Parliament and of the Council on the activities and supervision of Institutions for Occupational Retirement Provision (IORPs) of June 3, 2003.

[4]Belgian State Gazette, Nov. 10, 2006.

[5]Council Directive 2003/49/EC of June 3, 2003, on a common system of taxation applicable to interest and royalty payments made between associated companies of different member states (OJ L 157, June 26, 2003, p. 49).

that the U.S. can fully tax. The latter is a U.S. policy to prevent purchasers of residual interests that would have a competitive advantage over U.S. purchasers at the time those interests are initially offered. There are, indeed, opportunities for tax avoidance created by differences in the timing of taxable and economic income produced by those interests.

Contingent interest is defined from a U.S. point of view as interest that does not qualify as portfolio interest under U.S. domestic law. The definition is in IRC section 871(h)(4); it must ensure that the exceptions of section 871(h)(4)(c) will apply. Belgium, however, could charge 15 percent on any interest arising in reference to the receipts, sales, income, profits, or other cash flow of the debtor or a related person, to any change in the value of any property of the debtor or a related person or to any dividend, partnership distribution, or similar payment made by the debtor or a related person.

V. Gains

Gains derived by a resident of a contracting state that are attributable to the alienation of real property situated in the other contracting state may be taxed in that other state. By using the term "attributable to the alienation of real property" rather than "gains from the alienation" (see the OECD model treaty), the U.S. can look through distributions made by a REIT and some RICs and tax the capital gain on the underlying real property on the basis of article 13 rather than on the basis of article 10 (dividends).

Moreover, the term "real property" includes "United States real property interest," which denotes shares in a U.S. corporation that owns sufficient U.S. real property interests to satisfy an asset-ratio test on specific testing dates (section 897(c)) and some foreign corporations that have elected to be treated as U.S. corporations (section 897(i)).

VI. Directors' Fees

Under the old treaty, directors' fees could only be taxed in the state of residence of the paying company insofar as the director's fees were treated as a distribution of profits. This reflected old legislation that was abolished in 1987. Since then, directors' fees are generally deductible for the Belgian company paying the fees. Directors' fees received by Belgian-resident directors of U.S. companies were therefore treated as "income not expressly mentioned" and taxed in the director's state of residence while the other contracting state could also tax the income if it was derived from sources within that state.

That condition has been abandoned, and directors' fees now may be taxed in the state of residence of the company paying the fees and other compensation, subject, however, to the services being rendered in that state. This article is subject to the saving clause of article 1(4): The United States may tax the full remuneration that a U.S. citizen residing in Belgium derives as a director of a U.S. corporation.

The new protocol clarifies that remuneration for day-to-day functions of a managerial or technical, commercial, or financial nature by a director or by a partner in a company other than a company with share capital will be taxable in accordance with the provisions of article 14 (income from employment), to the extent that the company is a Belgian company.

However, a partner's share of the income of an entity that is treated as fiscally transparent, such as a U.S. partnership, will be treated as business income (article 7).

VII. Pensions

The treaty confirms the principle that pensions and other similar remuneration in consideration of past employment are taxable only in the state of residence of the beneficiary, with the exception of social security pensions. The treaty also provides for several measures to eliminate discontinuities regarding the deductibility of pension contributions in order to remove barriers to the free movement of personal services relating to the deductibility of pension contributions.

A. Pensions

The term "pensions and other similar remuneration" includes both periodic and single sum payments. The current treaty did not cover single sum payments, which could therefore be taxed in both countries. The protocol clarifies that the term "other similar remuneration" refers to U.S. tier 1 railroad retirement benefits.

On the U.S. side, the term must encompass qualified plans under section 401(a), individual retirement plans (including those that are part of a simplified employee pension plan that satisfies section 408(k), individual retirement accounts, and section 408(p) accounts), section 403(a) qualified annuity plans, and section 403(b) plans. However, if these U.S. pensions are to be exempt for U.S. residents, Belgium must grant the same exemption (and vice versa).

B. Maintenance Payments

Alimony paid will be taxable in the state of residence, it being understood that these are periodic payments made under a written separation agreement or a decree of divorce, separate maintenance, or compulsory support, and those payments are taxable to the recipient under the laws of the state of which he is a resident.

Remarkably, though, maintenance payments for child support are taxable in the country of residence of the payer. The U.S. model provides that it will be tax-exempt in both countries.

VIII. Pension Funds

Apart from the zero withholding tax rate on dividend mentioned in Section III.C, pension funds are entitled to some other benefits.

Income earned by a pension fund in one state may not be taxed as income of an individual residing in the other state, unless it is paid out from the pension fund to — or for the benefit of — that individual.

Transfers between pension funds in the same state cannot be taxed. The treaty provides for tax-free rollover of pension contributions to qualifying plans in the same contracting state, but not for cross-border transfers.

A. Cross-Border Contributions

If an (employed or self-employed) individual pays cross-border contributions to a pension plan in one state and works in another, these are tax-deductible or (if they are paid on his behalf) excluded in computing his taxable income. It is irrelevant whether the individual takes up residence in the state where he works. However, that state cannot be obliged to give more relief than it grants its residents for a pension plan established in the U.S. or a pension plan recognized for tax purposes in Belgium, respectively

There are a few conditions and limitations. The individual must have been a participant to the fund before coming to work in the other state, he must not have been working in the other state for more than 10 years, and the competent authority of the other state must have accepted the pension plan.

B. U.S. Relief for Contributions

For a U.S. citizen working and resident in Belgium, the treaty deals with contributions to a Belgian pension fund (or a fund in a comparable third state), provided that his income from that employment is taxable in Belgium and the contribution is borne by a Belgian employer or a Belgian PE of the employer. His contributions to the pension plan during his employment in Belgium that are attributable to the employment will be deductible (or excludable) in computing his taxable income in the United States. Furthermore, any benefits accrued under the pension plan, as well as his employer's contributions, during and attributable to the employment, will not be treated as part of his taxable income in computing his U.S. taxable income.

This U.S. tax benefit will not exceed the lesser of either the corresponding relief in the U.S. or the amount of the contributions or benefits that qualify for tax relief in Belgium. Furthermore, for determining whether the individual has exceeded the annual limitation on contributions to an individual retirement account, the U.S. can take account of the contributions to a Belgian pension fund.

Finally, for these tax benefits to apply, Belgian pension funds must be approved by the U.S. Treasury.

C. Third-State Pension Funds

For the application of what is said under Section VIII.A or XI, pension funds in a third state may be assimilated to a U.S. or Belgian pension fund if they are established in a member state of the European Economic Area, North American Free Trade Agreement, or Switzerland, provided these countries grant comparable favorable treatment for contributions to a Belgian or U.S. pension fund that is a resident of the contracting state and if it has an information exchange provision with the state that is providing benefits under Section VIII.A or XI.

IX. Other Income

Under the current treaty, "income not expressly mentioned" is taxable only in the state of residence, but the other contracting state may also tax that income if it is derived from sources within that state. The new treaty will eliminate the right for the other contracting state to tax that income.

X. Tightened LOB Provision

The 1987 protocol introduced an LOB clause, but that was limited to dividends, interest, or royalties. The new treaty introduces general anti-treaty-shopping provisions to prevent residents of third countries from benefiting from what is intended to be a reciprocal agreement between two countries. Instead of relying on a taxpayer's determination of purpose or intention, the treaty sets a series of objective tests. A resident of a contracting state that satisfies one of the tests will receive benefits regardless of its motivations in choosing its particular business structure.

Although the LOB provision is reciprocal, it is clearly meant to protect the interests of the U.S. Treasury. Nevertheless, the Belgian negotiators have been able to extend the benefit to publicly traded corporations listed on a stock exchange within the EEA[6] and to include a derivative benefits clause for "equivalent beneficiaries" residing within the EEA.

Apart from individuals, the states and their political subdivisions, local authorities, or tax-exempt

[6]The European Economic Area (EEA) includes the member states of the EU as well as Iceland, Liechtenstein, and Norway.

organizations (22(2)(d), companies may qualify under one of the following tests.

A. Publicly Traded Corporations

This requires that the company's principal class of shares (and any "disproportionate class" of shares) is listed and regularly traded on one or more recognized stock exchanges, and either:

- its stock is primarily traded on a recognized stock exchange, in the U.S., Canada, or Mexico (being parties to NAFTA), or in the EU or the EEA; or
- the company's primary place of management and control is in its state of residence.

Subsidiaries of publicly traded corporations qualify as well if at least 50 percent of the aggregate voting power and value of their shares is owned directly or indirectly by five or fewer publicly traded companies.

B. Ownership/Base Erosion

To qualify under this test, the taxpayer is owned for more than half of the year by qualifying taxpayers (for at least half of each class of shares or beneficial interests in the company) residing in its state of residence.

Moreover, the taxable base may not be eroded. This means that less than half of the taxpayer's gross income for the tax year (as determined in his state of residence) is paid or accrued, directly or indirectly, to persons who are not qualifying residents of either contracting state in the form of payments deductible in the taxpayer's state of residence.

C. Derivative Benefits

Contrary to the U.S. model treaty, the new treaty contains a derivative benefits clause. A person who is not a qualified person may be entitled to benefits if at least 95 percent of the aggregate voting power and value of the company are owned, directly or indirectly, by not more than seven "equivalent beneficiaries." An equivalent beneficiary is a person resident in a member state of the EU, the EEA, or a party to NAFTA, or in Switzerland but only if one of two alternative tests are satisfied.

The equivalent beneficiary must be entitled to all the benefits of a comprehensive convention between the state granting the benefit and the EU/EEA member state or NAFTA partner. Thus, if a Belgian corporation is owned by a French corporation, it must qualify for benefits under the France-U.S. treaty.

Alternatively, if such treaty does not contain a comprehensive LOB provision, the person will be an equivalent beneficiary only if that person would be a qualified person. In short, in that situation, it must satisfy the LOB provisions applicable in the new treaty for Belgian or U.S. residents.

Also, to qualify as an equivalent beneficiary regarding insurance premiums, dividends, interest, and royalties, the resident must be entitled under its treaty with the paying jurisdiction (either Belgium or the United States) to a rate of tax that is at least as low as the rate applicable to such income under the new treaty.

An equivalent beneficiary must also satisfy a base erosion test. An equivalent beneficiary will be entitled to the derivative benefits if and only if less than 50 percent of the company's gross income is paid or accrued, directly or indirectly, to persons who are not equivalent beneficiaries in the form of deductible payments (but not including arm's-length payments in the ordinary course of business for services or tangible property and payments in respect of financial obligations to a bank that is not related to the payer).

D. Active Trade or Business

A resident of one state engaged in the active conduct of a trade or business in that state may obtain the benefits of the convention regarding an item of income derived in the other state. The item of income, however, must be derived in connection with or incidental to that trade or business. Making or managing one's own investments is not a trade or business unless conducted by a bank, an insurance company, or a registered securities dealer as part of their business.

This general rule is subject to a further condition in cases in which the trade or business generating the item of income in question is carried on either by the person deriving the income or by any associated enterprise. In that case, the trade or business carried on in the state of residence, under these circumstances, must be substantial in relation to the activity in the state of source. This requirement is intended to prevent a limited case of treaty-shopping abuses in which a company attempts to qualify for benefits by engaging in de minimis connected business activities in the treaty country in which it is resident (that is, activities that have little economic cost or effect on the company business as a whole).

The determination of substantiality is made based on all the facts and circumstances and takes into account the comparative sizes of the trades or businesses in each contracting state, the nature of the activities performed in each contracting state, and the relative contributions made to that trade or business in each contracting state. In any case, in making each determination or comparison, the relative sizes of the economies in the two contracting states will be considered.

To determine whether a company is engaged in an active trade or business, the treaty attributes the activities of related persons to the company. Persons are considered connected if one possesses at least 50 percent of the aggregate vote and value or beneficial interest in the other, or if another person possesses, directly or indirectly, at least 50 percent of the aggregate vote and value or beneficial interest in each person.

E. Other Tests

A resident of either state that functions as a headquarters company for a multinational corporate group may qualify if it meets a set of conditions.

If a Belgian company derives interest or royalties from the U.S. via a PE in a third country, it will not be entitled to the benefits of articles 11 and 12 if the PE does not pay at least 60 percent of the tax that would have been payable in Belgium.

A resident who does not qualify under any of the other tests may still seek from the competent authority of the source state a determination that the principal purpose of the establishment, acquisition, or maintenance of such person and the conduct of its operations is not to obtain treaty benefits. The competent authority will not deny the benefit without consulting with the competent authority of the other state.

XI. U.S. Citizens Residing in Belgium

A. Saving Clause

Article 1(4) is the saving clause found in all U.S. treaties. The U.S. reserves the right to tax its residents and citizens as provided notwithstanding any provisions of the convention to the contrary.

For example, if a Belgian resident is self-employed in the U.S. but does not have a PE in the U.S., the income cannot be taxed in the U.S. under article 7 (business profits). If, however, that resident is also a U.S. citizen, the saving clause permits the United States to include the remuneration in the citizen's worldwide income and subject it to tax under the normal code rules (that is, without regard to IRC section 894(a)).

Under paragraph 4, the U.S. reserves its right to tax former citizens and former long-term residents[7] for a period of 10 years following the loss of such status in accordance with IRC section 877. A former citizen or long-term resident of the United States who relinquishes citizenship or terminates long-term residency continues to be liable to tax if either of the following criteria exceed established thresholds:

- the average annual net income tax of that individual for the period of five tax years ending before the date of the loss of status; or
- the net worth of that individual as of the date of the loss of status.[8]

B. Exceptions to the Saving Clause

Article 1(5) lists exceptions to the saving clause. The provisions referred to are intended to provide benefits to U.S. citizens and residents even if those benefits do not exist under internal U.S. law. Those exceptions are as follows:

- the right to a correlative adjustment regarding income tax due on profits reallocated under article 9 (article 9(2));
- exemptions from source or residence state taxation for some pension distributions, social security payments, and child support (articles 17(1)(b), (2), and (5));
- an exemption for some investment income of U.S. pension funds (article 17(6) and (9), see Section VIII.B above);
- relief from double taxation (article 22);
- nondiscrimination (article 23); and
- the mutual agreement procedure (article 24).

A different set of exceptions to the saving clause is granted to temporary U.S. residents (for example, holders of nonimmigrant visas), but not to citizens or permanent residents:

- the beneficial tax treatment of pension fund contributions (article 17(7));
- host country exemptions for government service salaries and pensions (article 18);
- some income of visiting students and trainees (article 19); and
- income of diplomatic agents and consular officers under (article 27).

C. Relief From Double Taxation

Since U.S. citizens, regardless of residence, are subject to United States tax at ordinary progressive rates on their worldwide income, the U.S. tax on the U.S.-source income of a U.S. citizen resident in Belgium may be higher than if he were not a U.S.

[7]The U.S. defines "long-term resident" as an individual (other than a U.S. citizen) who is a lawful permanent resident of the United States in at least 8 of the prior 15 tax years. An individual is not treated as a lawful permanent resident for any tax year if that individual is treated as a resident of a foreign country under the provisions of a tax treaty between the United States and the foreign country and the individual does not waive the benefits of that treaty applicable to residents of the foreign country.

[8]Respectively, $131,000 (in 2006) and €2 million. The first figure is subject to cost-of-living adjustments.

citizen. The provisions of article 22(4) must ensure that Belgium does not bear the cost of U.S. taxation of its citizens, former citizens, and former long-term residents who are Belgian residents.

For income originating in *third countries*, as determined under the laws of Belgium, and received by a resident of Belgium, U.S. taxation will not affect the taxation in Belgium. For U.S.-source income, Belgium will grant an exemption of income tax as if the U.S. tax paid on that income were the tax due if the resident were not a citizen or a former citizen or a former long-term resident of the United States. In practice, this will not make any difference as Belgium calculates the exemption in respect of income. And when the U.S. computes the U.S. income tax on these items of income, the U.S. will grant a credit for the Belgian income tax calculated in that manner. In allowing the credit, the U.S. will not reduce its tax below the amount that is taken into account in Belgium.

Since the U.S. grants a credit for what really is U.S.-source income, this income must be re-sourced to Belgium before the U.S. can credit the Belgian tax paid. This is why these items of income are deemed to be from Belgian sources to the extent necessary to avoid double taxation under paragraph 4(b). Subparagraph 3(c)(iii) of article 25 (mutual agreement procedure).

XII. Relief From Double Taxation

Belgium grants relief from double taxation in accordance with the exemption with progression method for income other than dividends, interest, and royalties. In its explanatory memorandum to the Senate,[9] the government explains that the subject-to-tax provision is to be read in light of the case law of the Supreme Court[10] and means that the income has been subjected to the tax regime that normally applies, even if that means that the income is in fact tax-exempt. Therefore, Belgium will exempt income from U.S. real property, income from an enterprise, or capital gains realized by a Belgian resident via a U.S. partnership (that is, a vehicle that is not a body corporate and is treated in the United States as transparent for tax purposes).

Remarkable is that the government spells out that it is giving two other forms of relief:

- Belgium will exempt income that is treated as dividend under Belgian law, that is paid out by an entity that is a corporation but that is not taxed as such (in particular the limited liability companies that are liable to tax directly in the hands of their shareholders). The Belgian resident shareholder must, however, have been taxed by the United States proportionally to his participation in the entity, on the income out of which the "dividends" are paid.[11]
- A Belgian-resident parent company is entitled to the participation exemption if the U.S. subsidiary meets the conditions under Belgian law.[12] If it does not meet these conditions, it will be entitled to credit against the Belgian corporate income tax the U.S. tax levied in accordance with article 10.

XIII. Mutual Agreement Procedure

The protocol introduces a mandatory binding arbitration mechanism for settling some issues that cannot be resolved through the normal competent authority process. A similar provision had been agreed recently in the tax protocol signed between the U.S. and Germany on June 1, 2006. (For the full text, see *Doc 2006-10666* or *2006 WTD 107-9*.)

The U.S. business community had been asking for that provision to speed up the resolution of issues submitted to the competent authorities, to moderate the positions taken by the tax authorities, and to ensure possible relief from double taxation. Issues relating to individual residence, PEs, business profits, associated enterprises, and royalties generally must be submitted to binding arbitration if they cannot be settled within two years.

The arbitration panel consists of three members: Each competent authority appoints one member, and those two members appoint a third. The third member, who cannot be a citizen of either treaty country, chairs the panel. After the appointment of the chair, each competent authority has 60 days to submit a proposed resolution and a position paper and another 60 days to submit a reply. The panel must adopt the resolution of one of the two parties within six months of the chair's appointment. The arbitration model opted for is often referred to as the "baseball arbitration model" (the panel must chose between two proposed resolutions). It is not the preferred option of the OECD or the European Union, but the U.S. Treasury has expressed its preference for this model because it obliges the competent authorities to take the most reasonable

[9]Parliamentary Documents, Senate, 2006-2007, 3-2344/1, p. 35.

[10]Cass. Sept. 15, 1970, Pasicrisie, 1971, I, 37.

[11]Even if the income is tax-exempt, the Belgian resident must declare the income so that the municipal surcharge on the income tax can be computed.

[12]A minimum participation of 10 percent or €1.2 million. Moreover, the subsidiary must not fall within any of the specific antiavoidance exclusions, which in practice implies that the subsidiary must meet a subject-to-tax condition.

approach, because they want their approach to be the one that is adopted. And that should make the process faster and less protracted.[13]

The determination of the panel is binding on the competent authorities. The taxpayer does not have the right to submit a proposed determination, but the protocol gives him the right to walk away from the process and to reject the panel's determination. He has the right to opt out of the process within 30 days of receiving the determination.

All parties to the proceeding must agree to terms of confidentiality, and the arbitration panel will not provide a rationale for its determination, which will have no precedential value.

XIV. Exchange of Information

When President Bush agreed to renegotiate the Belgium-U.S. tax treaty, the U.S. Treasury was not keen to do so. It had previously aborted discussions regarding a new treaty because the Belgian negotiators were refusing to budge on the Belgian banking secrecy rules.

Under Belgium law, Belgian banks cannot give information about their clients to the tax authorities. However, fiscal bank secrecy is being eroded by new money laundering rules and the qualified intermediary system. Moreover, last year, the Belgium Parliament adopted a law providing that banks could no longer invoke the privilege in dealings with tax collectors.

As mentioned before (see Section III.A), the U.S. Treasury has made the benefit of the zero withholding tax rate dependent on compliance with article 25. Also, Treasury has imposed provisions that would specifically oblige Belgium to change its tax legislation. Paragraphs 5 through 8 are indeed not standard in the U.S. model treaty. The Belgian tax authorities must have the power to ask for the disclosure of tax information and to conduct investigations and hearings, even if that is contrary to, or outside the time limits of, Belgian domestic tax law. If a person refuses to give information requested by the United States, the Belgian tax authorities would need to have the power to impose penalties and to bring appropriate enforcement proceedings, for example, by way of summary proceedings.

The Belgian negotiators have however been able to include an exception in the protocol. Banking records will be exchanged only on request in which both the taxpayer and the bank or financial institution are specifically identified. If that is not the case, the Belgian competent authority may decline to obtain any information that it does not already possess.

Given that the standard applicable statute of limitations for investigating tax returns is three years (and five years if the income tax legislation has been infringed with a fraudulent intention or with the intention to harm), ratifying the double tax convention required a change to the Belgian tax procedures. Reynders has taken a practical approach. Rather than changing the domestic rules, Reynders counts on the fact that the treaty overrides the domestic legislation, and he has included some provisions in the act ratifying the treaty so that when they are carrying out an investigation for the U.S. Treasury, the Belgian tax authorities can investigate bank accounts, even outside the situation of serious organized fraud or the ordinary time limits (articles 5 to 7 relating to articles 318 and 333 of the Income Tax Code).

Belgium has shorter time limits for keeping accounting documents. Before the Chamber of Deputies, Reynders confirmed that he had informed the U.S. Treasury that these time limits could prevent the exchange of information and that older information could only be provided if the information could be retrieved in the tax authorities' own files.[14]

As for the Belgian tax authorities, they are allowed to use the information they receive from the U.S. tax authorities but only if they have been gathered by the latter outside the Belgian territory. Reynders also confirmed that this excluded the use of information that the Belgian tax authorities gathered on behalf of the U.S. tax authorities or the use of information they had requested from the U.S. tax authorities outside the domestic time limits.[15]

XV. Entry Into Force

The new treaty must be ratified by the two governments before it can enter into force. The new treaty will enter into force on the date on which the later of the notifications is received. Its provisions will apply for tax periods beginning on or after January 1 following the date on which the treaty enters into force. In the case of withholding tax, the treaty will enter into force as of the first day of the second month following the date on which the treaty enters into force.

However, a taxpayer has the right to claim the benefit of the prior treaty for a period of 12 months if it is entitled to greater benefits under that treaty.

[13]Benedetta Kissel, quoted in "U.S. to arbitrate U.S. tax disputes," *International Tax Review*, Mar. 2007.

[14]Parliamentary Documents, Chamber of Deputies, 2006-2007, 51/ 3054/002, p. 11.

[15]*Id.*, p. 10.

Conclusion

Belgium is now waiting for the U.S. to ratify the treaty. However, that may not happen soon. The new tax treaty with Belgium is not on the agenda of the U.S. Senate Committee on Foreign Relations yet, although it might get there by the beginning of June. Belgium's ratification may speed up things. ◆

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