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PRACTITIONERS' CORNER

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One reason for Belgium's popularity in international tax-planning structures is the absence of capital gains tax for individuals. Belgium does not have a wealth tax, either, so that makes the country attractive for wealthy individuals.

The financial newspaper *De Tijd* reported on June 8 that the Supreme Court of Justice had dealt a serious blow to the tax-exempt regime of capital gains realized by an individual on his shares of a company. This gives us an opportunity to review the current rules regarding Belgium's capital gains tax regime.

Capital Gains Taxation

The taxation of capital gains is in the income tax code. Capital gains made in a business are taxed as income. That is true for companies; it is also true for individuals who realize a capital gain on the assets they hold in their business or in the exercise of their profession.

Capital gains on ''private assets'' are taxed at a rate of only 33 percent[1] if they fall outside the ''normal management of a private estate consisting of securities, tangible assets or real property.''

Nevertheless, capital gains resulting from the sale of a ''substantial shareholding'' in a Belgian company to an entity outside the European Economic Area[2] are taxed at a rate of 16.5 percent even if the sale is ''in the course of the normal management.''[3] A shareholding in a Belgian company is deemed to be ''substantial'' when an individual taxpayer and his close relatives hold or have held a direct or indirect participation of more than 25 percent at any time during the five years before the sale.

Normal Management of a Private Estate

The notion of ''normal management'' has been defined by the courts as a conservative, risk-averse, and unsophisticated management of one's private estate.[4] The general understanding was, therefore, that capital gains on private assets were taxable only if they were of a speculative nature.

The traditional belief was that there was speculation if an individual purchased and sold assets quickly and repeatedly, borrowing to do so, using sums that are sizable for his private estate, and with the help of pseudo-professional means. Consequently, the tax authorities had to prove that an individual had been speculating to tax a capital gain.

Single transactions in particular could never be deemed to fall outside the normal management of a private estate. The sale of shares in a privately owned

[1]Articles 90, 1° and 171, 1° a of the Income Tax Code 1992.

[2]Article 90, 9° ITC 1992. Until recently this applied to all non-Belgian entities, but the European Court of Justice held that this was contrary to the principle of the free movement of capital. (For prior coverage, see *Doc 2004-13184* or *2004 WTD 124-1*.)

[3]Article 171, 4° e) ITC 1992.

[4]Antwerp, Nov. 18, 1997, *Fisc. Act.*, 1998/2, 4; Antwerp, Feb. 2, 1993, *F.J.F.,* No. 93/186; Luik, Dec. 19, 1991, *Bull. Bel.,* No. 723,121; *Fiskoloog* 1993, No. 421, 11.

company usually constitutes ''normal management,'' so that the resulting capital gain is tax free.

The Belgian tax authorities have made several attempts to expand beyond mere speculation the notion of what is ''outside the normal management of a private estate.''

'Internal' Capital Gains

Because one-shot transactions were generally seen as tax exempt, a favored tax planning technique was for an individual shareholder to assign his majority shareholding in a company to an entirely owned holding company, either against shares to be issued by the holding company or against a receivable owned by the holding company. A receivable allowed the shareholder to convert dividends into a tax-exempt reimbursement of the receivable.

The tax authorities started adopting a different reading of what constitutes normal management in order to tax those capital gains. The capital gains were referred to as ''internal'' capital gains because they did not involve a third party. The tax authorities took the position that a transaction did not have to be speculative to fall outside the normal management of a private estate. In particular, they said that setting up a holding company to hold a participation did not constitute normal management.

This position was contested before the courts with varying degrees of success. At the instigation of the Ruling Committee, the tax authorities have come up with a practical solution. A private individual can safely assign his participation to an entirely owned holding company, against shares to be issued by the holding company, if he subsequently maintains a status quo as to the share capital and the dividend policy. At the time, the Ruling Committee was reluctant to approve any transactions in which an individual shareholder sells his participation to a holding company that records the price to be paid in a current account.

However, in a March 22, 2011, position paper, the Ruling Committee confirmed that it would apply the criteria found in case law to decide whether a planned assignment of shares falls outside the normal management of a private estate. The sale of a cash company will not qualify as normal management.

The following is a list of elements the Ruling Committee will look at to determine whether the transaction falls within the normal management of a private estate:

- the economic criteria for the transaction or the absence thereof;
- the complex nature of the transaction or a sophisticated set of facts surrounding the transaction;
- whether some of the companies involved have been recently incorporated;
- the capital gain;
- the valuation of the shares;
- the method of the financing and securities provided;
- the financial resources of the purchaser; and
- the distribution of dividends since the acquisition of the company and the transaction.

In general, the entire transaction must be considered: Are companies involved that are controlled by the applicant, and does he work with specialists (advisers) — in other words, how does he manage his private estate?

Also, the Ruling Committee will likely favor a transaction in which the individual shareholder refrains from:

- reducing the share capital of the holding to replace it with a receivable against the company;
- reducing the share capital of the subsidiary;
- paying out higher dividends from the subsidiary to the holding company; and
- paying out higher management fees or director's fees unless the holding company actually takes over activities from the subsidiary (for example, accounting tasks).

The subsidiary can, however, reduce its share capital or pay out a higher dividend if the funds released are used for new investments or to finance other companies of the group or other affiliated companies as long as they are not distributed to the individual shareholders. Higher dividends may also be used to pay back a loan or a current account of a shareholder who leaves the company. The reimbursement must be spread over a sufficiently long period of time.

The Ruling Committee will give a favorable ruling after it has reviewed past transactions and the transactions planned after the transaction for which a ruling is requested. Moreover, rulings will only be valid if the transaction is carried out within a one-year period.

Capital Gains Made by a Company Director

In another attempt to tax capital gains realized by an individual shareholder of a company, the tax authorities make a distinction between active and passive shareholders. The tax exemption would be reserved to shareholders who take a passive role in the company. If, however, the taxpayer who is selling his participation is an active shareholder who has been working in and for the company, has an influence on the management of the company, and works to increase the value of the shares of the company, the tax authorities believe that the capital gain was not realized in the normal management of his private estate.

This argument has been rejected by the courts of appeal in Mons and Antwerp and more recently by the courts of first instance of Brussels and Antwerp.

However, the Supreme Court appeared to give the taxpayer a setback when it decided that the courts may take into account the fact that the taxpayer who is selling his participation of the shares acts as the director of the company in order to decide that the transaction falls outside the normal management of his private estate.

In fact, the Supreme Court only confirmed that the courts of appeals applied the law correctly. The court's powers are limited to an examination of the law by the lower courts. It cannot reexamine the facts of the case; it can only examine whether the court of appeals correctly applied the law.

The Supreme Court confirmed that the lower courts must limit their examination of the facts to the single transaction that results in a capital gain. The courts can take account of a larger set of transactions surrounding that specific transaction, in particular if they find a construction that is inspired by tax reasons. For that reason, the court, when examining whether a transaction was speculative or not normal, was allowed to examine what the shareholder had done on behalf of the company or what was done by the company in which he had a participation.

The facts of the case before the Ghent Court of Appeal showed a sophisticated construction that appears to have been set up by a director (Mr. H) of a group of companies that planned to transfer the shares of one company (HBV) in the group to another (AL). A shareholding of 30 percent of the shares of HBV was not transferred directly to AL but passed through a company (Refin) that did not appear to have any links with the group.

What was remarkable, though, was that: Refin was set up after a letter of intent was signed with Mr. H for the sale of the shareholding; Refin bought HBV with a loan from the group; HBV paid a dividend to Refin; and Mr. H then bought a participation in Refin before Refin sold its shares in HBV to AL with a substantial capital gain. Not even 18 months after its incorporation, Refin was put into liquidation and Mr. H realized a significant capital gain on his participation.

In itself, the transaction in which Mr. H took a participation in Refin and a year later made a sizable profit appears to be a normal, lucrative transaction. However, the surrounding circumstances indicate that he had been planning this transaction in order to make the profit.

The tax authorities may still try to reverse the case law, but the case law seems to be firmly in favor of the company directors who make an honest profit on the sale of shares of their company. If they set up a sophisticated construction to try and make fictitious capital gains, they may well be found out. ◆