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News Analysis: Belgian Official Puts Reforms on Table

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At a July 4 news conference in the Belgian Parliament, Walloon Socialist Party leader Elio Di Rupo, recently appointed by King Albert II to lead the formation of a coalition government, announced a five-pronged reform package that includes numerous new tax proposals.

Di Rupo, as the newly appointed *formateur*, has asked the other political parties to decide whether they want to pursue government formation talks on the basis of the proposals.

Background

Following more than a year of protracted negotiations between all the political parties, King Albert II in May asked Di Rupo to form the next Belgian government.

Prime Minister Yves Leterme was unable to push through promised state reforms after years of discussions and stalemates. His government fell after Parliament was dissolved, and new general elections were held on June 13, 2010.

The big winners in the election were the pro-separatism New Flemish Alliance (N-VA) and the Walloon Socialist Party. N-VA, supported by other Flemish parties, insisted on a major state reform before it would agree on the next government's policy. This resulted in a standoff between all the political parties that lasted more than a year. Guinness World Records has officially recognized Belgium as the holder of the record for the longest period for a democratic nation to go without a government.

After appointing one politician after another as *informateur* (who investigates the possibilities for the formation of a Cabinet), mediator, facilitator, and so on, King Albert II in May asked Di Rupo to form the next Belgian government. Following the lead of his predecessors, Di Rupo worked in the shadows for seven weeks before submitting his proposals on July 4, marking the first time that a major player had made his proposals public.

Early reactions have been favorable. Di Rupo is the first to stick out his neck and tackle issues that have been taboo for both the left (unemployment benefits and pensions for civil servants) and the right (capital gains tax and wealth tax). The proposals are still open for discussion.

Di Rupo's Proposals

Public Finances

The state budget must be balanced by 2015. To cover the current deficit of some €22 billion, the new coalition government will draw up a budget that will balance extra income and tax cuts with reductions of the interest payments on the national debt and other measures (such as initiatives targeting tax and social security fraud). Lower spending would be achieved by allowing the healthcare budget to grow only 2 percent per year, instead of 4.5 percent, until 2015 and by freezing civil service expenditures for two years.

New Tax Measures

The budget proposals include some new, unexpected tax measures. However, some of them may not last when the time comes to put them into practice.

Personal Income Tax

The tax-free allowance for individual taxpayers would be raised by €1,000. The existing tax framework for interest and dividends would be maintained with a withholding tax as the final tax, but the rate for interest income would be raised from 15 percent to 20 percent. The tax rate for interest on savings accounts would be maintained at 15 percent for the first tranche of €1,770.

Dividends would be subject to a single rate of 25 percent. (Rates currently range from 15 to 25 percent.) The same rate of 25 percent would apply to capital gains realized on shares and securities if they are sold within eight years. To stop speculation, the tax rate would be set at 50 percent for capital gains on shares and securities sold within the first year. Capital losses could be set off against capital gains.

Di Rupo wants to make investment choices more neutral by applying the tax regime for interest and dividends to all investment products, regardless of their legal form. This likely would mean that insurance products and SICAVs (open-ended collective investment schemes) would become taxable at the same rate.

Another proposal would introduce a temporary crisis wealth tax on large estates (those worth more than €1,250,000), excluding the primary family home and assets used for a business or professional activity. The rate would be set at about 0.5 percent.

Users of big company cars (considered by Di Rupo as any car larger than a Volkswagen Polo) would be hit as well. The value of that fringe benefit would be raised in proportion to the effect on the environment (carbon emissions) and the value of the car. Di Rupo proposed a special tax on first-class and business-class airline tickets.

Company Income Tax

Belgium grants a participation exemption (the Belgian equivalent of the dividend received deduction) for dividends received by a parent company that has held a shareholding of at least 10 percent (or with an acquisition value of €2,500,000) for a period of one year without interruption. As proposed, the minimum holding period would become two years.

The capital gains tax exemption would be subject to the same conditions as the participation exemption for dividends. Currently, capital gains realized by companies are tax exempt regardless of the percentage of the participation and the holding period.

The notional interest deduction regime would be improved to control the cost of the system and to combat abuses. The current rate of 3.425 percent would drop to 3 percent (3.5 percent for small and medium-size enterprises). Equity that is required by law would be excluded for all enterprises, and the carryforward of the unused notional interest deduction would be excluded.

Other Tax Measures

The nuclear industry would have to pay more for the right to keep nuclear power plants open for a longer period of time. The tax regime for stock exchange transactions would be modernized to limit speculation with a higher tax rate and a lower cap. And service vouchers would become more expensive and would no longer be tax deductible.

It is far from certain which of these tax measures will become law. The new tax rates for interest and dividends and the taxation of other investment products would be the easiest measures to implement. A temporary crisis tax would require some sort of wealth register to be effective, and that could not be set up quickly.

State Reform

Belgium's sixth state reform calls for splitting the controversial Brussels-Halle-Vilvoorde constituency into three constituencies: Brussels, Flemish Brabant, and Walloon Brabant. French-speaking voters with special facilities in the six Flemish municipalities around Brussels would get the right to vote in Flanders or in Brussels. The Brussels judicial district would be split, as well.

The various regions and communities would receive considerable new powers, especially with regard to employment, healthcare, and child allowances — changes that Di Rupo says would not affect the core of Belgium's social security system.

For the Brussels-Capital region, Di Rupo suggested the voluntary creation of a cross-regional community that would connect Brussels with its hinterland and focus on employment and mobility. Brussels would receive extra funding from the federal state, Flanders, and Wallonia.

Fiscal Autonomy for the Regions

Another proposal involves a reform of the finance law, which governs the financing of the federal state and the devolved authorities, regions, and communities.

Under this reform, the regions would be authorized to collect 29 percent of the personal income tax (currently limited to 6.75 percent) and would be authorized to give tax credits of not more than 5 percent of the total company income tax. Di Rupo insists that taxes would not be increased to provide the extra funds for the regions and communities.

Social Economic Reforms

Di Rupo said further economic reforms focusing on the labor market, pensions, and health insurance are needed, but he promised not to dismantle the automatic indexation of wages and benefits in accordance with the retail price index.

He proposed maintaining the retirement age at 65 and getting more Belgians in the 60 to 65 age bracket into the workforce. The minimum age for early retirement would be increased progressively by two months a year. Retirees who have worked more than 45 years would have higher pensions. The minimum state pension for employees and the self-employed would be increased by 2 percent every two years, and the minimum pension for the self-employed would be raised to that of employees. Notably, the cap on earnings after the retirement age would also be lifted.

Civil servants would see major changes to their pensions, which would be calculated on the last 10 years instead of the last five years. The automatic linking of pensions to the salaries of civil servants would no longer be guaranteed.

The unemployment benefit would be linked more closely to past earnings. It would increase during the first four months of unemployment, but be cut for those who remain on the dole longer. Di Rupo did not propose stopping the unemployment benefit after a period of time.

Other Reforms

Di Rupo also proposed to reform Parliament by cutting the number of representatives by 15 percent and turning the Senate into a nonpermanent institution with senators who are elected to devolved parliaments. Federal, regional, and European elections would be held at the same time; and candidates would be able to appear on only one list. A new federal constituency would be created, with voters electing 10 members to the House of Representatives.

Di Rupo also announced proposed changes in the areas of migration and asylum, with one minister responsible for both. He also called for justice system reform and for a new political culture. ◆

♦ *Marc Quaghebeur, partner, Vandendijk & Partners, Brussels*