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Belgium Reaches Agreement on Budget, Pushes Tax Obstacles Aside

Posted on Oct. 19, 2016

By Marc Quaghebeur

In the early hours of October 15, Belgian Prime Minister Charles Michel announced that his government had reached an agreement on the 2017 budget. The three topics that were at the center of the budget discussion -- an in-depth reform of the corporate tax, a capital gains tax for individuals, and new measures to channel savings into the economy -- have been shelved for now.

The Sticking Points

Corporate Tax Reform

A major overhaul of the corporate tax regime, with the tax rate slashed to 20 percent, had been put forward by Finance Minister Johan Van Overtveldt, who had launched a comprehensive plan to get to "20 percent by 2020." (Prior coverage .)

In brief, he wanted to reduce the corporate tax rate from 33.99 percent to 20 percent in 2019. To offset that lower rate, Belgian companies would have to waive several favorable tax measures, such as:

- the notional interest deduction and the carryforward of losses (at least partially, so that companies would pay at least 12 percent tax -- that is, 20 percent tax on 60 percent of their tax losses);
- the introduction of the interest deduction in line with the anti-tax-avoidance directive (Council Directive (EU) 2016/1164); and
- a raise of the standard withholding tax rate from 27 percent to 30 percent.

At the same time, the finance minister proposed dropping the "fairness tax" and the 0.4 percent CGT on shareholdings held by companies, raising the dividend received deduction from 95

percent to 100 percent, and lowering the CGT rate from 25 percent to 20 percent.

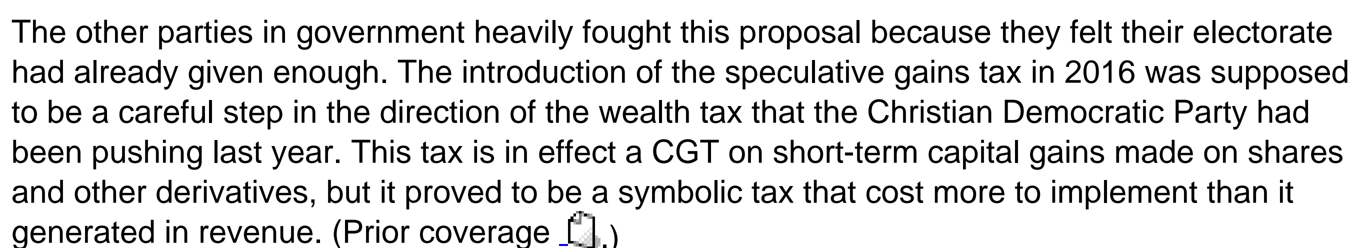
CGT

Minister of Employment Kris Peeters, a Christian Democrat, wanted to link the corporate tax reform to the introduction of a CGT for individuals. He sprang this proposal on his colleagues because his party wanted to counterbalance the corporate tax reform and show Peeters's voters that he was doing something to restore fiscal justice and, according to his party, that fair taxation means "the wealthy should pay tax too."

His plan called for a CGT on listed and unlisted shares and derivatives. CGT on the shares of start-ups or small and medium-size enterprises would, however, be exempted.

There would be a threshold of €50,000 per taxpayer (€100,000 for a couple) over a period of 10 years, or €5,000 per year. Moreover, the taxpayer would be able to set off broker fees, stock exchange taxes, bank collection and custody fees, interest on loans to acquire the shares, and capital losses.

The tax rate would be set at the new standard withholding tax rate of 30 percent. The tax rate would go down by 1 percentage point every year over a period of 30 years, bringing the rate down to 0 percent.

The other parties in government heavily fought this proposal because they felt their electorate had already given enough. The introduction of the speculative gains tax in 2016 was supposed to be a careful step in the direction of the wealth tax that the Christian Democratic Party had been pushing last year. This tax is in effect a CGT on short-term capital gains made on shares and other derivatives, but it proved to be a symbolic tax that cost more to implement than it generated in revenue. (Prior coverage .)

Mobilize Savings for the Economy

Not to be outdone, the conservative-liberal party Open Flemish Liberals and Democrats (Open VLD), wanted to launch new measures to encourage taxpayers to invest their savings in the economy by investing in shares or bonds to be issued by the recipient enterprises.

For the last week, all parties in the coalition government were holding off in what could only be described as a stalemate. It was rumored that agreement had been reached on the budget figures and that all that was needed was an agreement on these aforementioned measures. Tensions ran high, not in the least because of the time pressure, as the budget had to be submitted to the European Commission on October 17. Peeters left the talks when his CGT proposal was rejected by the other coalition parties, nearly causing the government to fall.

Michel had to postpone his annual State of the Union speech before the Parliament from October 11 to October 16 to try to reach an agreement. It became clear that the only solution would be to postpone any decisions on the three major topics: the corporate tax reform, the introduction of a CGT, and new measures to use savings for the economy.

The Budget

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The government needed to find €3 billion to satisfy the criteria of the European Commission and to provide for a buffer of €739 million. Seventy percent of the total will come from spending cuts, 20 percent from fiscal measures, and 10 percent from other sources.
The larger part of the spending cuts will be made in the health sector, and the way hospitals are financed will be reformed earlier than anticipated. The use of generic medicines will be favored, antibiotics will become more expensive, and doctors' fees will not be allowed to follow the inflation rate entirely.

Cuts in welfare spending will be important. The so-called welfare envelope, designed to help those on the lowest benefits, will be reduced by 25 percent.

Some decisions will affect working practices. These include allowing night work at e-commerce companies and allowing greater flexibility in the application of the 38-hour workweek.

New Taxes

On the side of the new taxes, the most important measure is that the default withholding tax rate on dividends and interest will go up from 27 percent to 30 percent on January 1, 2017. That is only one year after it rose from 25 percent to 27 percent. In most cases, the tax rate will have doubled from 15 percent in the last five years.

The stock exchange tax rates will be maintained but the tax will be extended to transactions via foreign platforms that had remained tax-exempt until now. Investors will presumably be asked to report the stock exchange transactions in a special tax return since Belgium cannot require foreign banks and intermediaries to pay the tax. Moreover, the cap of the stock exchange tax will be raised from €800 to €1,600 for stocks, €1,300 for bonds, and €4,000 for investment funds.

The highly symbolic speculation tax on short-term capital gains will be abolished.

Company cars are, once again, an easy target. When the employer issues a company car with a fuel card, only 75 percent of the cost of that fuel card (and the supply of fuel) is currently deductible. This will be limited further to about €250 per employee. However, employees who have a company car will be able to opt for additional net salary as an alternative to a company car; the figure of €450 per month was put forward.

Tax and social security benefits will be linked to a minimum period of employment and residence in Belgium. This follows a recent report that asylum seekers who are registered on a waiting list are effectively Belgian residents and must file income tax returns even if they do not have any taxable income. They are entitled to some tax deductions and possibly tax reimbursements, in particular for dependent children. The government has already agreed on a draft bill of law to clarify that asylum seekers will be deemed to be nonresident.

As usual, the budget anticipates measures designed to tackle tax and social fraud.

Internal Capital Gains

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A short sentence in the presentation of the budget may have unexpected results. The government intends to tax "internal capital gains," a typical Belgian tax term for to a very specific situation.

In principle, capital gains realized on a taxpayer's private estate -- consisting of securities, tangible assets, or real property -- are tax-exempt only if the gains are realized on transactions that are outside the limits of the "normal management of a private estate" (article 90, Income Tax Code 1992).

The courts have defined the notion of "normal management" as a conservative, risk-averse, and unsophisticated approach to the ownership of a private estate. The phrase "outside the limits of the normal management of a private estate" has traditionally been read as meaning that private capital gains are only liable to income tax if they are of a speculative nature. From that perspective, the tendency of the courts was to determine whether the taxpayer had been speculating by looking at whether he had been purchasing and selling assets repeatedly and at a fast pace, taking out loans that are excessive compared to the value of his possessions, and using pseudo professional means (for example, a Reuters terminal).

Consequently, single transactions are not deemed to fall outside the normal management of a private estate. The sale of a privately owned house or a one-time sale of the shares of a company would, therefore, be tax-exempt unless there was a speculative intent.

At the end of the last century, the tax authorities started taking a different reading of what constitutes normal management. They had noticed that individuals who held a majority shareholding in a company were selling that shareholding to an entirely owned holding company, either against shares to be issued by the holding company or against a payable due by the holding company. This allowed the individual shareholder to freeze his capital gains (that is, to record a tax-free capital gain in view of a possible takeover in the future). Alternatively, it allowed the shareholder to create share capital or a current account through which he could pay out future dividends, tax-free. Such one-shot transactions with entirely controlled companies were not speculative and could not be taxed.

The tax authorities took the position that a transaction did not need to be speculative to fall outside the normal management of a private estate. In particular, they held that setting up a holding company to hold a participation did not constitute normal management and that such capital gains (internal capital gains) were taxed as capital gains realized outside the normal management of a private estate.

That position was contested before the courts, and the courts generally confirmed that these capital gains were not taxable. The tax authorities have reviewed their position and opted for a practical solution. In practice, 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 the status quo for a period of three years.

These are the internal capital gains that the government wants to tax, and it is likely that doing so will generate more than the €31 million the government anticipates.

Hot Potatoes

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The prime minister has confirmed that the three issues that caused so much friction between the coalition parties will be discussed at a later date. The texts of the corporate tax reform will be examined in more detail, as will the measures to increase investment for SMEs and start-ups, and the digital agenda -- the measures to better exploit the potential of information and communication technologies in order to foster innovation, economic growth, and progress. Proposals relating to income and capital gains will be subject to closer examinations.

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