Belgium

Branch Reporters
Marc De Mil*
Tom Wallyn**

Summary and conclusions

The R&D sector is fundamental for economic growth and job creation. In order to stimulate economic growth, the federal and regional governments have implemented three types of incentive: cash grants, employment and training incentives, and tax-related incentive. These tax-related incentives can mainly be found in business income taxation (BIT). The extent of the tax climate goes further, however, than BIT alone, with tax incentives for instance to recruit foreign specialised personnel and measures reducing labour cost.

On the input side, Belgian tax law provides general and specific incentives for R&D. The most applied general incentive is the notional interest deduction (NID). Specific incentives include the R&D investment deduction and the payroll tax exemption for researchers.

Taxpayers can benefit from an additional tax deduction on their R&D expenditure. On top of the tax deductibility of R&D expenditures, taxpayers may opt for capitalising R&D expenditure following which an investment deduction can be claimed. The R&D investment deduction targets capital expenditure, including both tangible and intangible assets. In order to qualify, both the tangible and intangible assets should be new and be used solely for business purposes in Belgium. The tax legislator has in addition also opted to provide for loss-making taxpayers a tax credit which equals the amount of the investment deduction multiplied by 33.99 per cent. Belgium also promotes investment in R&D through an 80 per cent payroll tax reduction on the salary of researchers. It is important to note that the Act of 17 June 2013 has introduced the “Frascati” definition in Belgian tax law, thereby making the “classic” distinction between fundamental, industrial and experimental research.

On the output side, Belgium has introduced a patent income deduction (PID). Taxpayers subject to BIT are entitled to an 80 per cent deduction of their gross patent income from their taxable base. The result is an effective tax rate of a maximum 6.8 per cent. This tax measure only applies to granted patents and supplementary protection certificates. Other intellectual property (IP) rights do not qualify. For reasons of manageability, a definition of qualifying “patents” is

* International Tax Expert, Belgian Federal Public Service Finance.
** Tax Director, PwC

embedded in the Belgian Income Tax Code (BITC). As such, the PID applies to both (a) patents fully or partly self-developed by Belgian taxpayers, either in R&D centres in Belgium or abroad, constituting a branch; and (b) patents acquired by/licensed to a Belgian taxpayer qualify provided they are being further developed in R&D centres in Belgium or abroad, constituting a branch of the taxpayer. The PID applies to income received by the owner (or co-owner), the usufructuary, or the licence holder from the licensing of patents. In addition, the PID is also applicable to patent income embedded in the sales price of a patented product. Anti-abuse provisions apply to patents acquired to avoid a double deduction of the costs and/or a double dip because of successive licences and sublicences.

Given the current international tax development, the question arises whether the Belgian tax incentives blend in a globalised tax environment and how the Belgian tax authorities try to counter tax abuse in respect of intangibles. In general, it can be stated that R&D incentives apply to both Belgian and foreign taxpayers.

Action item 5 of the OECD base erosion and profit shifting (BEPS) action plan clearly intends to revamp the previous work of the Forum on Harmful Tax Practices. The BEPS action plan thereby focuses on two different elements: improving transparency and requiring substantial activity for preferential regimes. The Belgian PID regime does not seem to be in breach of the "substantial activity criterion". Indeed, in order to be eligible for the PID, the patents either have to be "completely or partially developed" or have to be further improved by the taxpayer claiming the deduction in the R&D centres. Under the 1998 Code of Conduct for business taxation as introduced by the European Commission, the activity test seems to be applied in a more stringent way, but also it can be defended that the Belgian PID should be compliant. Furthermore, the PID only applies to the extent and insofar as the patent income is included in the Belgian taxable base. In other words, if the patent income from a transfer pricing perspective should be attributed to the company to which the R&D activities are outsourced, no PID would be available for the taxpayer outsourcing its R&D activities. From a state aid perspective, it has to be noted that the PID regime aims at stimulating R&D activities. Furthermore, as the measure is not limited to certain taxpayers, it should not be considered as selective. Concerning the payroll withholding tax exemption for young and innovative companies (YICs), however, the European Commission has initiated a formal investigation procedure.

Finally, for measures to counteract tax abuse, tax practice shows that the tax authorities apply a number of means to counter illegitimate transfers of intangibles to entities located in low-tax jurisdictions. In this respect, the European Court of Justice (ECJ) jurisprudence on exit taxation should evidently be observed. In terms of the interpositions of intermediary companies, the Belgian tax authorities often argue that such companies should not be considered the beneficial owner of the royalty. This beneficial ownership test can be applied for treaty situations as well as under the Interest and Royalty Directive. Belgian tax practice generally adheres to a legal interpretation of the beneficial ownership concept. As such, unless there is a mere nominee or fiduciary owner (which could be e.g. the case in pure back-to-back situations), the legal owner is to be considered the beneficial owner. In such cases, a withholding tax reduction or exemption should hence not be denied.

As a conclusion, it can be stated that Belgium is well equipped with a number of very competitive R&D incentives compatible with a changing and globalised tax environment. As such, they form a catalyst for the future growth and competitiveness of the Belgian economy.

1. R&D incentives under domestic tax law[1]

1.1. Introduction

In order to stimulate economic growth, the federal and regional governments have implemented three types of incentive for businesses that establish operations in Belgium: cash grants, employment and training incentives, and tax-related incentives. Given that currently 2 per cent of GDP is spent on R&D incentives, Belgium still has a way to go (taking into account the threshold of 3 per cent defined in the EU 2020 Strategy).

1.2. Brief overview of BIT

BIT in general does not make any distinction between domestic and foreign companies.[2]

A company is considered to be a resident of Belgium for tax purposes if it has its registered office, its principal place of business or its place of management in Belgium.[3] The place of management is defined as the place from where directions emanate or the place where the company's effective management and central administration reside, meaning the place where the corporate decision-making process actually takes place.[4]

Non-resident companies will be subject to BIT provided they have a taxable establishment in Belgium. The definition of a Belgian establishment under Belgian domestic tax law corresponds to,[5] albeit being broader than, the definition of a permanent establishment (PE) under the OECD model tax convention (MTC) or Belgian double taxation treaties (DTTs), whichever prevails.

Generally, partnerships as such are not subject to income taxation (contrary to their Belgian or foreign partners).[6]

In general, the tax base for BIT purposes is determined on an accrual basis and consists of the worldwide income less allowed deductions (including R&D

1 This report is based on the legislation in force as per 31 October 2014.

2 Albeit in the form of a mere "fiscal" branch (or permanent establishment) or a legally established branch. For the purposes of this report and for the ease of reading, the report will use the term "taxpayer" for both Belgian companies and foreign companies (operating in Belgium through a permanent establishment or legal branch) subject to BIT. Where a difference in treatment is relevant or if the context otherwise requires, the report will explicitly mention this. In that case, the report will use the term "branch" for both permanent establishments and legal branches.

3 Art. 2, §1, 5°, b BITC.

4 Administrative commentaries to the BITC (Comm.BITC), no. 179/22. See also art. 4 of the 2010 OECD model tax convention (MC).

5 Art. 229 BITC.

6 Art. 29, §1 and art. 229, §3 BITC.

expenditure).[7] The income tax base is based on the Belgian generally accepted accounting principles (GAAP) financial statements. BIT is levied at a rate of 33 per cent plus a 3 per cent crisis tax, which is a surtax, implying an effective rate of 33.99 per cent.[8] Capital gains on shares that are realised before a one-year holding period has been complied with are taxed at 25.75 per cent (25 per cent plus a 3 per cent crisis tax) provided certain conditions are met,[9] and at 0.412 per cent if the one-year holding period has been complied with and provided certain other conditions are met.[10] The 33.99 per cent statutory tax rate can, however, be significantly reduced by application of the NID,[11] resulting in an effective tax rate varying between 26 and 27 per cent.

Provided certain conditions are met, a progressive scale of reduced rates applies to taxpayers with lower amounts of taxable income (i.e. taxable income up to a maximum of 322,500 euro.[12]

As of tax year 2014, large resident taxpayers (i.e. not small and medium-sized enterprises (SMEs)) are subject to a fairness tax on their distributed dividends.[13] The fairness tax is a separate assessment at a rate of 5.15 per cent (5 per cent increased by the 3 per cent crisis tax).[14] The tax is, however, only applicable if, for a given taxable period, dividends have been distributed and (part or all of) the taxable profit has been offset against (current year) NID and/or tax losses carried forward.

Furthermore, also the following features are available: a 95 per cent participation exemption;[15] no tax consolidation (contrary to VAT); a 5 to 1 general thin capitalisation rule;[16] unlimited carryforward of tax losses (no carryback exists); numerous dividend, interest and royalty withholding tax exemptions and a wide treaty network. The arm's length principle is formally codified in the BITC to prevent artificial inbound or outbound profit shifting.[17] Finally, no specific transfer pricing documentation requirements or rules on the selection of transfer pricing

7 For non-residents, in some cases, the tax base can also be determined on a lump-sum basis or cost-plus basis.

8 Art. 215, s. 1, art. 246 and art. 463*bis* BITC.

9 Art. 217, 2° and art. 246 BITC.

10 Art. 217, 3° and art. 246 BITC. For SMEs, this 0.412 per cent tax charge does not apply. An SME is a company that does not exceed more than one of the following criteria during the two foregoing financial years when evaluated on a consolidated level: a yearly average number of employees of 50, a turnover of 7.3 million euro (excluding VAT) or a total asset value of 3.65 million euro.

11 The NID is a fictitious deduction reflecting the economic cost of the use of capital, equal to the cost of long-term, risk-free financing. It is calculated as a percentage of the accounting equity according to Belgian GAAP. The NID rate for tax year 2015 (i.e. accounting years ending between 31 December 2014 and 30 December 2015, both dates inclusive) is 2.630 per cent (3.130 per cent for SMEs). See art. 205*bis et seq.* BITC.

12 Art. 215, ss. 2 and 3, art. 246 and art. 463*bis* BITC.

13 Note that the fairness tax also applies to Belgian branches up to the part of the profit of the Belgian permanent establishment or legal branch included in dividend distributions made by its head office.

14 Art. 463*bis* BITC.

15 Art. 202 *et seq.* BITC.

16 Art. 198, §1, 11° and §3 BITC.

17 Art. 185, §2 BITC. See also arts. 26 and 207, s. 2 BITC.

methods are included in Belgian tax legislation.[18] Advance pricing agreements (APAs) and rulings, which are valid for a five-year period, can be concluded.

1.3. Tax policy considerations relating to R&D incentives

1.3.1. General tax climate for R&D

When entities are classified in, on the one hand, cost centres, and, on the other hand, profit centres, "research and development departments" are generally classified as cost centres. Cost centres mean instant costs, so direct tax relief is something these types of companies are in favour of.

From the general overview under section 1.2, it may be concluded that the Belgian BIT regime primarily focuses on profit centres. Nonetheless, Belgian policymakers have made significant efforts over recent years to position Belgium as a competitive location for cost-centre types of activity.

As such, next to the specific R&D incentives mentioned below, a general investment deduction is integrated in the BITC. The investment deduction allows the taxable profit to be reduced by a percentage of the amount of the investments made during the taxable period. Recently,[19] this incentive was revamped as all SMEs were granted an investment deduction for their investments in the years 2014 and 2015.

The extent of the general tax climate goes further than BIT alone. Belgium has for instance a long tradition of using tax incentives to recruit foreign specialised personnel (the so-called expat tax regime). In addition, an Act has recently been published to reduce the labour cost for investments in areas in difficulties.[20]

1.3.2. Reasons for introducing R&D incentives

Belgium committed itself to invest 3 per cent of the GDP in R&D. This target was split up into a private industry target (2 per cent) and a public sector target (1 per cent). Part of this 1 per cent can be achieved by the granting of subsidies (regional competence of the three Belgian regions – Flanders, Wallonia and Brussels Capital), another part can be achieved with tax incentives (federal competence).

In the law-making process concerning the PID, this was described as follows:

> "The government wishes to encourage Belgian companies to go for technical innovation by stimulating all activities related to R&D and the development of patents, and by obtaining the ownership of licences of patents and the production of products based on these patents. This goal can be achieved through the granting of a tax deduction for licence income from patents held by a Belgian

[18] Nonetheless, the Belgian tax authorities adhere to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and the EU Code of Conduct. In the administrative guidelines that were issued, taxpayers are urged to proactively compile a coherent and consistent documentation set, although there is no legal obligation to do so. If information is requested, the taxpayer must provide the data requested within one month.

[19] Notice in the Belgian Official Gazette (BOG), 26 March 2005.

[20] Act of 15 May 2014, BOG, 22 May 2014.

company or a Belgian branch or for income related to self-produced products based on such patents."[21]

When the increased investment deduction was introduced for patents, the rationale set forth in the parliamentary documents was "to stimulate the acquisition of patents for all companies".[22]

In other cases (introduction of R&D tax credit), it was mentioned that the measure was aimed at providing a better presentation of the R&D cost in international reporting and giving the taxpayer the choice between two types of R&D tax incentives.[23]

As regards the tax measures concerning the exemption from payroll tax, the legislator referred to the government agreement providing that "the Belgian economy should benefit from incentives that would stimulate the formation of new companies and the conduct of research and development on new technologies. … Stimulating research in the industry allows Belgium to decrease the competitive disadvantage on salaries and support in R&D."[24]

Also on a regional level, significant action was undertaken to stimulate R&D. The Walloon region, for instance, introduced the concept of company networks (clustering) as a new *modus operandi* of the productive fabric and as a source of innovation. In Flanders, the white book for industrial development was published in 2011.

Subsequently, tax measures (BIT is still on a federal level in Belgium) were matched with regional incentives to obtain a maximum result. For instance, a tax exemption was introduced for certain regional grants.[25]

1.3.3. R&D incentives, equality of treatment, and ability to pay

In the law-making process of the specific R&D incentives (and in most cases these R&D incentives are only applicable in BIT), there has not been a lot of discussion because it is very easy to create a company in Belgium. Furthermore, Belgian tax law in principle makes no distinction between Belgian and foreign companies in this respect. Some of the tax incentives are also applicable to personal income tax, which in fact made a discussion redundant.

The possibility of using certain R&D tax incentives (see further under section 1.3.5) was a topic of discussion, however.

1.3.4. Subjective scope

Not all taxpayers can claim the same R&D incentives. Here are a few examples. Some of these incentives are limited to entities subject to BIT (e.g. the PID and the tax exemption for regional grants). Others are limited to non-resident personal tax (e.g. the expatriate status for foreign researchers), albeit that the incentive applies irrespective of the residency of the employing entity (Belgian or foreign). Some

21 Special Finance Act (Programme Act) of 27 April 2007, BOG, 8 May 2007.
22 Parliamentary Documents 49, 208/8, pp. 32–33.
23 Parliamentary Documents 51, 2128/3, p. 19.
24 Parliamentary Documents 51, 2128/3, p. 25.
25 Art. 193*ter* BITC.

incentives are applicable in BIT and personal income tax but are applied in a different way (e.g. the investment deduction and the tax credit for R&D), whereas others are applied in the same way (e.g. the payroll tax exemption for researchers and the tax allowance for additional employees).

1.3.5. R&D incentives: multinational enterprises (MNEs) versus SMEs?

Generally, there are no specific R&D incentives tailored to SMEs. Instead, the measures applicable to MNEs generally similarly apply to SMEs. As mentioned above under section 1.3.3, however, there were discussions on the possibility of applying certain R&D tax incentives. It was for instance argued for the PID that, given the conditions in the tax law, "the patents needed to be either self-developed or acquired provided they [were] being further developed in Belgium or abroad in a R&D centre that qualifie[d] as a branch", and it was almost impossible for SMEs to fulfil this condition. A solution was found in practice as the Belgian Rulings Commission adopted a pragmatic approach. This has recently been adapted in the tax legislation. As of 1 January 2013, SMEs are exempted from the branch requirement.[26]

1.3.6. Definition of R&D for tax purposes

Until very recently, no general definition of R&D was included in Belgian tax law.[27] Reference was made to accounting law as well as to the 2002 Frascati Manual and the European Regulation (EC) no. 800/2008 of 6 August 2008,[28] which adheres to the OECD definition as used in the 2002 Frascati Manual. The Frascati Manual defines research and (experimental) development as "creative work undertaken on a systematic basis in order to increase the stock of knowledge, including knowledge of man, culture and society, and the use of this stock of knowledge to devise new applications".

From this definition, three criteria can be distinguished, which have to be met simultaneously. First, the activity has to result in a scientific or technological advancement. Second, scientific or technological uncertainties must have appeared in the course of the activity. Third, the activity has to be carried out following an experimental development process, meaning that use has to be made of a systematic approach, including trials and analyses. R&D also encompasses any new application or combination of knowledge already acquired. Hence R&D does not necessarily involve any kind of revolution. More often it indeed concerns an evolution in knowledge.[29]

26 Art. 205/2, §1, s. 2 BITC.

27 A definition, albeit in a specific context, was already included in an old Practice Note (which has not been enacted, however) on the expat tax regime (providing an attractive regime for, amongst others, highly qualified researchers). According to that Practice Note, the notion of "scientific or technical research" is to be understood as "a set of intellectual and other activities aimed at discovering new knowledge or theories, or new products or production methods".

28 Art. 30(2), (3) and (4) of this regulation.

29 P. Brauns and F. Gevers, "Les incitants fiscaux belges en matière de recherche et développement", *Ing.-Cons.*, 2012/4, p. 718.

The Act of 17 June 2013 has introduced the "Frascati definition" into Belgian tax law,[30] thereby making the "classic" distinction between fundamental, industrial and experimental research.[31] In this respect, the question is frequently raised whether or not software development can qualify as R&D under the Frascati Manual. Following the manual, this is indeed so in certain cases.[32] As such, in these cases, the software development should also qualify as R&D for Belgian tax purposes.

1.4. R&D input incentives

1.4.1. General overview of R&D input incentives

In short, Belgian tax law provides for both specific incentives for R&D and general incentives that can also be applied to R&D investments.[33]

Specific incentives include the R&D investment deduction/tax credit, the payroll tax exemption (80 per cent), and the specific tax regime for YICs. Belgian tax law also provides for an exemption of certain grants provided for by the regions in the framework of investments in R&D.[34] The report will not elaborate on the latter. General incentives include the expatriate tax regime and the NID. The report will not elaborate further on these either. Please note that as far as incentives are concerned the report will further elaborate on these in the following sections only if they are relevant.

Belgian taxpayers can benefit from an additional tax deduction or tax credit on their R&D expenditure. Indeed, on top of the general tax deductibility of R&D expenditure,[35] Belgian taxpayers may opt for capitalising this R&D expenditure following which an investment deduction or tax credit can be claimed.[36]

It is then required that the investments in R&D have no negative impact on or do not harm the environment, or help reduce any such negative impact or environmental harm as much as possible. To that end, a certificate has to be requested (each year) from the regional authorities (see further under section 1.6).

Belgium also promotes investments in R&D through (indirect) grants in the form of a reduction of the employment cost of researchers. As such, the payroll tax – which is basically a prepayment of the tax due in the hands of the individual researchers to be withheld and paid by the employer to the Belgian Treasury – is significantly reduced. Various categories of qualifying taxpayers exist in this respect. In all cases, 80 per cent of the payroll tax should not be remitted to the

30 Art. 275^3, §3 BITC.

31 As such, neither Belgian tax law nor the Belgian tax authorities' guidelines include any reference to the Oslo Manual (Guidelines for Collecting and Interpreting Innovation Data), OECD, 2005.

32 Frascati Manual, pp. 46–48.

33 Note that these incentives generally apply to both Belgian and foreign companies (operating through a taxable permanent establishment or legal branch in Belgium). Indeed, for foreign companies the BITC (in particular art. 235, 2° and art. 240, s. 2 BITC) refers to the relevant provisions applicable to Belgian companies.

34 Art. 193*ter* BITC.

35 Under the conditions of art. 49 *et seq.* BITC. If the R&D expenditure is capitalised, it will be expensed through the yearly depreciation of the capitalised R&D. If the R&D expenditure is not capitalised, it will be expensed immediately for its full amount.

36 Art. 69, §1, 2°, a and b, art. 201 and art. 289*quater* BITC.

Belgian Treasury.[37] Since this constitutes taxable income under BIT rules, the actual benefit amounts to 53 per cent (but may vary depending on the effective tax rate), which results in a labour cost reduction of between 15 and 25 per cent. Note that this exemption only benefits employers (and hence not employees). Below, the report will briefly describe the two most important categories.[38]

A first measure[39] is intended for companies that employ[40] researchers with a qualifying degree in qualifying R&D projects or programmes.[41] Two conditions have to be met. First, the employees concerned must have a qualifying degree,[42] being a Ph.D. in applied sciences, exact sciences, medical sciences, veterinary surgery, pharmaceutical sciences or civil engineering, or a master's or similar degree[43] in a number of areas. In this respect, the law provides for a number of degrees for both the Flanders Community[44] and the French Community.[45] Second, the researchers must be employed in qualifying R&D projects or programmes.[46]

A second measure concerns YICs.[47] These are SMEs that also meet the following conditions: (a) they have existed for less than ten years before 1 January of the year for which the partial payroll tax exemption is granted; (b) they have not been established in the framework of a concentration of companies, a restructuring or an enlargement or a takeover of an existing activity; and (c) they incur R&D costs amounting to at least 15 per cent of the overall costs of the previous year. For such companies, all employees hired as scientific staff are considered employees eligible for the payroll tax exemption, regardless of their degree.[48]

1.4.2. Privileged R&D expenditure

The R&D investment deduction/tax credit is aimed at capital expenditure, including both tangible and intangible assets.

37 Art. 275^3 ITC. Over time, the exemption percentage has increased from 25 per cent to 80 per cent (currently).

38 This regime may also be applied to other categories of companies such as companies having entered into partnership agreements with universities or colleges located in the European Economic Area (EEA).

39 Art. 275^3, §1, para. 3, 3° BITC.

40 Note that this exemption only applies to employees and, as such, not to self-employed people carrying out R&D activities based on e.g. a service agreement.

41 This implies that the exemption only applies to the extent that qualifying researchers effectively work in that programme. Depending upon the case, a pro rata is hence applicable.

42 Art. 275^3, §2 BITC.

43 Also similar foreign degrees are eligible. Bachelor's degrees, on the other hand, do not qualify. See also art. 30(5) EC 800/2008 of 6 August 2008.

44 Sciences, applied sciences, applied sciences in biology, medical sciences, veterinary medicines, pharmaceutical sciences, bio-medical sciences, industrial, technical or medical sciences, biotechnology, architecture and product development.

45 Sciences, engineering sciences, agronomical and biological engineering, medical sciences, veterinary sciences, bio-medical and pharmaceutical sciences, architecture, industrial sciences and industrial and agronomical sciences.

46 Art. 275^3, §3 BITC.

47 Art. 275^3, §1, para. 3, 2° BITC.

48 Note that on 4 December 2013 it was announced that the European Commission had opened an in-depth investigation to determine whether this measure is in line with the EU rules on state aid (European Commission, IP/13/1203). See also further under section 2.2.3.

Tangible assets in practice cover those assets that are used to carry out R&D activities. In principle, such tangible assets need to be used within a qualifying R&D centre.[49] The main conditions to qualify as an R&D centre can be summarised as follows: (a) the R&D centre should constitute a branch, i.e. a separate business unit that is able to operate autonomously; (b) separate accounts should be kept for the R&D centre; and (c) the assets concerned only qualify to the extent that they do not exceed the normal limit necessary for the operations of the R&D centre. In practice, the foregoing will typically come down to a factual analysis.

In terms of valuation, which is paramount for calculating the effective benefit, it should first be noted that the value for tax purposes generally equals the accounting value. Therefore, the tangible assets concerned are generally capitalised against their acquisition value (being the acquisition price, manufacturing price or contribution value).[50] Tangible assets are generally depreciated over their economic lifetime.[51] Examples are: IT equipment, lab utilities, buildings, office furniture, and prototypes.

Intangible assets, on the other hand, are defined as R&D expenses, i.e. the costs of the research, manufacture and development of prototypes and products, inventions and knowhow, which are useful for developing the taxpayer's future activities.[52] Patents,[53] licences and knowhow also qualify.[54] Furthermore, based on accounting law (from which tax law does not seem to deviate in this respect), brands and similar rights qualify as well.[55] Also in this case, such intangible assets need to be utilised within a qualifying R&D centre, but again limited exceptions are available.[56]

Following the accounting guidelines in this respect, R&D expenses can be capitalised if the following conditions are met: (a) the amount capitalised does not exceed a prudent estimate of its usefulness or its contribution to the taxpayer's future profitability; (b) the asset is clearly defined and individualised; (c) the costs attributable to the product or process can be separately identified and measured reliably; (d) the technical feasibility of the project can be demonstrated; and (e) adequate resources exist to complete the development project.[57] Capital-

49 Art. 48, §1, A, 1° and art. 82, §1 of the Royal Decree implementing the BITC (RD/BITC). However, there are a limited number of exceptions to this rule (see art. 48, §1, A, 2° and 3° RD/BITC).

50 Art. 35 of the Royal Decree implementing the Belgian Companies Code (RD/BCC).

51 For assets with an indefinite lifetime, write-downs need to be recorded in the case of a decrease in value. See arts. 45–49 RD/BCC.

52 Art. 95, §1, II, point two RD/BCC.

53 Art. 47*bis* RD/BITC and art. 81*bis* RD/BITC. Important to note is that patents only qualify for the one-off investment deduction/tax credit and hence not for the spread investment deduction/tax credit.

54 Art. 48, §1, B RD/BITC and art. 82, §1 RD/BITC. In order to avoid double use, tax law provides that depreciation with respect to a qualifying tangible asset that are capitalised as an intangible asset does not qualify for the investment deduction/tax credit for intangible assets. This condition is not imposed for depreciation on qualifying intangible assets (other than capitalised costs for R&D).

55 Finally, also prepayments on both the costs for R&D and the patents, knowhow, brands, licences and similar rights qualify.

56 Art. 48, §1, B, s. 3 RD/BITC and art. 82, §1 RD/BITC.

57 Opinion 2012/13 of the Belgian Accounting Standards Commission.

ised R&D expenses have to be depreciated over at least three years from a tax perspective; other intangible assets have to be depreciated over a period of at least five years.[58] From a Belgian GAAP perspective, intangible assets are depreciated over a period of a maximum five years, unless otherwise justified and duly commented on in the notes to the annual accounts.[59] Examples are payroll costs of the researchers, self-developed patents, patents licensed from third parties, non-patented technologies, and R&D costs that are recharged.

In order to qualify, both the tangible assets and the intangible assets have to be new.[60] In this respect, it is irrelevant whether the assets concerned are acquired from third parties or are self-developed. Contrary to their position on tangible assets,[61] the Belgian tax authorities accept the qualification as new for intangible assets as long as the assets have not been used in Belgium for business purposes.[62]

It is important to note that, based on the rulings practice, it is not required for the taxpayer carrying out R&D activities to own all IP resulting from the R&D activities as long as the taxpayer can demonstrate that the knowhow created at the level of the R&D centre will increase the future performance of the R&D centre and will contribute to the taxpayer's future profitability. This implies that taxpayers carrying out contract R&D activities can also claim an R&D investment deduction/tax credit, notwithstanding the fact that the R&D costs concerned are typically charged on to the beneficiary of the R&D activities.[63] In this reasoning, the same approach can be taken under cost-sharing types of collaboration, unless such cost-sharing would only imply that part of the costs is incurred by the Belgian taxpayer (e.g. the mere charging of part of the costs of an R&D project on to the Belgian taxpayer). As in the latter case no actual activity is carried out by the Belgian taxpayer, the R&D investment deduction/tax credit may be denied by the Belgian tax authorities.

1.4.3. Tax credit versus allowance

Constituting an allowance, the investment deduction results in a decrease of the tax base.[64] As they have no tax base, loss-making taxpayers cannot actually benefit from this measure.

As such, the Belgian tax legislator has opted to also provide for a tax credit,[65] the amount of which equals the amount of the investment deduction multiplied by 33.99 per cent.[66] Hence, the investment tax credit is identical to the investment

58 Art. 63 BITC.

59 Art. 61 RD/BCC. In this respect, patents should e.g. be depreciated over their remaining lifetime (maximum 20 years), unless it can be demonstrated that the majority of the profits stemming from the patents will e.g. be realised during the first years of the patent's lifetime, in which case a five-year depreciation period can be applied.

60 Art. 68 BITC.

61 Comm.BITC, no. 68/15.

62 Comm.BITC, no. 68/16.

63 See *inter alia* decisions no. 2012.107 and no. 2013.046 issued by the Belgian Rulings Commission (*Dienst Voorafgaande Beslissingen/Service des Décisions Anticipées*).

64 Art. 201 BITC.

65 Art. 289*quater et seq.* BITC.

66 Which is the standard Belgian statutory corporate tax rate.

deduction, albeit that the tax credit is a credit against the tax effectively due. In the case where, however, no tax is due, the tax credit becomes refundable after a five-year period (including the year to which the tax credit relates, i.e. the year during which the qualifying investments were made).[67] The introduction of a credit is furthermore initiated in order to provide a more accurate view on the cost of carrying out R&D activities for international reporting requirements.[68]

This incentive can take the form of a one-off deduction or credit or a spread deduction or credit. The one-off deduction[69]/credit[70] is calculated as a percentage on the acquisition value of the qualifying assets. For tax year 2015,[71] this percentage amounts to 13.5 per cent. The spread deduction[72]/credit,[73] on the other hand, is calculated as a percentage on the yearly depreciation of the qualifying assets. For tax year 2015, this percentage amounts to 20.5 per cent. Generally, the one-off deduction/credit results in a net tax benefit of approximately 4.5 per cent, whereas the spread deduction/credit results in a net tax benefit of approximately 7 per cent.[74]

Both the investment deduction and the tax credit can be carried forward, albeit that, once the tax credit has been opted for, the investment deduction can no longer be applied (complex transitory measures exist in this respect).[75] The investment deduction can be carried forward indefinitely[76] whereas the tax credit, as mentioned, is repaid after a five-year period.[77] For both the investment deduction and the tax credit, the yearly amount that can be claimed is capped.[78]

67 Art. 292*bis*, §1, s. 5 BITC.
68 Parliamentary Documents 51, 2128/3, p. 19. See also Herwig Opsomer, Tom Wallyn, Pieter Deré and Laurence Buyse, “Belastingkrediet voor O&O: een logische boekhoudkundige en fiscale verwerking”, *Fisc. Act.*, 2014, no. 6, pp. 7–11.
69 Art. 68 BITC.
70 Art. 70 BITC.
71 I.e. financial years ending between 31 December 2014 and 30 December 2015 (both dates inclusive).
72 Art. 289*quater* BITC.
73 Art. 289*sexies* BITC.
74 Assuming an asset of 1,000 euro, the one-off investment deduction would amount to (1,000 euro × 13.5%) or 135 euro, resulting in a tax benefit of (135 euro × 33.99%) or 46 euro (being 4.6 per cent of the value of 1,000 euro). The latter amount also equals the one-off tax credit benefit. The spread investment deduction, on the other hand, would yearly amount to (assuming (for tax purposes) a depreciation period of three years): ((1,000 euro/ 3) × 20.5%) or yearly 68 euro. Following the three-year depreciation period, this would result in a total deduction of 204 euro, implying a tax benefit of 69 euro (being 6.9 per cent of the value of 1,000 euro). Again, the latter amount equals the spread tax credit benefit.
75 Art. 201, s. 6 and art. 530 BITC.
76 Art. 72, s. 1 BITC.
77 Art. 292*bis*, §1, s. 5 BITC.
78 Art. 72, s. 2 and art. 292*bis*, §1, s. 3 BITC. For the investment deduction carried forward, the yearly amount is capped at 620,000 euro or, if the investment deduction carried forward exceeds 2,480,000 euro, 25 per cent of the amount of investment deduction (amounts for tax year 2015, yearly indexed). For the tax credit carried forward, the yearly amount is capped at 160,440 euro or, if the tax credit carried forward exceeds 641,760 euro, 25 per cent of the amount of investment deduction (amounts for tax year 2015, yearly indexed).

1.4.4. Territorial scope

Tangible and intangible assets should be used solely for business purposes.[79] Furthermore, they should be used in Belgium in order to qualify for the R&D investment deduction/tax credit.[80] The fact, however, that the assets would also be used outside Belgium (for business purposes) does not exclude them from application of the investment deduction/tax credit.[81]

As such, based on a traditional approach, the assets should be used in Belgium within a (Belgian) qualifying R&D centre. On this point, it can be concluded that Belgian law is not in line with the principles put forward by the European Court of Justice (ECJ) in the *Laboratoires Fournier* case.[82] The tax authorities seem to adhere to this position as, based on a 2010 update of the administrative commentaries to the BITC, it can be defended that an exclusive use outside Belgium should not exclude the assets from the investment deduction/tax credit[83] provided the related income is taxable in Belgium.

1.4.5. Anti-avoidance provisions

In order to avoid abuse of the R&D investment deduction/tax credit incentive, the Belgian legislator has first of all introduced a list of assets that are excluded from application of the investment deduction or tax credit.[84] It concerns: (a) fixed assets that cannot be depreciated and assets with a depreciation period of less than three years; (b) fixed assets acquired or developed with a view to transferring the right to use the assets; (c) fixed assets of which the right to use is transferred to another taxpayer (except if the other taxpayer is an individual (or, as from 1 January 2013, a taxpayer that would also qualify for application of the R&D investment deduction/tax credit at the same rate or at a higher rate), using the assets in the framework of a business activity in Belgium);[85] (d) ancillary costs that are not depreciated over the same period as the fixed assets to which they relate; and (e) cars.

In addition, Belgian tax law requires that the tangible[86] and intangible assets acquired from third parties (other than patents) are used to carry out qualifying R&D activities during the entire depreciation period.[87] If this condition is no longer met and the assets are, for example, allocated to another purpose during the depreciation period, an investment deduction/tax credit recapture rule will apply.[88] This recapture rule would, however, only come into play in the case where the one-off R&D investment deduction/tax credit is applied (and hence not in the case

79 Art. 75, 1° and art. 289*octies* BITC.
80 Art. 68 and art. 289*quater*, s. 1 BITC.
81 P. Verbanck, *Investeringsaftrek*, Ced. Samsom, Brussels, 2001, no. 39.
82 C-039/04, 10 March 2005. See also further under section 2.3.2.3.
83 Comm.BITC, no. 68/18, which seems to deviate from the clear wording of the law.
84 Art. 75 and art. 289*octies* BITC.
85 An exception to this rule exists in order to stimulate the audio-visual sector (arts. 76 and 289*octies* BITC).
86 Both assets acquired from third parties and self-developed assets.
87 Art. 48, §2 and art. 82, §2 RD/BITC.
88 Art. 48, §3 and art. 82, §3 RD/BITC.

where the spread regime is applied).[89] This recapture rule applies in the case where neither the tangible nor the intangible assets concerned are sold or put out of use. Indeed, in this case, Belgian tax law explicitly provides for an additional investment deduction/tax credit in the case where one applies the spread investment deduction/tax credit. This additional investment deduction/tax credit equals the positive difference between the total amount of the spread investment deduction already applied and the amount of the one-off deduction/tax credit that would have been obtained if the taxpayer initially had opted for it.[90]

Finally, the reporters also want to point out that, upon a change of control of a Belgian taxpayer having a carryforward investment deduction or tax credit, the deduction and credit are in principle forfeited, unless the change of control meets legitimate financial or economic needs.[91]

1.5. Output R&D fiscal incentives (patent box or similar incentive)

1.5.1. General overview of output incentives

Belgium introduced in 2007 (tax year 2008)[92] a PID. Taxpayers subject to BIT, irrespective of their size or industry, are entitled to an 80 per cent deduction of their gross patent income from their tax base. The result is an effective tax rate of a maximum of 6.8 per cent on this income. Any excess PID cannot be carried forward nor is it refundable.

1.5.2. Definition of privileged IP rights

This tax measure only applies to patents and supplementary protection certificates.[93] Other IP rights (copyrights, knowhow, designs, trademarks, models, secret formulas, operating procedures, manufacturing processes, information on experience in the field of trade and science, etc.) do not qualify. In this respect, the question is often raised whether or not software can be patented. Subject to certain conditions, this should indeed be the case.[94]

The text of the Act only mentions the "patent" terminology. Since no specific definition is given in the text of the Act, it can be assumed that the terminology is borrowed from the Belgian law on inventions.[95] The PID is not restricted to Belgian patents. European patents, US patents or patents valid in other jurisdictions also qualify. The terminology "supplementary protection certificates" refers to the EU Council Regulation (EEC) No. 1768/92 of 18 June 1992 concerning the creation of a supplementary protection certificate for medicinal products, and Regulation (EC) No. 1610/96 of the European Parliament and of the Council of 23 July

89 Verbanck, *op. cit.*, nos. 153–155 and no. 237.
90 Arts. 71 and 289*sexies*, s. 2 BITC.
91 Art. 207, s. 3, art. 235, 2°, art. 240, s. 2 and art. 292, §2 BITC.
92 Programme Act of 27 April 2007, BOG, 8 May 2007.
93 Art. 205[1] BITC.
94 See *inter alia* M. Janssens, "Bescherming van computerprogramma's: oude wijn in nieuwe vaten?", *DAOR*, 2011, pp. 205–221.
95 Art. 2, Act of 28 March 1984, BOG, 9 March 2007.

1996 on the creation of a supplementary protection certificate for plant protection products.

For reasons of manageability, a definition of qualifying "patents" is embedded in the BITC.[96] As such, the PID applies to both (a) patents fully or partly self-developed by Belgian taxpayers, either in R&D centres in Belgium or abroad, constituting a branch; and (b) patents acquired by/licensed to a Belgian taxpayer qualify provided they are being further developed in R&D centres in Belgium or abroad, constituting a branch of the taxpayer. As of 1 January 2013, SMEs are not required to fulfil the branch requirement.[97]

The PID is also not restricted to so-called "research centres – laboratories". The measure is also valid for all sectors and companies. During the parliamentary debate, it was clearly mentioned that the PID does not only apply to the pharmaceutical sector.[98] The Finance Minister gave the examples of research for reducing the CO_2 emission of vehicles and passenger cars in the automotive sector, research for the construction of new types of windmills, and research in the field of renewable energy.[99]

In Parliament, during the law-making process, the question was raised why the patent should be developed in an R&D centre, constituting a branch. The Finance Minister answered that this condition was set because it was necessary to create employment with this tax incentive. A Belgian taxpayer operating as a serving-hatch (conduit company) for patent income is not sufficient to grant the PID.[100]

On the question of whether an application for a patent is sufficient to obtain the tax deduction, the answer has always been negative.[101] The tax deduction is only applicable if a patent is actually granted by the competent body (national, international or European patent organisation).

1.5.3. IP acquired

As already mentioned, the benefit of the PID is not limited to self-developed patents. Acquired patents can also benefit from the PID providing the additional condition of further improving the patent is met. There is no obligation for this "further improvement" of the patent to lead to a new patent.[102]

1.5.4. Pre-existing IP

The PID is applicable starting in tax year 2008 (income year 2007). To avoid any abuse and to limit the scope of the incentive, the tax incentive is only applicable to "new" income from patents. "New" means income from patents that have not been used by the Belgian taxpayer, a licensee or a related party, for the purpose of the supply of goods or services to third parties before 1 January 2007.

[96] Art. 205^2 BITC.
[97] Art. 205^2, §1, s. 2 BITC.
[98] Parliamentary Documents 51, 3058/015, p. 14.
[99] *Ibid.*
[100] Parliamentary Documents 51, 3058/015, p. 15.
[101] Frequently Asked Questions on the PID.
[102] Parliamentary Documents 51, 3058/015, p. 38.

1.5.5. Development condition

This condition is paraphrased in a different way. For new patents, the law mentioned the wording "completely or partially developed" while, for patents that are acquired or licensed to a Belgian taxpayer, the wording is "further improved".[103] This condition requires the patents to be developed or improved in an R&D branch in Belgium or abroad (except for SMEs).

When confronted with this question, the tax authorities explained "improvement" by saying that this meant "leading to an added value for instance if the value of the patented product or procedure was raised".[104] Income from knowhow that is related to this improvement should therefore also classify as patent income that can benefit from the PID.[105]

If a Belgian taxpayer owns a patent and works at an R&D centre, it can benefit from the PID. If a Belgian taxpayer owns a patent, develops or improves the patent but outsources the R&D operations by using contract R&D operators, it can also benefit from the PID provided the overall responsibility and management of the R&D activities lie with the company.[106]

1.5.6. Privileged IP income

The PID applies to income received by the owner, the usufructuary and the licence holder derived from licensing a patent but is also applicable to patent income that is embedded in the sales price of a patented product or service. The service provider cannot benefit from privileged IP income. The law does not stipulate that there should only be one owner. So, in principle, all co-owners can benefit from this tax measure according to their ownership percentage. In this respect, also the economic owner of a patent should qualify for the PID provided it is demonstrated that all patent development costs have been borne by the economic owner.[107]

The BITC gives a definition of privileged IP income.[108] The first part of the definition relates *sensu stricto* to income flows, of whatever nature, for licences granted by the taxpayer on patents as part of the Belgian taxable result. Only the income related to the patent can be considered as privileged IP income. If there is a particular relation between the paying entity and the receiving entity, only an arm's length remuneration will qualify. The PID, secondly, also applies to the embedded royalty (that income that would have been received from a third party should the taxpayer license the patents). Similarly to the first part of the definition, this embedded royalty should not differ from the income that would have been paid by third parties. The determination of this income generally requires the application of transfer pricing methods.

The measure applies to variable income flows, fixed income flows, as well as upfront fees, milestones, etc. Capital gains on the sale of qualified IP do not,

103 Art. 205^2, §1, s. 1 BITC.
104 Frequently Asked Questions on the PID.
105 *Ibid.*
106 *Ibid.*
107 B. Springael, "Rulings bieden oplossing waar wet en FAQ tekort schieten", *Fisc.*, 2012, no. 1321, p. 4.
108 Art. 205^2, §2 BITC.

however, fall within the scope of this incentive. Contributions received from another entity in order to finance its own R&D activities do not qualify either.[109]

The PID can only be granted for income received during the period for which the taxpayer has a patent. If income is received during the period the patent is applied for and granted (even if a patent is granted afterwards) or if income is received after the life-span of the patent, it cannot be considered privileged IP income.[110] If there is opposition against a patent and the final decision on the opposition is the revocation of the patent, the PID is no longer granted and eventually the formerly granted PID needs to be reviewed (provided the statute of limitation has not yet elapsed).

If a product is protected by multiple patents and commercialisation of the patent has begun when some patents were granted and some patents are still in the application phase, the PID can only be granted for income related to the patents granted,[111] unless it can be demonstrated that the first patent qualifies as an umbrella patent without which any future patent could not exist.[112]

Needless to say, the PID is only applicable if the income is taxable in Belgium.[113] If the income is attributed to a foreign branch that is exempted in Belgium under a DTT, it cannot benefit from the PID. For foreign companies, the PID is only granted insofar as the patent income is part of the taxable result of the Belgian branch. Furthermore, the frequently asked questions on the PID state that, if a product or technology is patented in the manufacturing state, all income linked to that patent will qualify for the PID (irrespective of the place of commercialisation). Conversely, if a product or technology is not patented in the manufacturing state, only the income from products commercialised in states where that product or technology is patented will qualify.

1.5.7. Anti-avoidance provisions

Anti-abuse provisions apply to patents acquired in order to avoid, first, a double deduction of the costs and, second, a double dip because of successive licences and sublicences.

The acquisition can be in the form of property, joint property, usufruct or a licence agreement. Income from acquired patents must be reduced by the compensation paid to third parties for obtaining use of the patent or by the depreciation applied to the acquisition value of the patents.[114] To prevent related taxpayers from trying to maximise the PID by selling the patents to Belgian taxpayers at too low a price, the tax authorities require the reduction to be calculated at a higher than normal market price in these cases.[115] The deduction of these amounts, however, does not affect the genuine deductibility of business expenses.

109 Art. 205^2, §2, s. 3 BITC.

110 Based on administrative practice, however, the PID can be applied as from the first day of the financial year during which the patent is granted. Conversely, the PID is no longer available during the last year of its validity.

111 Art. 205^2, §2, s. 2 BITC.

112 Decision no. 2010.281 from the Belgian Rulings Commission.

113 Art. 205^2, §2, s. 1 BITC.

114 Art. 205^3, §1 BITC.

115 Art. 205^3, §§2 and 3 BITC.

The costs related to R&D (whether capitalised or not), however, do not need to be deducted from the patent income. This is also the case for any contributions paid in order to finance R&D activities performed by another entity.[116]

1.5.8. Credit for foreign withholding taxes

If royalties are subject to a foreign withholding tax, Belgium will grant a lump-sum tax credit limited to the foreign tax rate, with a maximum of 15 per cent.[117] The foreign tax credit can, however, only be set off against the tax on the patent income.[118] Any excess foreign tax credit cannot be carried forward and is not refundable.[119]

1.6. Procedural requirements

In order to benefit from the above incentives, a number of particular formalities need to be complied with.

With a view to improving the control (and fighting any improper use) under the payroll tax exemption scheme, only projects and programmes that have been notified to the relevant authorities (Public Federal Department of Scientific Policy) will be taken into consideration.[120] The notification procedure concerns an electronic registration for each project and programme. In order to accommodate R&D divisions/centres involved in scientific research activities on a structural basis, a simplified registration procedure has been developed as well. Furthermore, the law provides the possibility to ask the Department of Scientific Policy for a binding opinion (to be delivered within a three-month period).[121]

The following formalities have to be complied with when applying the (spread) R&D investment deduction/tax credit. At the time of the annual CIT return, a special "275U" form (R&D investment deduction) or "275W" form (R&D tax credit) has to be added to the CIT return.[122] Furthermore, a certificate should be obtained from the Flemish region confirming the innovative and environmentally friendly character of the development (assuming that the R&D centre is located in the Flanders region).[123] A separate and yearly updated "defence" file related to the application of the R&D investment deduction/tax credit should be kept at the disposal of the Belgian tax authorities.[124]

In order to claim the PID, the taxpayer has to submit a special application form together with the CIT return (form 275P). In respect of the PID, it is often recommended to apply for an advance tax decision (i.e. a ruling).

116 Art. 205^3, §1, s. 3 BITC.
117 Art. 286, s. 1 BITC.
118 Art. 286, ss. 2 and 3 BITC.
119 Art. 304, §2 BITC.
120 Art. 275^3, s. 4 BITC.
121 Art. 275^3, s. 5 BITC.
122 Art. 47, 1° RD/BITC.
123 Art. 48, §4, 5° BITC.
124 Art. 47, 2° and 48, §4 RD/BITC.

2. R&D incentives in an international context

2.1. Introduction

Looking at the BITC, it can be concluded that the Belgian legislator nowadays hardly ever starts with the idea that a regulation should only apply to Belgian nationals or Belgian residents and this notwithstanding the fact that tax incentives are often used as the growth engine for a national government policy. In the BITC this is expressed in two ways: either, the word "Belgium" is not mentioned, or, on the other hand, it is clearly stipulated as "Belgian and foreign". However, this does not mean that no questions were asked concerning the "international" application of these R&D incentives.

2.2. Eligible taxpayers and territorial scope of R&D incentives

2.2.1. Compatibility with the non-discrimination provision of DTCs

Belgium extended the benefit of R&D incentives to Belgian branches of foreign companies so no incompatibility should occur in this respect.

2.2.2. Compatibility with EU fundamental freedoms

Belgium, being a first day member of the EU, seems not to have built in conditions that limit the application of the R&D incentives to the Belgian territory.[125]

2.2.3. Compatibility with EU state aid rules

As already mentioned, certain tax incentives are limited to certain types of taxable persons (individuals or companies) but the policy of the legislator on the abovementioned incentives was always in direct harmony with the target group, so that the question was hardly ever raised.

However, the European Commission has initiated a formal investigation procedure with regard to the payroll withholding tax exemption for YICs.[126] In 2006, the Commission approved this support scheme but during a screening in 2011, the Commission found that Belgium had not introduced the definitions of the types of research eligible for this tax incentive in its legislation, resulting in a potential distortion of competition.

2.3. Patent box regimes and harmful tax competition

2.3.1. Under the OECD BEPS action plan

Action item 5 of the OECD BEPS action plan clearly intends to revamp the previous work of the Forum on Harmful Tax Practices. The BEPS action plan thereby

125 See also Comm.BITC, no. 68/18 as referred to above under section 1.4.4.
126 See footnote 46.

focuses on two different elements: improving transparency and requiring substantial activity for preferential regimes.[127] The "substantial activity" criterion in this respect targets transactions that are purely tax driven and are not based on the economic environment surrounding the preferential regime.[128] The Belgian tax authorities could challenge such transactions by applying the Belgian GAAR provision or sham doctrine.

In the light of the foregoing, the Belgian PID regime does not seem to be in breach of the "substantial activity" criterion.[129] Indeed, in order to be eligible for the PID, the patents either have to be "completely or partially developed" (for self-developed patents), or have to be further improved (for acquired patents) by the taxpayer claiming the deduction, in R&D centres in Belgium or abroad constituting a branch (the branch condition is no longer required for SMEs).[130]

2.3.2. Under EU state aid rules and the code of conduct for business taxation

2.3.2.1. Under the code of conduct for business taxation

Under the 1998 code of conduct for business taxation as introduced by the European Commission, the activity test seems to be applied in a more stringent way.[131] Reference can be made in this respect to the investigation by the European Commission of the UK patent box regime. It was thereby argued that, notwithstanding the fact that the regime clearly includes a development condition, it cannot prevent UK taxpayers from claiming the benefit of the regime without having any real and substantial activities in the UK. The fact that apparently UK companies are outsourcing their R&D activities to other group companies (without having any R&D activity in the UK) is considered as particularly problematic.[132]

As far as the Belgian PID is concerned, two situations have to be distinguished. In the first situation, the taxpayer develops or improves the patents in an R&D centre in Belgium or abroad (without outsourcing any R&D activities). At least in a European context, the activity test under the code of c onduct seems to be met. In the second situation, the taxpayer outsources part or all of its R&D activities to another company. In this case, Belgian law still provides that the patents have to be developed or improved in an R&D centre of the Belgian taxpayer, implying that R&D activities still have to be conducted in Belgium or directed substantially from it. Despite the fact that these activities may (also) consist in the development of the R&D strategy and the steering and managing of it, this cannot be considered as violating the "substantial activity" criterion.[133]

127 L. Faulhaber, "Towards coherence: some recent developments in the OECD's action plan on base erosion and profit shifting", *AFT*, 2014, nos. 6–7, p. 70.

128 K. Dirix, "Harmful tax competition: six Belgian tax incentives under the microscope", *EC Tax Review*, no. 2013/5, p. 235.

129 See also *ibid.*, p. 241.

130 Art. 205^2, §1, s. 1 BITC.

131 J. Luts, "Belgisch regime van de aftrek voor octrooi-inkomsten", *AFT*, no. 2104/3, p. 30.

132 R. Danon, "Patent boxes regimes: overview and compatibility issues", *AFT*, no. 2014/6-7, p. 73.

133 See also Luts, *op. cit.*, p. 34.

Furthermore, the PID only applies to the extent and insofar as the patent income is included in the Belgian taxable base and is considered at arm's length (for related party transactions). In other words, if the patent income from a transfer pricing perspective should be attributed to the company to which the R&D activities are outsourced (which would imply that no substantial activity takes place in Belgium), no PID will be available.

2.3.2.2. Under state aid rules

From a state aid perspective, it has to be observed that the Belgian PID regime clearly aims at stimulating R&D activities. Furthermore, as the measure is not limited to certain taxpayers in terms of size, location, sector, nature or source of the income, it should not be considered as selective.[134] Hence, it can be concluded that, under current rules, this measure should not be considered as illegal state aid. This conclusion, at least implicitly, can also be underpinned by referring to the European Commission's Communication regarding a more effective use of R&D tax incentives.[135]

2.3.2.3. Harmful tax competition and fundamental freedoms

As mentioned above, a condition for applying the Belgian PID is that the patent should be developed or improved in an R&D centre in Belgium or abroad (without outsourcing any R&D activities). At least in a European context, this should suffice. Indeed, requiring that the development or improvement activities should be performed in Belgium is deemed to be in violation of the European fundamental freedoms as also expressed by the ECJ in the *Laboratoires Fournier* case.[136]

2.4. Intangibles and BEPS situations

2.4.1. Introduction

One of the major issues identified in the BEPS action plan concerns transfer pricing and the enforcement of the arm's length principle. As such, in action 8, the OECD envisages among other things countering multinationals which have been able to use and/or misapply the existing transfer pricing rules on intangibles to separate income from the economic activities that produce that income and to shift it into low-tax environments, for instance by transferring hard-to-value intangibles to low-tax jurisdictions. Further to the BEPS action plan, on 30 July 2013, the OECD also released its Revised Discussion Draft on the Transfer Pricing Aspects of Intangibles which provides guidance on the question of how to correctly allocate the so-called intangible related returns.

[134] Dirix, *op. cit.*, p. 241; Luts, *op. cit.*, p. 16.
[135] COM(2006)728, 22 November 2006.
[136] ECJ 10 March 2005, Case C-39/04 *Laboratoires Fournier*; see also Luts, *op. cit.*, p. 33.

2.4.2. Transfer of intangibles to low-tax jurisdictions

Belgian tax practice shows that the Belgian tax authorities apply a number of means to counter illegitimate transfers of intangibles to entities located in low-tax jurisdictions. As such, the Belgian tax authorities may defend the position that the foreign entity in fact should be considered a Belgian tax resident entity (if its actual place of management is indeed situated in Belgium). Furthermore, the foreign entity may be deemed to have a branch to which an arm's length profit should be allocated (if the foreign entity carried out qualifying activities in Belgium). Also, the Belgian tax authorities could apply transfer pricing adjustments in order to align the profit (or loss) allocation between the Belgian entity and the foreign entity with business reality. This is in line with OECD guidance that states that disregarding the transaction should be the exception and that tax authorities should challenge the transaction through transfer pricing principles.[137]

The Belgian tax authorities often apply the Belgian GAAR provision or sham doctrine as a means to prove such an illegitimate transfer. In that context, although very rarely applied in practice,[138] Belgian tax law also provides for a very specific anti-abuse measure. Indeed, following article 344, §2 BITC, the Belgian tax authorities are allowed to disregard tax-driven transfers of certain assets (among other IP) to low-tax jurisdictions.[139] By doing so, the income stemming from those assets can still be taxed in the hands of the transferring Belgian entity. For transactions within the EU, however, this article should not apply.[140]

Finally, in the particular case in which a Belgian company transfers its intangibles to a foreign EU branch, the question can be raised whether or not the Belgian tax authorities are allowed to levy an exit charge upon such transfer. Based on the European case law in this respect, no such exit taxation should occur at the time of the transfer. Instead, the taxpayer should have the option to defer the taxation to for instance the time at which the intangibles are effectively realised.[141]

2.4.3. Royalty payments to intermediary IP companies

The interposition of an intermediary company is frequently applied in order to avoid royalty withholding taxes. Whereas such an interposition in some cases is perfectly legitimate, in other cases it may be considered abuse of withholding tax exemptions or reductions.

The Belgian tax authorities sometimes try to tackle this by arguing that the intermediary company should be considered as a resident of another state than the state in relation to which Belgium provides for a withholding tax exemption.

Primarily, however, the Belgian tax authorities argue that the intermediary company should not be considered the beneficial owner of the royalty. This beneficial

137 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, July 2010, nos. 1.64–1.69.

138 See P. Lion, "Artikel 344 § 2 van het WIB: 'een papieren tijger'", *AFT*, 1995, pp. 317–344.

139 L. De Broe, *International Tax Planning and Prevention of Abuse*, IBFD, 2008, nos. 44–62.

140 *Ibid.*, 247.

141 W. Oepen and N. Lenaerts, "De zaak DMC: gordiaanse knop inzake exitheffingen doorgehakt?", *Fisc. Int.*, no. 367, pp. 7–8.

ownership test can be applied for treaty situations as well as under the Interest and Royalty Directive. Notwithstanding the fact that such a test is not included in all DTTs concluded by Belgium, it will be applied in all treaty situations.[142] Upon implementation of the Interest and Royalty Directive, the Belgian legislator has defined the beneficial owner as the "owner or usufructuary". Although it can be debated whether such definition is in line with article 1(1) of the Interest and Royalty Directive,[143] in general Belgian tax practice adheres to a legal interpretation of the beneficial ownership concept. As such, unless a mere nominee or fiduciary owner (which could be for instance the case in pure back-to-back situations), the legal owner is to be considered as the beneficial owner. In this case, a withholding tax reduction or exemption will not be denied.

Addendum

Compatibility with EU state aid rules

On 23 January 2015, the European Commission finalised its investigation of the payroll WHT exemption for young and innovative companies under the EU state aid rules. According to the Commission, this tax system complies with the EU state aid rules and can thus be maintained.

The European Commission now indeed concludes that no indications were found of irregular practices in granting the benefit that would fall beyond the scope of the EU framework for state aid for research, development and innovation. The positive outcome of the investigation means that the tax incentive will not be reclaimed from the Belgian companies that benefited from it. However, the European Commission still expects Belgium to bring its domestic legislation in line with the updated EU guidelines and regulations in respect of state aid for research, development and innovation.

Note that the official decision has not yet been published.

Patent box regimes and harmful tax competition

Within the EU, in order to determine whether or not a patent box regime constitutes harmful tax practice, a compromise to apply the so-called "modified nexus approach" (see the OECD 2014 deliverable on action 5) has been endorsed by the EU code of conduct group. Under this approach, a state is allowed to provide a preferential tax regime for IP related income to the extent that the IP income has been generated by "qualifying R&D expenditure". Following the report of the group dated 11 December 2014 (document number 16553/1/14 REV 1), an uplift of 30 per cent on these qualifying R&D expenditures may be applied.

According to the OECD 2014 deliverable on action 5,

142 Administrative Commentaries to the OECD Model Convention, no. 10/04.
143 De Broe, *op. cit.*, no. 271.

> "Qualifying expenditures must have been incurred by a qualifying taxpayer, and they must be directly connected to the IP asset. Jurisdictions will provide their own definitions of qualifying expenditures, and such definitions must ensure that qualifying expenditures only include expenditures that are necessary for actual R&D activities. They would include the types of expenditures currently granted R&D credits under the tax laws of multiple jurisdictions. They would not include interest payments, building costs, acquisition costs, or any costs that could not be directly linked to a specific IP asset."

The deliverable thereby indicates that "all qualifying expenditures for activities undertaken by unrelated parties – whether or not they were within the jurisdiction – (should) qualify, while all expenditures for activities, undertaken by related parties – again, whether or not they were within the jurisdiction – would not count as qualifying expenditures."

In terms of timing, the report of the group dated 11 December 2014 states that existing regimes which are not compliant with the modified nexus approach (and apparently none of the existing EU patent box regimes would be compliant) can no longer apply to new entrants (both in terms of new tax payers as well as new IP assets) after the date that a new compliant regime would take effect and, in no event, later than 30 June 2016. For taxpayers and IP assets benefiting from an existing regime, grandfathering rules may be introduced. The existing regimes should, however, come to an end on 30 June 2021 at the latest.

The impact of these new developments on the Belgian patent box regime will have to be analysed upon actual implementation of the proposed changes.