



**2014 IFA Congress Mumbai (Subject 2)  
Qualification of Taxable Entities and Treaty Protection**

**National Report: Belgium – Pascal Faes, NautaDutilh  
(Presentation IFA Belgian Branch, 17 September 2013)**

**Part I. Entity Classification under Domestic Tax Law**

## Entity Classification – Domestic Entities

Determinative nexus for taxable status: Legal personality

- Articles 179 juncto 2, § 1, 5°, a) ITC: “corporation”
- Article 18 ITC: dividend qualification dependent on distributing entity being a “corporation”
- Article 29, § 1 ITC: entities without legal personality are fiscally transparent
- Article 29, § 2 ITC: entities with legal personality deemed to be associations without legal personality for income tax purposes

“Legal personality”: concept of (corporate) private law – no (separate) definition under Belgian tax law

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## Entity Classification – Foreign Entities

- Key-criterion for classification: legal personality
- Recognition of foreign legal entities (for Belgian income tax purposes) governed by the rules of Belgian international private law (IPL)
- Primary IPL conflict of law rule: *lex societatis*
- *Lex societatis*: place of principal establishment of the entity, i.e. place from where the company is effectively managed (“real seat”-doctrine)

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## Entity Classification – Foreign Entities – Typology (I)

- (I) The foreign jurisdiction knows the concept of legal personality:
  - (a) The foreign entity has legal personality under the private (corporate) law rules of the foreign jurisdiction and is treated as a taxable entity under the laws of the foreign jurisdiction: *de plano* recognition (and, hence, opaque treatment for Belgian income tax purposes)
- No double taxation due to asymmetrical entity classification should arise

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## Entity Classification – Foreign Entities – Typology (II)

- (I) The foreign jurisdiction knows the concept of legal personality:
  - (b) The foreign entity has no legal personality under the laws of the foreign jurisdiction: acceptance of lack of legal personality (and, hence, fiscally transparent treatment for Belgian income tax purposes)
- Double taxation may arise because Belgium treats the foreign entity as fiscally transparent (and, hence, imposes tax on the Belgian partners on their pro rata share of the partnership income), while the partnership jurisdiction considers that the non-resident partners have a (taxable) PE in its jurisdiction or (more unlikely) treats the partnership as a separate taxpayer

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### Entity Classification – Foreign Entities – Typology (III)

(I) The foreign jurisdiction knows the concept of legal personality:

(c) The foreign entity has legal personality under the private (corporate) law rules of the foreign jurisdiction, but is treated as fiscally transparent under the income tax rules of that jurisdiction: Belgium recognizes the separate legal personality and, hence, will treat the entity as a separate taxpayer for Belgian income tax purposes

- Double taxation may arise because the non-resident partners are taxed in the State of source if the partnership derives income sourced there (e.g. income from real property), while Belgium will tax the Belgian resident partners on foreign-source dividends at the time the partnership “distributes” its profits
- Cfr. *Prince de Ligne I* and II

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### Entity Classification – Foreign Entities – Typology (IV)

(II) The foreign jurisdiction does not know the concept of legal personality:

- Application of *lex societatis* conflict of law rule to derive characteristic features of the foreign entity with subsequent testing of these features against the characteristics attributed to legal entities under Belgian law (*lex fori*)
- Example: Court of Appeals of Brussels, 30 April 1998 – US General Partnership

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## Entity Classification – Foreign Entities – Typology (V)

### (III) Belgium as State of source

- Comparability test of Article 227, 2° ITC: foreign entity treated as separate taxpayer if it is an association, institution or body without legal personality that is established in a legal form that is “comparable” with the legal form of a corporation under Belgian law
- What is “comparable”?
  - Corporate law criteria as opposed to tax law criteria
  - Centralization of management, limited liability of partners, transferability of shares/parts, continuity of the entity

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## Part 2. Case Studies on Tax Treaty Entity Qualification Issues – Introduction

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## OECD Partnership Report (1999)

- Entity Classification
  - State of source (State S) to take account of subjective classification of the entity by the State where the entity is organized (State P)
- Income Qualification Issues Arising as Result of Asymmetrical Entity Classification
  - Article 23 OECD Model Tax Convention Approach: State of residence (of the partners/members of the entity) (State R) to grant relief where State S considers a given tax treaty provision to be applicable to the income at issue, possibly taking into account the qualification of that income under its domestic law, and that tax treaty provision attributes the taxing power to State S (unless State S has applied the provisions of the treaty to exempt the underlying income or applies treaty provisions mirroring Art. 10(2) or 11 of the OECD Model Tax Convention to such income)

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## Belgium and the OECD Partnership Report (I)

Strong indications that Belgium adheres to – and applies – the OECD Partnership Report

- Belgium did not formulate any reservations on the OECD Partnership Report
- 2004 and 2010 Circular Letters
- Cass., 2 December 2004 (implied)
- Decisions of Ruling Commission re: UK Limited Liability Partnerships
- Recent tax treaty policy where the OECD Partnership Report approach is embedded

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## Belgium and the OECD Partnership Report (II)

### 2004 and 2010 Circular Letters

- Expressly refer to examples directly derived from the OECD Partnership Report and the OECD Commentary
- Accept the principle that double taxation relief must be granted by Belgium (as State R) if State S has taxed the income in accordance with the provisions of the applicable tax treaty (even when based on the latter's domestic law classification rules)

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## Belgium and the OECD Partnership Report (III)

### Cass., 2 December 2004 (implied)

- French-source real property income received by a Belgian resident who was a shareholder of a French *Société Civile Immobilière (SCI)*, a legal person under French law but treated as fiscally transparent (*translucide*) for French internal tax law purposes
- Supreme Court accepted that (i) the income of the SCI was taxable in France as income from “real property”, (ii) the income qualification of State S (France) was binding upon Belgium; and (iii) Belgium thus had to exempt the income
- No explicit reference to OECD Partnership Report, but analysis and conclusion fully consistent with the principles laid down therein

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## Belgium and the OECD Partnership Report (IV)

Decisions of Ruling Commission re: UK Limited Liability Partnerships (UK LLPs)/US Limited Liability Company (US LLC)

- Foreign-source income earned via a UK LLP, despite the fact that a UK LLP has legal personality under UK law (and therefore should be deemed a separate taxpayer under Belgian domestic entity classification rules), is to be attributed to the Belgian partners and is to be exempt in Belgium (and thus not to be treated as taxable dividend income in their hands)
- A Belgian resident holding US real property through a US LLC (not treated as a corporation and thus not resident for US tax purposes) is held to be directly entitled to the benefits of the (old) US-Belgium tax treaty as he must be considered to have directly obtained the income derived through the US LLP; as regards income qualification, Belgium is bound by the qualification given to the income by the State of source (i.e. the US)
- Express references to OECD Partnership Report

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## Belgium and the OECD Partnership Report (V)

Recent tax treaty policy

- 2007 and 2010 Belgian (draft) Model Convention
  - Article 22
- Tax treaties concluded with The Netherlands, USA

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## Belgium and the OECD Partnership Report – Three Side Remarks (I)

*First side remark:* Can the OECD Partnership Report approach be applied in the context of tax treaties concluded by Belgium prior to the publication of the OECD Partnership Report and the insertion of its principles in the OECD Commentary (and the Belgian (draft) Model Convention(s))?

- Ruling Commission and recent case law (Court of Appeals of Ghent, 3 January 2012) seem to advocate dynamic interpretation...
- ...but the matter remains controversial (see also the reservation made by The Netherlands on the OECD Partnership Report)

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## Belgium and the OECD Partnership Report – Three Side Remarks (II)

*Second side remark:* Expression “may be taxed in the [State of source]” (Art. 23 OECD Model Tax Convention) *versus* expressions “is taxed in the [State of source]” or “is subject to tax in the [State of source]” used in certain tax treaties concluded by Belgium

- Extensive and liberal application of “subject-to-tax” requirement by Belgian tax authorities on basis of “*exemption vaut impôt*”-doctrine...
- ...appears to come under mounting pressure whereby “taxed” necessarily implies effective taxation (e.g. Court of Appeals of Brussels, 17 January 2008)

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## Belgium and the OECD Partnership Report – Three Side Remarks (III)

*Third side remark:* Abolishment of foreign tax credit for dividends, interest and royalties for Belgian resident individuals not acting in a professional capacity

- May render moot the Article 23 OECD Model Tax Convention “tax relief” approach (to the extent that the unilateral abolishment of the foreign tax credit can be considered to be treaty compliant)

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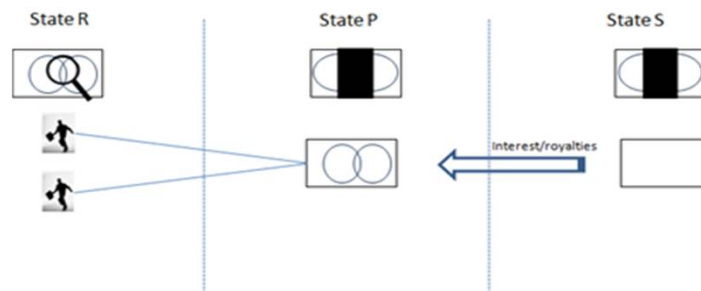
## Part 2. Case Studies on Tax Treaty Entity Qualification Issues – Treaty Entitlement Cases

*Working assumption:* The analysis of the cases assumes that the relevant Belgium tax treaty follows the OECD Model Tax Convention

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**Case Study:** *An entity is established in State P and is receiving interest or royalties from sources in State S and the shareholders (partners) of this entity are residents of State R*

A. Assume that States P and S treat this entity as a taxable entity and State R as a transparent entity:



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A. Assume that States P and S treat this entity as a taxable entity and State R as a transparent entity:

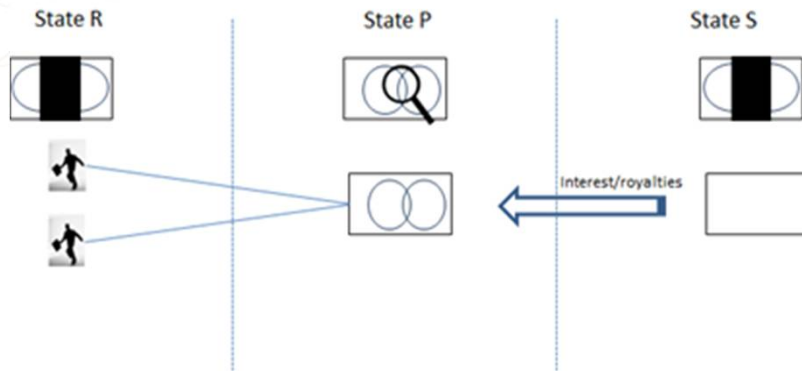
*If your country is State S: which tax treaties would be applicable in State S in order to reduce withholding taxes on interest and royalties? The treaty between States S and P, the treaty between States S and R or both?*

There will be double entitlement to treaty benefits with respect to the same income:

- P should be considered by Belgium (as State S) to be entitled to the benefits of the S-P tax treaty in respect of the interest/royalties it derives from Belgium as P is liable to tax in State P
- The partners, residents of State R, should be considered to be entitled to the benefits of the S-R tax treaty as State R treats P as fiscally transparent and, hence, treats the partnership income as being taxable in the hands of the partners
- In such a case: Belgium to impose the lowest amount of tax allowed under the two treaties (OECD Partnership Report, R(15)-32, para. 74)

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B. Assume that States R and S treat this entity as a taxable entity and State P as a transparent entity:



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B. Assume that States R and S treat this entity as a taxable entity and State P as a transparent entity:

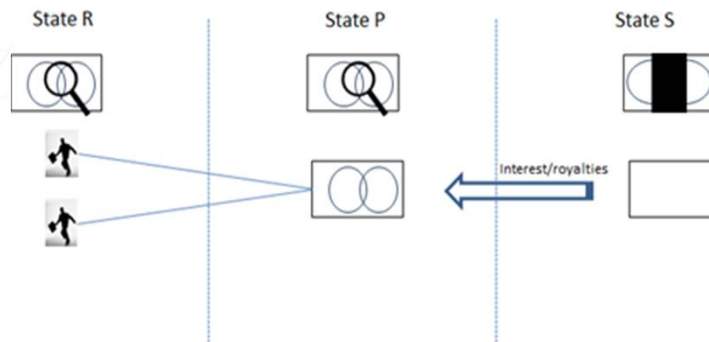
If your country is State S: Which tax treaties would be applicable in State S in order to reduce withholding taxes on interest and royalties? The treaty between S and P or the treaty between S and R or both?

Belgium (as State S) should be entitled to tax the interest/royalties income without restriction:

- P is not liable to tax in State P and is therefore not a resident of State P for purposes of the P-Belgium treaty
- Similarly, though P is treated as a taxable entity for purposes of the domestic laws of Belgium and the income is allocated to P under the domestic laws of State R, P is not liable to tax in State R because it is not treated as a resident
- Finally, though the partners are potentially liable to tax as residents in State R, under State R's allocation rules the income is not allocated to them but to P; thus, P is not a resident of State R and the partners "behind" P are not entitled to benefit from the R-Belgium treaty

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C. Assume that State S treats this entity as a taxable entity and States R and P as a transparent entity:



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C. Assume that State S treats this entity as a taxable entity and States R and P as a transparent entity:

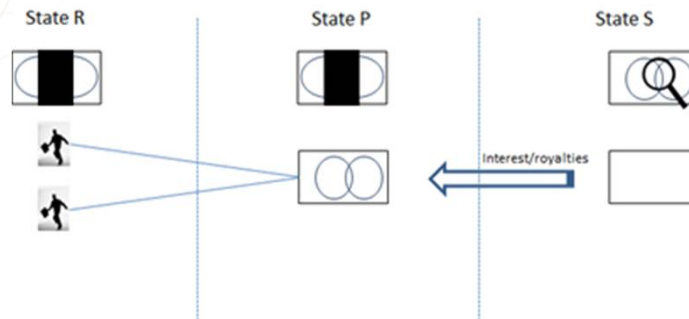
If your country is State S: which tax treaties would be applicable in State S in order to reduce withholding taxes on interest and royalties? The treaty between S and P or the treaty between S and R or both?

The Belgium-R treaty should be applicable:

- P may not claim benefits under the Belgium-P treaty since it is not a resident of State P (it is not liable to tax in State P)
- As State R allocates the income to the partners “behind” P, the said partners are liable to tax on that income and are entitled to benefits under the Belgium-R treaty

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D. Assume that States R and P treat this entity as a taxable entity and State S as a transparent entity :



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D. Assume that States R and P treat this entity as a taxable entity and State S as a transparent entity:

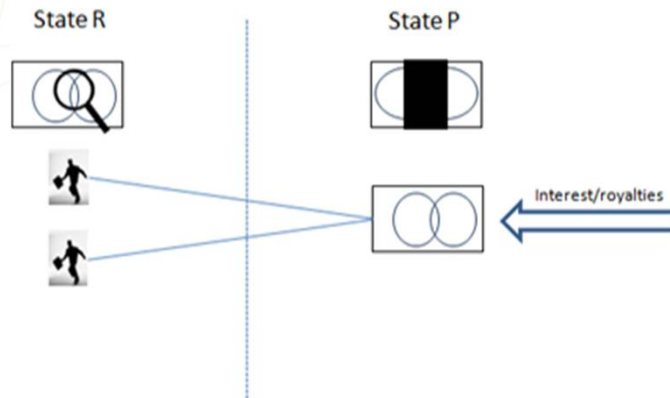
If your country is State S: which tax treaties would be applicable in State S in order to reduce withholding taxes on interest and royalties? The treaty between S and P or the treaty between S and R or both ?

The Belgium-P treaty should be applicable:

- Belgium (as State S) is bound by State P's subjective qualification
- P is a resident of State P and is liable to tax there; hence, P should be considered to be the recipient and beneficial owner of the interest/royalties income derived from Belgium
- If Belgium, based on the Belgium-P treaty, may levy a (reduced) withholding tax, the question whether applicable participation thresholds are met should be assessed in the hands of P, not in the hands of the partners "behind" P

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E. Assume that State P treats this entity as a taxable entity and State R as a transparent entity and that interest and royalties are derived from sources in State P:



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E. Assume that State P treats this entity as a taxable entity and State R as a transparent entity and that interest and royalties are derived from sources in State P:

a) If your country is State P: is the allocation of income in State R relevant for State P and has State P therefore to reduce the (withholding) tax on interest and royalties, according to the tax treaty (0% withholding tax on royalties or 10% withholding tax on interest under the OECD Model Convention) or has this scenario treated as a merely domestic situation with the result of exclusive taxation in your country (according to Art. 7 or Art. 21 OECD Model Convention, since the residence state of the entity is State P) ?

Belgium (as State P (and State S)) is likely to view this fact pattern as a purely domestic matter:

- For Belgian purposes, P is a resident taxpayer and as such liable to tax on its income arising in Belgium (i.e. Belgium is simply taxing domestic-sourced income of a resident taxpayer)
- Example: Belgian limited partnership (commanditaire vennootschap/société en commandite simple) with Dutch partners
- This analysis is consistent with the majority view of the OECD Committee on Fiscal Affairs in the OECD Partnership Report (R(15)-51/52, para. 131)

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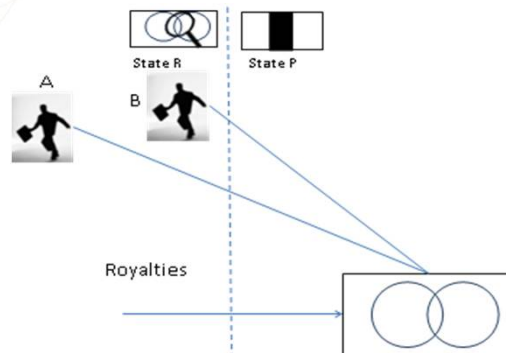
E. Assume that State P treats this entity as a taxable entity and State R as a transparent entity and that interest and royalties are derived from sources in State P:

b) If your country is State R: is State R obliged to follow the allocation of income of State P and is State R therefore prevented to tax the income in the hands of the shareholders? Which treaty rules would State R require to do this? Or is State R allowed to levy tax on the interest and royalty income? If so: Why? And would State R have to grant a credit on the tax levied in State P at the level of the entity ?

- Belgium is likely to accept to be bound by the income qualification of State S (which is also State P) and, hence, should grant relief if State S levies tax in accordance with the tax treaty at hand (see 2010 Circular Letter and Belgian (draft) Model Treaty; see also e.g. 2006 US-Belgium tax treaty)
- Belgium (as State R) should not have to grant a credit on the tax levied in State P at the level of P because Belgium, treating P as a fiscally transparent entity, will only recognize the income generation at the level of the partners but not the (subsequent) income distribution by P to the partners (cfr. OECD Partnership Report, R(15)-54, para. 137)

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F. Assume that State P treats this entity as a taxable entity and State R as a transparent entity and that interest and royalties are derived from sources in State R:



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F. Assume that State P treats this entity as a taxable entity and State R as a transparent entity and that interest and royalties are derived from sources in State R:

If your country is State P: is the allocation of income in State P relevant for State P and has State R therefore to reduce the (withholding) tax on interest and royalties, according to the tax treaty (0% withholding tax on royalties or 10% withholding tax on interest under the OECD Model Convention) or has this scenario treated as a merely domestic situation in State R with the result of exclusive taxation in State R (according to Art. 7 or Art. 21 OECD Model Convention, since the residence state of the partner is State R)? And would State P be obliged to grant a credit at the level of the entity for a withholding tax levied in State R (where the partners are the relevant taxpayers)?

Two approaches appear to be theoretically possible:

- The royalties may only be taxed in State P because P qualifies as a resident of State P and is the beneficial owner of the royalties arising in State R, thus satisfying the conditions of Art. 12(1) of the OECD Model Tax Convention (assumed to be reflected in the R-Belgium treaty)
- State P should allow State R to consider that the partners, resident in State R, have received their share of the royalties for the purposes of taxation in that State (hence, domestic situation where Art. 12(1) of the OECD Model Tax Convention cannot apply)
- Second approach is majority view of OECD Committee on Fiscal Affairs (OECD Partnership Report, R(15)-50, para. 127; see also Para. 6.1 of OECD Commentary on Article 1 OECD Model Tax Convention)

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## Part 2. Case Studies on Tax Treaty Entity Qualification Issues – Distributive Rules (Dividends and Interest)

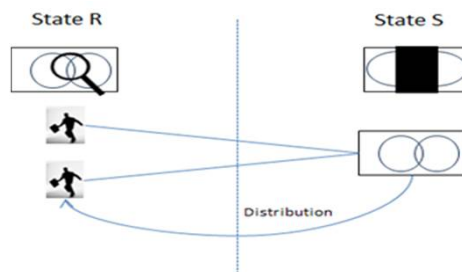
*Working assumption: The analysis of the cases assumes that the relevant Belgium tax treaty follows the OECD Model Tax Convention*

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### Article 10 – Dividends

**Case Study:** An entity is established in State S and its shareholders (partners) are residents of State R. The entity “distributes” income to its shareholders (partners).

- A. Assume that State R treats the entity as transparent and State S as a taxable entity:



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- A. Assume State R treats the entity as transparent and State S as a taxable entity:
- a) If your country is State R: would it be possible to grant a credit for the withholding tax levied in State S on the “dividends” distributed (although State R does not treat the entity of State S as a taxable entity)?
- Belgium is unlikely to recognize the “distribution” by P to its shareholders/partners as it treats P as a fiscally transparent entity and is not bound by the entity classification of State S (cfr. OECD Partnership Report, R(15)-53, para. 134 *et seq.*)

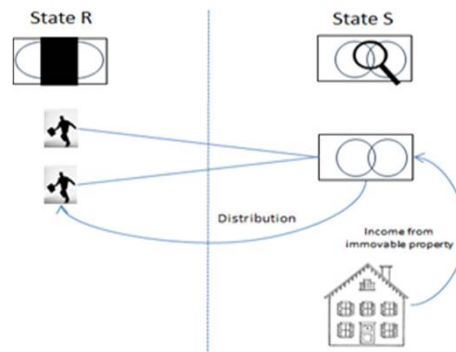
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A. Assume State R treats the entity as transparent and State S as a taxable entity:  
 b) If your country is State R and under your domestic law you allocate the profits of the entity in State S to the shareholders who are residents of your country: would your country feel to be prevented to tax the entity's income in the hands of the shareholders under the tax treaty? If so: why ?

- Belgium (as State R), treating P as fiscally transparent, should exempt from tax the generation of profits at the level of P (in year x) on the basis that the dividend article of the relevant tax treaty would allow them to be taxed when distributed (in year x+1) in State S (as State S treats P as a taxable entity) (cfr. OECD Partnership Report, R(15)-54, para. 137)

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B. Assume State R treats the entity as taxable entity and State S as a transparent entity:



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B. Assume State R treats the entity as taxable entity and State S as a transparent entity: If your country is State R and under your domestic law you treat the income as a distribution of dividends, but under State S' domestic law the income is treated as income from immovable property in the hands of the individuals (residents in State R): would Art. 6 or Art. 10 OECD Model Convention considered to be applicable in your country?

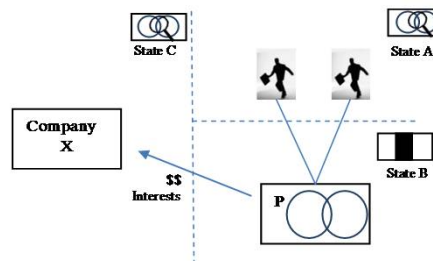
- Under the *Prince de Ligne I and II* approach, the initial income allocation to the entity is not recognized, but rather the (subsequent) “dividend” distribution constitutes the taxable event; thus, Art. 10 rather than Art. 6 OECD Model Tax Convention would be applicable
- Cass., 2 December 2004 abandons the *Prince de Ligne I and II* approach: Belgium (as State R) should accept to be bound by the income qualification of State S (real property income within the meaning of Art. 6 of the OECD Model Tax Convention) and, hence, should exempt the income under the exemption (for individuals: with progression) method
- See also decision of Ruling Commission re: US real property held by a Belgian resident through a US LLC

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### Article 11 – Interest

**Case Study:** Entity P is established in State B and its shareholders (partners) are residents of State A. The entity pays interest to Company X, resident in State C.

A. Assume that States A and C treat the entity as transparent, while State B treats it as opaque.



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A. Assume that States A and C treat the entity as transparent, while State B treats it as opaque.

a) If your country is State A: is the interest sourced in State A and has State A to apply Art. 11 of the treaty between C and A and reduce its withholding taxes accordingly ?

- Belgium (as State of residence of the partners) considers P to be fiscally transparent and, thus, from a Belgian perspective, P is lacking legal personality. Therefore, P cannot contract a loan and, hence, the interest payment cannot be allocated to P
- Rather, each partner should be deemed to have paid the interest “owed” by P in proportion to his/her rights in P
- Since interest is deemed to arise in the Contracting State when the payer is resident of that State (Art. 11(5) of the OECD Model Tax Convention) and the partners (who are deemed to be the payer of the interest) are resident in State A, Belgium is likely to consider that the interest is sourced in Belgium and that, hence, the State A-State C treaty is applicable

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A. Assume that States A and C treat the entity as transparent, while State B treats it as opaque.

b) If your country is State B: is the interest sourced in State B and has State B to apply Art. 11 of the treaty between C and B and reduce its withholding taxes accordingly ?

- Belgium (as State B) treats P as a taxable entity and thus considers that P has legal personality
- Under Belgian law, therefore, P is legally able to contract a loan and, as a result, the interest can be imputed to P
- Since P is a resident of State B, Belgium is likely to consider that the income is sourced in Belgium and, hence, the applicable treaty would be the treaty between State B and State C

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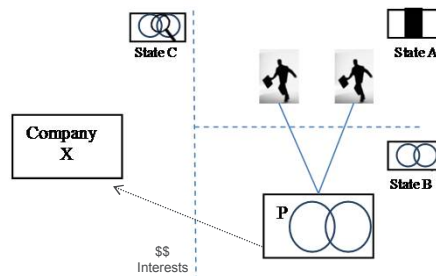
A. Assume that States A and C treat the entity as transparent, while State B treats it as opaque.

c) If your country is State C: assume there is a reduced withholding tax levied both in A and B: is State C obliged to grant a credit for the withholding tax levied in A or in B or for both of them? Why?

- Belgium (as State C) should not be bound by the entity classification and/or income qualification by State A and/or State B
- In the author's opinion, the tax credit grant issue should be addressed under the A-Belgium treaty as Belgium treats P as fiscally transparent
- The position could be different (i.e. applicability of the B-Belgium treaty) if P were to have legal personality under the laws of State B as, in that case, Belgium would recognize such legal personality *de plano* and treat P as a taxable entity; this is, however, not the fact pattern of the case at issue

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B. Assume that States B and C treat the entity as transparent, while State A treats it as opaque.



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B. Assume that States B and C treat the entity as transparent, while State A treats it as opaque.

a) If your country is State A: is the interest sourced in State A and has State A to apply Art. 11 of the treaty between C and A and reduce its withholding taxes accordingly ?

- Belgium (as State A) considers P to be opaque and thus that P has legal personality
- Therefore, Belgium is likely to consider that the interest is sourced in State B and that, hence, the treaty between Belgium and State C cannot be applicable

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B. Assume that States B and C treat the entity as transparent, while State A treats it as opaque.

b) If your country is State B: is the interest sourced in State B and has State B to apply Art. 11 of the treaty between C and B and reduce its withholding taxes accordingly?

- Belgium (as State B) treats P as fiscally transparent and, hence, is likely to consider that the interest is not sourced in Belgium (but is sourced in State A)
- The response should be different if P is engaged in a professional activity and the partners of P may be deemed to have a PE in Belgium:
  - Art. 11(5) of the OECD Model Tax Convention: interest is held to come from the PE if the indebtedness on which the interest is paid is incurred in connection with the PE and if the PE bears the interest expense
  - Thus, the interest would have its source in Belgium and, as Belgium considers the partners as the debtors of the interest, the Belgium-State C treaty should be applicable

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## The 10,000 words straight jacket of an IFA national reporter...

...another hybrid feeling

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