Belgium

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Summary and conclusions

Belgium, which is situated in the heart of Europe, is characterized by a very open economy. Furthermore, its domestic market is quite small, which stimulates Belgian enterprises to expand activities to foreign markets. The application of the exemption method under the treaties guarantees that from a fiscal point of view these Belgian enterprises are not put at a disadvantage compared to the local enterprises. They can benefit from the fact that their foreign business profits are often subject to lower rates than the rates which would apply if the Belgian corporate income tax were applicable (as would be the case if the credit method were used). For dividends paid between companies the participation exemption applies if certain conditions and modalities are respected; for interest and royalties the fixed proportion of foreign tax is credited.

There appear to be some deficiencies in each of these methods which could possibly result in unrelieved double taxation. An important tendency which can be perceived in recent years is the fact that the Belgian tax administration tries to resolve these problems by means of explicit provisions in the tax treaties. Furthermore, in some cases double taxation is adjusted by means of judicial decisions.

Exactly what problems have been exposed?

In the first place the exemption method only applies to business profits if the profits are derived in a country with which Belgium has concluded a double tax treaty. Indeed, for profits from countries without a treaty, Belgian corporate income tax is levied at the normal rate and thus no avoidance of double taxation is applied (but the foreign corporate income tax does qualify as an expense which may be deducted from taxable profits).

When an entity is considered to be fiscally transparent in the source state and is considered to be a company in accordance with domestic law in Belgium, a loophole in the present Belgian tax law leads to the fact that no avoidance of double taxation can be granted when residents of Belgium derive certain income from the source state through this entity. An explicit provision in some double tax treaties and in the Belgian model tax convention of 2010 stipulates that such income which is considered as dividends in accordance with Belgian domestic law is exempt from tax. When tax treaties do not contain an explicit provision on this matter (which goes for the majority of cases) there is a clear tendency in jurisdiction and

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in the decisions of the Advanced Ruling Office (ARO) towards solutions which eliminate double taxation.

For dividends which cannot benefit from the participation exemption provided for in domestic law because the taxation conditions have not been fulfilled, in the Belgian model tax convention of 2010 and already in a few recently signed double tax treaties a special treaty provision extends the exemption to dividends arising from income that is generated by the active conduct of a business, if the other conditions and limits provided for in domestic law are respected.

When the dividends do not qualify for the above-mentioned participation exemption the tax which is levied in the partner state on these dividends and on the profits out of which these dividends are paid is credited against the Belgian tax relating to the dividends, and this also in virtue of a new provision in the Belgian model tax convention of 2010.

With respect to the crediting of the fixed proportion of foreign tax (FFT) it is noted as an example that in many double tax treaties article 12 attributes a limited taxation right over royalties to the source state, whereas Belgium conserves the primary taxation rights in its capacity as resident state. In such cases the concurrence of the treaty provisions for the avoidance of double taxation and the rules of Belgian domestic law concerning the determination of the taxable basis and the calculation of the foreign tax credit may result in an unrelieved double taxation due to an asymmetry in the definition of “royalties” for which Belgian law grants the right to the foreign tax credit and of “royalties” as defined under article 12 of the double tax treaties.

Actually in the Belgian provisions for the avoidance of double taxation (applicable treaties and domestic law) there certainly remain a number of situations where double taxation cannot be properly eliminated. Thus one can only hope that the above-mentioned development will be continued and that the still remaining loopholes will be further eliminated, preferably by means of explicit provisions.

At a completely different level, the insertion of the new article 7 (business profits) and of article 25, paragraph 5 of the OECD model (arbitration procedure) in the Belgian double tax treaties (both in new treaties and in old treaties as soon as they are revised) will in the long term undoubtedly also contribute to a further reduction of the cases of unrelieved double taxation.

1. Introduction

The Belgian measures for the avoidance of double taxation with respect to income derived by companies can be summarized as follows.

1.1. Unilateral measures

Since the law of 24 December 2002,[1] Belgium no longer grants avoidance of double taxation with regard to active business profits in the relations with non-treaty

[1] Law modifying the corporate income tax law and introducing a system of advanced tax rulings in fiscal affairs (Belgian Official Gazette, 31 December 2002).

countries. As regards income from movable property and capital (principally interest and certain royalties), in accordance with article 285 *et seq.* of the Income Tax Code 1992 (ITC 92) the FFT is credited against Belgian tax if the income was subject abroad to a tax similar to the individual income tax, the corporate income tax or the income tax on non-residents and insofar as the movable property and capital concerned were used for the exercise of the professional activity in Belgium. Under certain conditions, dividends derived by companies/residents are exempt from tax according to the participation exemption regime provided for by the domestic law.[2]

1.2. Measures in the framework of double tax treaties (based on the provisions for the avoidance of double taxation which are laid down in paragraph 2 of article 22 of the Belgian model tax convention of June 2010)[3]

For active business profits which are taxed in the source state in conformity with the convention, Belgium applies the exemption method. Business profits are deemed to be taxed abroad when they have been subject to the tax system (exemption included) which is normally applicable to that income in the source state.[4]

When entities are considered to be fiscally transparent in the source state and in Belgium are considered to be a company according to domestic law, a loophole in the Belgian tax law leads to the fact that no avoidance of double taxation can be granted when residents of Belgium derive certain income from the source state through such entities. An explicit provision in the Belgian model tax convention stipulates that in such cases income that is considered as dividends in accordance with Belgian domestic law is exempt from tax in the same way as the income would be exempt if it had been realized through a fiscally transparent entity which would not possess legal personality and which would not have been established in a similar legal form as that of a company under Belgian law.

For dividends derived by companies/residents the participation exemption regime mentioned above applies. When this exemption system cannot be applied because the taxation conditions are not met, a special provision extends the exemption to dividends arising from income that is generated by the active conduct of a business, provided the other conditions and limits which are provided for in domestic law are respected.

When the dividends are paid to a company being a resident of Belgium and such dividends cannot enjoy the advantage of the above-mentioned exemptions, the tax which is levied in the partner state on these dividends and on the profits out of which these dividends are paid is credited against the Belgian tax relating to these dividends.

For interest and royalties, the Belgian tax treaties provide for the above-mentioned credit of the fixed proportion of taxes paid abroad in accordance with the rules of domestic law.

2 Cf. arts. 202 to 205 ITC 92.

3 http//fiscus.fgov.be/interfafznl/fr/downloads/modStand_en.pdf; as a matter of fact, some of these provisions have only been included in very recent double tax treaties.

4 Commentary on the ITC 92, no. 155/20 – judgment of 15 September 1970 of the Court of Cassation in the *SIDRO* case; circular letter AFZ no. 4/2010 dated 6 April 2010 as addendum to the circular letter AOIF noCi.R9.Div/ 577.956 dated 11 May 2006.

Finally, in certain situations a special provision has to prevent a double deduction of losses.[5]

2. Key factors of unrelieved double taxation

2.1. Diverging views on taxable income: existence, source, nature or character

The above-mentioned causes of unrelieved double taxation can lead to problems. When, for example, Belgium is of the opinion that certain profits, which have to be attributed to the Belgian head office of a company/resident of Belgium, have been attributed by the source state to a permanent establishment (PE) of the Belgian enterprise situated therein in a way which is contrary to a double tax treaty,[6] it does not in principle grant avoidance of double taxation. The mutual agreement procedure of article 25 of the OECD model can possibly offer a solution for the unrelieved double taxation (by way of an agreement on the attribution of the profits between the Belgian and the foreign establishment of the enterprise).

As stated in the commentary of the OECD[7] on the new article 7, the lack of a common interpretation of the earlier version of the article created problems of double taxation (and non-taxation). The provisions of paragraphs 2 and 3 of the new article 7 will certainly help to reduce these problems.

Furthermore, different opinions regarding the nature of the income can be brought up for discussion, due to the fact that the provisions of articles 10 to 12 of the double tax treaties which follow the OECD model or the Belgian model contain definitions of the terms “dividend”, “interest” and “royalties” which apply only within the articles concerned, as it is clearly determined. According to the Belgian tax administration, these treaty definitions in principle do not affect chapter V of the double tax treaties (methods for the elimination of double taxation). Thus, when the terms “dividend”, “interest” and “royalties” are used in the elimination of double taxation article of the double tax treaties that Belgium has signed, the meaning which is given to these terms is the same meaning they have according to Belgian domestic (tax) law, a meaning that can differ from the definitions of these terms under articles 10 to 12 of the treaties.

The following specific example regarding royalties shows to which problems of unrelieved double taxation this may lead.

In accordance with item 6 of the final protocol to the Belgian-Brazilian tax treaty of 1972, payments which are derived for technical assistance or for the rendering of technical services come under the definition given to royalties in the treaty. The withholding tax on such remuneration may not exceed 10 per cent of the gross amount of the payments.

Closer examination of what Belgium has to do as residence state when a resident derives such payments from Brazil reveals that the exemption method is not

5 See para. 44 of the commentary on art. 23A and 23B of the OECD model.
6 Cf. arts. 5 and 7 of the OECD model.
7 Para. 4 of the OECD model commentary on art. 7.

applicable because royalties are explicitly excluded from the exemption system. On the other hand, the crediting of the FFT, which is normally applicable in the case of royalties, cannot take place either because it is explicitly stipulated in the treaty provisions that the credit is granted subject to the provisions of Belgian law concerning the crediting of taxes paid abroad against Belgian tax. Article 285 ITC 92 does not use the term "royalties" as such and limits the crediting of the FFT in principle to certain categories of miscellaneous income and income from immovable property and capital.[8] Payments derived in respect of the rendering of technical assistance are not included in such income, the result being that double taxation is not avoided (see below). Only an adaptation of the FFT system provided for by domestic law or of the treaty provisions can offer a solution in this matter.

2.2. Inconsistent allocation of deductions between domestic and foreign sources

Since the nominal rate of the corporate income tax in Belgium (33.99 per cent) has to be among the highest tax rates in the European Union and Belgium, according to treaty law, uses the exemption method for business profits, some enterprises could be tempted to try to erode the taxable basis in Belgium, for example by inflating the profits from PEs situated in countries with lower tax rates, which have to be exempted by virtue of a treaty or by diverting profits to subsidiaries which are situated in such countries.

However, to protect the taxable basis in Belgium the Belgian tax administration has a number of defence measures at its disposal. In the first place the business profits of a foreign establishment which have to be exempted by virtue of a treaty are determined in accordance with the rules that apply for the calculation of the taxable Belgian profits and not in accordance with the tax legislation of the source country. In addition some costs can be disallowed, especially if they do not correspond to the definition of deductible professional expenses in Belgian tax law,[9] and the deduction of some payments (such as interest) can be refused for more specific reasons.[10]

Furthermore, certain interest can be requalified as dividend[11] and profits can be adjusted by applying the arm's length principle[12] or by including in the profits the abnormal or benevolent advantages which have been attributed to certain non-resident taxpayers which are liable to tax,[13] etc.

The application of these rules can possibly (depending on the taxation regime of the other state involved) result in double economic taxation. In a "captive insurance" case, the Court of First Instance of Leuven[14] has confirmed the non-deductibility of certain insurance premiums, paid by a Belgian company to a Belgian insurance company, which in its turn reinsured the policies at 100 per cent with a Luxembourg company and belonging to the same group as the first-mentioned Belgian

[8] As defined in arts. 17 and 90, 5 to 7 ITC 92.
[9] Cf. art. 49 ITC 92.
[10] ITC 92: art. 54; art. 198, 10; art. 198, 11; art. 307, §1, third subparagraph.
[11] Art. 18, 4 ITC 92.
[12] In accordance with art. 185, §2 ITC 92.
[13] Cf. especially art. 26 ITC 92.
[14] Leuven 17 February 2006, TFR 332, December 2007, pp. 1032–1036.

company (insurant). The court was of the opinion that in the submitted case no real insurance premiums had been paid but that funds had been put at the disposal of a company that was established in Luxembourg for the purpose of creating a provision for future uncertain events that could happen to the insurant. However, in this particular case there was no real double taxation, because of an exemption of the premiums in Luxembourg.

In a note added to another judgment which was unfavourable for the tax administration (also regarding (re)captive insurance) of the Court of First Instance of Ghent,[15] L. Vanheeswijck draws attention to the varying success of the tax administration in the fight against "captive" reinsurance. He explains why enterprises engage in that kind of arrangement:

> "When the reinsurance company is established in a country where considerable tax-free provisions for later losses may be taken into account for the determination of the taxable basis, it is likewise possible to lay aside a portion of the group's capital with exemption of tax, in anticipation of the later use that will be made of it. When doing so there has no longer to be allowed for the stricter Belgian rules but only for the more flexible rules of the country where the reinsurance company is established."

2.3. Inability to deduct foreign losses against domestic income

With regard to the deduction against their domestic income of foreign losses incurred by Belgian enterprises in their foreign establishments, a distinction has to be made between losses incurred in treaty countries and losses incurred in non-treaty countries.

In relations with non-treaty countries, the principle of unlimited double taxation of business profits applies. In such case the foreign results are fully taxable in Belgium and in the source state (the foreign tax being only a deductible cost) so that the foreign losses also have to be taken into account when computing the Belgian tax: because of the parallel double taxation of the result[16] there is no problem of double deduction.

In the case of treaty countries on the other hand, the amount of professional losses incurred during the accounting year within foreign establishments or related to assets which the company has at its disposal abroad is not taken into account for the determination of the taxable basis, except for the proportional part of these losses for which the company justifies that it has not been deducted from taxable profits of that establishment in the state where it is situated and that it is not credited against profits that are derived by other foreign establishments of the company and that are exempt from tax in Belgium.[17] This provision of Belgian domestic law fits with the "recapture" provision of the double tax treaties.[18]

15 Ghent 4 May 2007, TFR 332, December 2007, pp. 1036–1043.

16 Explanatory memorandum, Bill governing the modification of the Income Tax Code 1992 with respect to the Council Directive 90/434/EEC of 23 July 1990, amended by the Council Directive 2005/19/EEC of 17 February 2005, Chamber of Representatives, Session 2007–2008 doc. 52-1398/001, pp. 9–11.

17 Art. 185, §3, ITC 92.

18 Art. 22, §2(h) of the Belgian model tax convention; commentary on art. 23A OECD model, no. 44.

The same system applies with regard to the crediting of professional losses incurred in previous years in foreign establishments. The crediting against Belgian profits of previous professional losses incurred in a foreign establishment which is situated in a state with which Belgium has signed a treaty for the avoidance of double taxation can only be allowed provided that the company proves that such losses were not deducted from the profits of that foreign establishment.[19]

Furthermore, the amount of the professional losses that the company has credited against its Belgian profits with respect to any taxable period will be added to the taxable income of the period but only for the proportional part of the losses which the company, with respect to the taxable period, no longer proves has not been deducted from the profits of that foreign establishment, or when the foreign establishment concerned is transferred during the taxable period within the framework of a transfer of assets, a merger, a division or an equivalent operation. Special rules apply with regard to the recuperation of previous losses during mergers and other restructuring operations between Belgian companies and companies which are situated in other EU Member States.[20]

On the other hand, the crediting of previous professional losses incurred in foreign subsidiaries against domestic corporate profits is in principle excluded in Belgium for want of a system of fiscal consolidation.

2.4. Foreign tax credit (FTC) limitations

It should be noted that the Belgian domestic law as such does not contain any particular allocation rules or limitations with regard to the deduction of foreign tax which are based on the source of the income (geographical limitations), and nor is the tax to be deducted broken down into credit categories or in “baskets”. However, in Belgium the following limitations apply when implementing the credit method (with an indication of the problems of unrelieved double taxation which may result from it).

2.4.1. Limitation according to the nature of the income

Pursuant to article 285 ITC 92, the credit method only applies to a limited number of income categories, in particular in respect of certain miscellaneous income[21] and of income from movable property and capital.[22] As a matter of fact, the FFT only applies to certain payments of “interest” and “royalties”. Dividends are in principle excluded.

As already mentioned above, the definitions which are given to the terms “interest” and “royalties” in articles 11 and 12 of the double tax treaties do not correspond entirely with the definitions given to them in the domestic legislation to be applied under article 23 of the treaties, which in practice could lead to unrelieved double taxation.

19 Art. 206, para. 1, second subparagraph, ITC 92.
20 Art. 206, §2, ITC 92.
21 Miscellaneous income as referred to in art. 90, 5 to 7 ITC 92.
22 This term is defined in art. 17 ITC 92.

In this context attention can be drawn to the judgment of the Court of Appeal of Ghent of 6 March 2001[23] with respect to the Belgian-French double tax treaty of 1964. One of the grounds for appeal concerned the refusal by the Belgian tax administration to allow the FFT credit with respect to the 15 per cent which had been withheld by the French tax administration as a tax on the late-payment interest which a Belgian taxpayer had demanded from a French company due to late payment of its debts.

Both tax administrations agreed that the late-payment interest concerned fell under the scope of article 16 (corresponding to article 11 of the OECD model) but the director of taxes (who had decided on the disagreement in first instance) was of the opinion that, according to the Belgian domestic law in force at that time, such late-payment interest could not be regarded as "interest" according to Belgian domestic law, and that, according to the then article 187 of the ITC, the FFT could not apply.

The relevant provision of the Belgian-French treaty (article 19) stipulates that the Belgian tax on article 16 income is due on the net amount of the income after deduction of the French withholding tax, reduced on the one hand by the movable withholding tax levied at the normal rate and on the other hand by the FFT that is deductible under the conditions laid down in Belgian law; however, that FFT may not be less than 15 per cent of the above-mentioned net amount after deduction of the French withholding tax.

According to the court, treaty law prevails over domestic law and thus the tax credit provided for in article 19 of the bilateral French-Belgian treaty was directly applicable and should also be applied with respect to late-payment interest, notwithstanding the wording of article 187 ITC/old.

According to the court, article 19 thus prescribes that the FFT that is deductible under the conditions laid down in Belgian law has to be credited against income from which tax has really been withheld at source and for which such tax has effectively been paid, without any repayment of a possible surplus. However, the court could not allow the grounds for appeal since the claimant never presented proof of the effective payment of the French withholding tax on late-payment interest and did not do so during the procedure of the appeal.

Another interesting case, but with a reverse decision, is the judgment of 22 January 2010[24] of the Court of Cassation concerning the way in which, according to the provisions of article 23A(b) of the double tax treaty of 19 June 1975 between Belgium and Czechoslovakia, the FFT had to be applied to royalties as referred to in article 12 of that treaty. With that judgment the Court of Cassation also confirmed one of the restrictions of the domestic law with regard to the deduction of foreign tax.

The facts in the proceedings are as follows. A production line was leased out by a Belgian company to a Czech company. The amount of the contractually determined three-monthly payment had been subject to withholding tax by the Czech tax administration by virtue of the provisions of article 12 of the above-mentioned

[23] Not published; see commentary in *Fiscologue International* 208 of 30 April 2001, p. 6.

[24] FJF (*Fiscale Jurisprudentie–Jurisprudence fiscale*) no. 2010/159 and commentary in *Fiscologue International* 316 of 31 March 2010.

treaty. The Belgian tax administration refused to allow the crediting of the FFT against the total amount of the payments.

First, judgment was given against the Belgian tax administration by the Court of Appeal of Brussels on 12 September 2008.[25] According to that Court, Belgium, when applying and calculating the fixed proportion of foreign tax, was not allowed to repudiate the qualification of royalties as defined in the source state, on the basis of the sole argument that, in accordance with the accounting legislation, a part of the lease payment was not taken into account for the determination of the taxable profits in the corporate income tax since that part corresponded from an economic point of view to the reconstitution of the base capital and not to income in the sense of the accounting law and the ITC 92.

Furthermore, the Court of Appeal was of the opinion that the Belgian tax administration could not put forward that it had taxation rights over certain income that it qualified as royalties and subsequently qualify the income otherwise (partly as a payment for the reconstitution of the capital and partly as an interest payment) and then apply the FTC only to the part that was qualified as an interest. The Court thought that by doing so the Belgian tax administration was acting contrary to the provisions of the treaty and that the taxpayer was entitled to the crediting of the fixed proportion for the whole amount of the royalties paid.

However, the Court of Cassation has reversed the judgment of the Court of Appeal and explained this by stating that the provisions of article 23A(b) of the treaty refer to a credit as this is provided for in Belgian domestic law, including the determination of the taxable basis and the calculation of the foreign tax credit. The treaty did not alter the Belgian law on that subject.

The judgment of the Court of Cassation confirms that there is a certain loophole in the Belgian legislation with regard to the avoidance of double taxation in the case of royalties.

In many double tax treaties concluded by Belgium, article 12 attributes a limited taxation right over royalties to the source state, while the residence state conserves the primary taxation rights to prevent double taxation.

In such cases the concurrence of the treaty provisions for the avoidance of double taxation and the rules of Belgian domestic law concerning the determination of the taxable basis and the calculation of the FTC may result in unrelieved double taxation due to the asymmetry in the definition of “royalties” for which Belgian law grants the right to the FTC and of “royalties” as defined under article 12 of the tax treaties.

2.4.2. Limitations related to the taxation condition

Pursuant to the explicit provisions of the Belgian legislation (article 285 ITC 92), the crediting is only allowed if the income has been subject abroad to a tax similar to the individual income tax, the corporate income tax or the income tax on non-residents. This concerns a taxation condition which implies that the income must have been subject to effective taxation.

With respect to the crediting of the FFT, the foreign tax involved has to be effectively levied, in contrast to the principles regarding the exemption method

25 See annotation in *Fiscologue International* 305 of 30 April 2009.

where the normal approach (see below) follows the judgment in the *SIDRO* case (*exemption vaut impôt*).

Several lower courts have passed judgments which stipulate clearly that the taxpayer that wants to claim a credit of the FFT has to prove that the income was subject to a tax which was similar to individual income tax, corporate income tax or the income tax on non-residents.[26] In its already mentioned judgment of 6 March 2001 (concerning the application of the Belgian-French double tax treaty) also the Court of Appeal of Ghent decided that the crediting of the FFT could not be granted if the taxpayer did not furnish the proof of foreign taxation.

In a dispute about the application of the treaty with the USA, the same Court stated on 23 January 2007 that it resulted from a combined reading of article 285 ITC 92 and article 23 §3(b) of the double tax treaty between Belgium and the USA that a crediting of the FFT was out of the question in the absence of effectively paid withholding tax. According to the commentaries on the OECD model under no. 23/123 the income has to be taxed in the source state and has to be effectively taxed. This results from the reference to the domestic law in Belgium as well as from the explicit mention in the tax treaty with the USA (article 23 §3(b). According to the Court the proof of taxation in the source state rests with the taxpayer. The Court considers it obvious that article 285, first subparagraph ITC 92 has to be understood in a way that is consistent with article 23 §3(b) of the Belgian-US tax treaty. The Court stated that there was no proof at hand of the fact that the retained withholding tax had been transferred into the hands of the US tax administration and in addition that all activities in the USA had been stopped and the companies had ceased to exist.

The Court decided that the so-called "withholding tax" had to be assumed to have never been effectively paid, and that, notwithstanding the fact that it could not be derived from article 285 ITC 92 that the foreign withholding tax must already have been retained and transferred at the time at which the Belgian company asked for the credit, the proof of effective payment of such withholding tax would have to be established during the taxation procedure.

2.4.3. Limitation of the credit to residents of Belgium or extension to PEs of non-residents.

Can a PE of a foreign company claim the crediting of the FFT in Belgium whereas the provisions of the convention for the avoidance of double taxation in principle only apply to residents of the residence state and consequently not to PEs of residents of partner countries which are situated in that state?

In a case on which the Court of First Instance of Brussels passed judgment on 9 November 2006,[27] the following issues were under discussion:

- Is a PE in Belgium of a company which is a resident of India entitled to the crediting of the FFT, not on the basis of the provisions for the avoidance of

[26] Cf. especially the judgment of 14 January 2004 of the Court of First Instance of Ghent and the judgment of 16 October 2009 of the Court of First Instance of Antwerp respectively concerning the double tax treaty with the USA and with Italy.

[27] TFR no. 327, 2007/63.

double taxation of the Belgian-Indian convention of 26 April 1993 (because these provisions are only applicable to residents of Belgium, which, by definition, a PE is not), but on the basis of the non-discrimination rules of that same convention?

- Is that same PE entitled to the crediting of the FFT, notwithstanding the fact that the income it has derived has not been subject to withholding tax in India? Thus, the condition of effective taxation was not fulfilled but the PE felt it could claim the application of the tax sparing clause of the convention by way of the non-discrimination provision.
- In addition, the question arose of the amount of FFT that had to be included in the taxable basis (the PE was of the opinion that the amount to be grossed up was the amount that followed from domestic law and not the amount that followed from the application of the provisions of the convention).

The Court of First Instance decided that the relevant treaty regime on non-discrimination compels Belgium to allow the crediting of the FFT in the name of the PE. Also the two other questions were decided to the advantage of the taxpayer (PE).

2.4.4. Limitations with regard to the carryover and the refund of the FFT

Article 292 ITC 92 stipulates explicitly that the FFT is entirely credited against corporate income tax but that the possible surplus is not refundable. In addition, article 123 of the Royal Decree/ITC 92 provides that such crediting of the FFT against corporate income tax only occurs insofar as it relates to income that is included in the taxable basis. Thus the FFT has to be considered to be lost in the case of a company that finds itself in a loss position.

2.5. Inconsistent classification of foreign entities

The application of the provisions of the Belgian double tax treaties with respect to the avoidance of double taxation has given rise to disputes about unrelieved double taxation when entities such as particular partnerships are treated asymmetrically in the residence state and in the source state (whether or not fiscally transparent).

These problems mostly have to do with the differences in qualification resulting from the differences between the domestic law of the states involved and with the fact that Belgium treats foreign fiscally transparent entities differently, depending on whether or not they possess legal personality.

Significant on this issue is the fact that, for the taxation of the relevant income, Belgium, as the residence state, maintains the definition given to that income in Belgium and avoids double taxation according to the method (exemption or crediting of the foreign tax) which, by virtue of the convention, is applicable to income that complies with that definition.[28]

Which double taxation problems are raised in practice by this approach of the Belgian tax administration is made clear by means of an actual lawsuit and a number of decisions made by the ARO.

28 Cf. circular letter AAF no. 5/2004 of 16 January 2004 (p. 29).

2.5.1. Court cases

The recent jurisdiction which is perhaps the most remarkable in this respect is the judgment of the Court of Cassation in the following case. A resident of Belgium had derived income in France in his capacity as a partner in a French *société civile immobilière* (SCI), which was occupied with the management and letting of immovable goods in France. That company was fiscally transparent for the French tax administration and the income was taxed in France as immovable income at the level of the partners (in accordance with article 3, §§1 and 2 of the Belgian-French double tax treaty of 1964).

However, for the application of the Belgian domestic law and of the provisions to avoid double taxation of the Belgian-French double tax treaty, the Belgian tax administration, having no problem with the above-mentioned taxation rights of the French tax administration, qualified the income in question, for the application of the treaty provisions for the avoidance of double taxation, as a payment of dividends since the French SCI possessed legal personality. In the submitted case this has had the regrettable consequence that, according to the provisions of the Belgian tax law, double taxation could not be avoided (no FTC and no exemption). The outcome would have been the same if the relevant partner/resident of Belgium had been a company.

In its decision of 7 November 2002,[29] the Court of Appeal of Brussels had followed the approach of the tax administration, but on 2 December 2004[30] the Court of Cassation decided that, also for the avoidance of double taxation, Belgium had to follow the qualification of the source state France, which resulted in the application of the exemption method with regard to immovable property income derived from France and for which the taxation rights have been exclusively attributed to that state.

This decision of the Court of Cassation has been strongly contested (but not always for the same reasons) by the tax administration (see below) and by the doctrine (e.g. the comments of Caroline Docclo annexed to the above-mentioned judgment of the Court of Appeal of Liège).

Notwithstanding this judgment of the Court of Cassation, the Minister of Finance has said in his answer to a parliamentary question[31] that the income which a resident of Belgium derives as remuneration of a participation in such a French SCI is always taxable as a dividend in Belgium, no matter how the company is taxed in France. According to the Minister, such an entity is usually treated as a company in Belgium with the consequence that the partners who are residents of Belgium receive dividends which are taxable in Belgium (separate taxation without crediting of taxes paid abroad for individuals; taxation under corporate income tax for companies without application of the participation exemption regime because the foreign entity is as such not subject to a tax similar to the corporate income tax).

29 FJF no. 2003/128.
30 FJF no. 2005/179.
31 Question no. 1067 of M. Van der Maelen of 11 January 2006, Questions and replies, Chamber of Representatives, 2005–2006, no. 108, pp. 20183–20186.

In the meantime, a new development has emerged from a judgment of 11 February 2010[32] of the Court of First Instance of Brussels. Apparently, the Belgian and the French tax administrations have changed their position regarding the qualification given by treaty law to the share in the profits which is derived by the Belgian partner from the French SCI. The relevant income is no longer considered as income from immovable property for which the taxation rights belong exclusively to France according to article 3 of the Belgian-French tax treaty of 1964. Nor can it be classified as income from shares, etc., in the sense of article 15 of the treaty. It can only be classified as "other income" as referred to in article 18 of the treaty for which the taxation rights belong exclusively to Belgium. In accordance with the provisions of Belgian domestic law (article 18, subparagraph 1, 1, ICT 92) such income is treated as a dividend for tax purposes.

If both countries continue to follow this approach in the future (and there are no different decisions of judicial bodies), there will no longer be a problem of double taxation in the present case.

2.5.2. ARO

In its decision with regard to transparent entities, the ARO seems to follow the above-mentioned point of view of the Court of Cassation. However, closer analysis shows that this is not always the case.

Indeed, in a quite recent decision[33] another approach was followed on the subject of the qualification of the income that in the submitted case was derived by the Belgian partners of a limited liability partnership (LLP) which was fiscally transparent in the United Kingdom (UK). Indeed, in paragraph 30 of this decision the following is stated:

> "As a consequence, the partners of an LLP do not receive a dividend in their capacity as shareholder but they receive an income in respect of their professional activity. Thus, the income is attributed to the partners not as a recompense for capital but as a remuneration for services performed. In other words, the income is not a passive but an active income. This is fundamental in the framework of the analysis towards the qualification of the income. Moreover, this is the LLP's real hybrid character which results in the fact that the nature of the income of such partnership cannot be covered by the univocal definition of dividends under Belgian domestic law but can rather be identified as an income as defined under Article 27 ITC 92."

And the ARO concluded that in Belgium such income was covered by the participation exemption regime.

In a similar decision[34] with regard to a US limited liability company (LLC) the ARO apparently has stuck to the same approach as in the case of an LLP, yet without putting it explicitly. The ARO came to the conclusion that the LLC has legal personality according to the company law but that it is treated as fiscally transparent in

[32] Not published.
[33] No. 800,347 of 10 June 2009.
[34] No. 600,220 of 12 December 2006.

the USA. The Belgian partner is supposed to derive profits which are attributable to a PE situated in the USA, which are taxable in the USA pursuant to the provisions of article 7 of the Belgian-US tax treaty of 1970 and which Belgium, by virtue of article 23, §3 of that treaty, in principle has to exempt under the general exemption regime.

The advanced ruling no. 600.252 dated 24 October 2006 on the other hand concerned a situation that is somewhat comparable with the above-mentioned SCI case. The application aimed at explaining which tax regime applied to income derived from a US LLC and which was in the possession of an individual, resident in Belgium, whose only asset consisted of an apartment in the USA. The ARO decided that, since the US LLC possessed legal personality according to the common law in the USA but yet was fiscally transparent for US tax law, the income was qualified by the USA as immovable income for the application of the treaty so that Belgium was compelled to exempt that income. Nevertheless the ARO observed that, since Belgium recognized the legal personality of this LLC, for the purposes of domestic law the income was all the same qualified as dividend at the time it was paid. According to the ARO this dividend had to be exempted (under the participation exemption regime) according to the ad hoc provisions of the Belgian-US treaty and the commentary on article 23 of the OECD model in paragraph 32(3). The ARO thus decided that Belgium had to follow the qualification of the source state for the avoidance of double taxation (immovable income with application of the exemption method). Since the ARO put forward at the same time that the income had to be qualified as dividend for the application of Belgian domestic law, this point of view seems to be a little ambiguous.

2.5.3. Other possible obstacles

Another obstacle to the resolution of double taxation in the case of hybrid entities is linked to the fact that Chapter V of the OECD model basically only deals with juridical double taxation. Indeed, no. 1 of the commentary on articles 23A and B of that model convention states clearly: “These Articles deal with the so-called juridical double taxation where the same income or capital is taxable in the hands of the same person by more than one State.”

In some cases, the aforesaid asymmetrical approach in the source state and in the state of residence implies that the tax is levied from two or more different persons so that actually there is no question of juridical but of economic double taxation. The OECD Partnership Report does not provide in all cases for a clear solution for this problem.

2.5.4. Belgian treaty policy

As already mentioned above, the Belgian tax administration is convinced of the necessity to lay down explicit rules where necessary in the double tax treaties because the afore-mentioned problems may give rise to unrelieved double taxation, which fundamentally is contrary to the aim of double tax treaties.

In this respect and by way of example, reference can be made to the double tax treaty between Belgium and the Netherlands of 2001 in which a number of specific provisions with respect to hybrid entities are included in protocol I, nos. 2 and 4(b).

Another example can be found in the convention of 27 November 2006 between Belgium and the USA and especially in the provisions of article 1, §6, article 3, paragraph 1(c), and article 22, paragraph 1(b), of that convention and in article 4 of the law ratifying the convention. Furthermore, the explanatory memorandum that goes with the bill governing the approbation of the tax treaty contains an extensive explanation regarding the provisions which are applicable to transparent entities.[35]

A more recent example is the provision of article 22, paragraph 2(b) of the Belgian model tax convention of June 2010 (extension of the exemption method under certain conditions). This special provision to avoid double taxation provides for a tax exemption for income which, according to the Belgian law, would be considered as dividends under the above-mentioned circumstances, in the same way as exemption would be granted for the income that would have been realized through a fiscal transparent entity which did not possess legal personality and would not have been established under a similar legal form as that of a company under Belgian law. This development is in agreement with the jurisdiction of the highest judicial body and with the ad hoc rulings of the ARO. However, most Belgian double tax treaties do not contain clear provisions on this matter.

2.6. Limitations regarding the exemption

With regard to the limitations in the application of the exemption method reference is made to section 3.3 of this report where the terms “may be taxed”, “is taxed” and “is effectively taxed”, which are used in the Belgian double tax treaties, are explained in depth.

With respect to the avoidance of double taxation for dividends of foreign origin and derived by companies/residents (participation exemption regime), domestic law imposes several conditions and limits (see above) which in principle apply in the relations both with treaty countries and countries without a treaty. This report solely focuses on the so-called taxation condition which can be a possible source of unrelieved double taxation in the system concerned.

Dividends credited or payable by a company which is not subject to a foreign tax that is similar to corporate income tax or which benefits in the country where it is situated from an assessment arrangement that is notably more advantageous than in Belgium do not qualify for deduction.

A tax system is considered to be notably more advantageous when the normal corporate income tax rate or the effective tax burden is lower than 15 per cent (however, the fiscal provisions of the common law which apply to companies that are situated in Member States of the European Union are considered not to be notably more advantageous than in Belgium).

This taxation condition can obstruct the repatriation of dividends to a parent company which is a resident of Belgium also in bona fide cases (dividends paid out of profits from real economic activities but taxed at a rate that is lower than 15 per cent) and it can also bring about that such dividends are repatriated to another company of the group that is situated in a third state because such dividends are actually exempt from tax in that third state.

35 Belgian Senate, session 2006–2007, 3-2344/1, pp. 48 *et seq.*

To solve this problem, provisions were introduced in the Belgian model tax convention 2010. Inspired by certain arrangements that are laid down in the legislation of neighbouring countries such as Germany, the Netherlands, Denmark, France or the United Kingdom, these provisions, as the case may be, exempt dividends from tax, even when the taxation condition is not fulfilled, or allow the crediting of the foreign tax with Belgian corporate income tax when no exemption can be granted in any case:

- Article 22, paragraph 2(f), differs from the taxation conditions as provided for by the arrangement which was introduced by domestic law for dividends derived by a company which is a resident of Belgium. It differs as well from the taxation conditions that apply to a company paying the dividends as from the conditions that apply to the income that is used for paying the dividends. From the time the dividends arise from income generated by the active conduct of a business, they are exempted, taking into account the other conditions and limits determined by domestic law and the anti-fraud measure laid down in article 27, paragraph 3 of the same model tax convention 2010.
- When the dividends are paid to a company which is a resident of Belgium and cannot benefit from the exemption, article 22, paragraph 2(g) provides that the tax which is levied in the partner state on those dividends and on the profits out of which these dividends are paid may be credited against the Belgian tax relating to those dividends.

All this means that in the above-mentioned cases no avoidance of double taxation for dividends can be obtained as long as such provisions do not appear in the majority of the double tax treaties that are signed by Belgium.

3. Pros and cons of credit versus exemption

3.1. Complexity, sophistication and administrative burden

The Belgian system with regard to the avoidance of double taxation combines the two basic methods presented on that matter in the OECD model tax convention: the exemption from tax and the tax credit. There are large gradations as regards complexity and sophistication, not so much between these two methods but rather within each method separately.

In the field of the exemption method, the simplest form is the customary exemption system with progressiveness reserve in conformity with the double tax treaties[36] in combination with article 155 ITC 92. At the other extreme is the far more complex arrangement consisting in the exemption of foreign dividends derived by Belgian companies and which is embedded in the double tax treaties[37] in combination with the ad hoc provisions of articles 202 to 205 ITC 92 (the so-called participation exemption regime).

But also with regard to the simplest exemption system there is a tendency towards a greater complexity. This is also the consequence of the necessity to

36 Belgian model tax convention of June 2010: art. 22, paras. 2(a) and (c), second subparagraph.
37 Belgian model tax convention of June 2010: art. 22, paras. 2(d) to (f).

counter certain unwanted side effects (such as the avoidance of a double deduction of losses)[38] as well as of the interpretations given to some terms in the administration (see the subtle distinction between the terms "taxed", "taxable" and "effectively taxed").[39] This tendency towards greater complexity results also from certain developments in the field of international taxation (especially court cases concerning transparent entities).[40]

With respect to the credit method, the simplest arrangement applies to some royalties. This method consists in the crediting of the fixed proportion of foreign tax as determined in the Belgian model tax convention of June 2010,[41] especially in combination with the provisions of article 286, first subparagraph, ITC 92. Much more complicated provisions apply to interest (see the Belgian model tax convention of June 2010[42] in combination with the provisions of articles 287 to 289 ITC 92).

But also with regard to the simplest credit arrangement there is a perceptible tendency towards a greater complexity. This is the consequence of the recent introduction of a special tax arrangement for patent income (article 286, subparagraphs 2 and 3 ITC 92).

On the other hand, the Belgian taxpayer has to declare his worldwide income in his tax return, determined according to the rules of Belgian domestic law. This means that a Belgian company with a PE in a treaty country, when completing its corporate income tax return, may not simply copy the amount of the profits of the PE which can be exempted by treaty from the tax return the company has completed abroad with respect to the income of the PE. The company has to recalculate those profits, taking into consideration the provisions for the determination of the taxable basis in Belgium, which of course is an additional burden.

3.2. Sensitivity to international tax planning and tax avoidance

The sensitivity of the exemption method in the field of international tax planning and tax avoidance results partly from the fact that in a certain sense the text of the OECD model tax treaty itself contributes to a possible double exemption. Indeed, when the exemption method under the double tax treaties is inspired by the ad hoc provisions of the OECD model (cf. in particular article 23A, paragraph 1 – exemption method – and paragraph 34 of the OECD commentary on that article) this offers certain possibilities for double exemption and thus can be the subject of tax planning.

According to the last-mentioned paragraph a resident of a contracting state is actually entitled to tax exemption when his income may be taxed in the other state in accordance with the treaty provisions, whether or not such income is effectively subject to any tax in that other state.

At the beginning the Belgian tax treaties literally followed the OECD model but over the years alternative wordings have been brought into use. However, it has to be observed that the substitution of the words "may be taxed" by the term "is

38 See the Belgian model tax convention of June 2010: art. 22, para. 2(h).
39 See circular letter AOIF no. Ci.R9.Div/577.956 of 11 May 2006 and its addendum of 6 April 2010, circular letter AFZ no. 4/2010.
40 Belgian model tax convention of June 2010: art. 22, para. 2(b).
41 See art. 22, para. 2(g).
42 See *ibid.*

taxed" has not always resolved the problem of a possible double exemption, due to the fact that the Belgian administration follows the Court of Cassation in the *Sidro* judgment of 15 September 1970.[43]

Indeed, according to that judgment, the term "taxed" acquires the same meaning as it has in domestic law. This means that income is deemed to be taxed abroad in the sense of article 156 ITC 92 when it has been subject in the state from which it arises to the same tax arrangement that normally applies to such income. However, this does not mean that the income has to be effectively taxed because of the *exemption vaut impôt* principle.

It is only in the tax treaty of 13 September 2004 between Belgium and Hong Kong that the term "taxed" (article 22, paragraph 2(a) has to be interpreted in the sense of "effectively taxed" (see below) according to the definition sub-point 7(a) of the protocol to that treaty. Likewise the term "taxed in the Netherlands" as used in article 23, paragraph 1(a) of the tax treaty of 5 June 2001 between Belgium and the Netherlands has to be interpreted as in the common commentary on article 21, paragraph 1 of the double tax treaty, which also uses the term "taxed", i.e. in the sense of "effectively taxed in the Netherlands".

As a matter of fact, possible double exemption as used in this context is only avoided in some more recent tax treaties which stipulate that the exemption is only granted if the income is "effectively taxed" in the source state. Income is "effectively taxed" in the source state when such income is liable to tax thereon and does not benefit from any tax exemption in that state. Thus, income that is deemed to be "taxed" is not deemed to be "effectively taxed" when the tax arrangement that normally applies to that income according to the legislation of the source state provides for non-taxation or exemption for that income. On the other hand, income is deemed to be "effectively taxed" when it is included in the taxable basis on which the tax is calculated but no tax is effectively due in the source state as a consequence of:

- the deduction of charges and expenses borne in order to acquire or maintain such income;
- the deduction of losses;
- the granting of benefits on account of family responsibilities; or
- the granting of other tax benefits.

The above-mentioned circular letter exemplifies how this approach has to be put into practice. When, for example, profits are derived through a PE situated in the partner state, such profits are taken into account in their entirety. Thus, when a portion of the profits of the PE is exempted from tax and a portion is effectively taxed, it must be assumed that the profits of the PE are effectively taxed in their entirety.

In conclusion it should be mentioned that according to the most recent version of the Belgian model tax convention of June 2010, the exemption method is applied on profits of PEs in conformity with the *Sidro* principle, i.e. when such profits "are taxed" in the source state.

[43] Cf. Com.IB92 155/20 and the administrative circular letter AFZ no. 4/2010 dated 6 April 2010 as addendum to the circular letter AOIF no. CiR9Div/577.956 dated 11 May 2006.

3.3. Compatibility with applicable international commitments

The question of whether the Belgian methods for the avoidance of double taxation are compatible with European law will be the subject of a separate report. Here the reporter will only mention the compatibility of possible adaptations of the relevant arrangements of the domestic law with the provisions of the Belgian tax treaties and into the implications of a possible switch from the exemption method to the credit method.

To avoid double taxation for certain items of income, most double tax treaties simply refer to the methods of domestic law, inclusive of the conditions and modalities of that law (FFT for interest and royalties, participation exemption regime for inter-company dividends). In principle, adaptations of these conditions and modalities will not require a revision of treaties but can be unilaterally implemented merely through interventions in the domestic law. But it is always possible that a Belgian court may not agree that the modified domestic rules are applicable. On the other hand, things become somewhat more complicated when consideration is given to substituting the general principle of the exemption method in the Belgian tax treaties with the credit method. Therefore, a revision of the existing network of treaties seems necessary.

The judgment of the Court of Justice confirming that the switch from exemption to crediting in the case *Columbus Container Services BVBA & Co.* v. *Finanzamt Bielefeld-Innenstadt* (judgment of 6 December 2007, case C-298/05) was Europroof does not lead to a different conclusion because the Court has put clearly under no. 46 that it was not authorized to pronounce judgment on the possible infringement by a contracting Member State of the provisions of a double tax treaty in which the exemption method was laid down. As the Solicitor General mentioned under item 46 of his conclusion, the Court could not examine how a national measure such as the measure at stake in the principal proceedings related to the provisions of a treaty for the avoidance of double taxation such as a bilateral tax treaty since that question did not concern the interpretation of Community law.[44]

3.4. Impact on economic decisions

More than likely, the Belgian provisions regarding the avoidance of double taxation have a big impact on the investment locations of Belgian enterprises. When, for example, an enterprise has to choose whether a new establishment will be set up in a country without a treaty or in a country with a treaty, it has considerable fiscal consequences.

In the first case the profits of the foreign establishment are not only subject to foreign corporate income tax but also to Belgian corporate income tax (in general 33.99 per cent). In the second case the application of the exemption method in combination with the principles of the *SIDRO* judgment (see the afore-mentioned point of view of the highest Belgian judicial body) in principle limits the tax burden to the foreign tax. Moreover, when the state of residence has introduced tax incentives which totally exempt the profits of the establishment in that state, this would still result in a payment of Belgian corporate income tax in the case of a country

44 Judgment of 14 December 2000, *AMID*, C-141/99, Jurispr. I-11619, point 18.

without a treaty, whereas this results in a complete exemption of the business profits of the PE for a country with a treaty.

The exemption method is traditionally used by countries with an open economy and with domestic markets which are too small to offer appropriate expansion opportunities for their enterprises. The very long practice in Belgium confirms this theory.

In its report of 20 April 2001 of the division *Fiscalité and parafiscalité* regarding the corporate income tax reform, the High Council of Finance was of the opinion that Belgium, by opting for capital import neutrality as a general principle in the avoidance of double taxation, permitted the parent companies of its enterprise groups to benefit from the more advantageous tax rates which often apply abroad. Insofar as these foreign tax systems are more advantageous than the Belgian tax system, Belgian enterprises are actually encouraged to delocalize economic activity, especially through the setting-up of PEs in treaty countries.

In a working paper the Federal Planbureau has tried to map out the delocalization of economic activity in the case of Belgium. However, it appears from this paper of March 2008 (Trade based measures of offshoring: an overview for Belgium) that this is actually a very difficult job for lack of conclusive quantifiable data. The tendency that apparently could be perceived through indirect methods was an increasing delocalization of economic activities, mainly in the field of services, most notably business services such as call centres or accounting. However, it cannot be demonstrated whether, and if so to what extent, the delocalization is based on fiscal reasons.

Another example of a measure with economic impact is the long-standing FFT system for certain royalties. Article 286 ITC 92 provides that the FFT amounts to 15/85 of the net income concerned and this is irrespective of the tax percentage which is really applied in the source state. When, for example, only a 5 per cent tax would have been effectively paid in the source state, the FFT is equal to 15/85 and not to 5/95. In other words, in such cases Belgian domestic law provides in fact permanently for a crediting of non-levied foreign tax. This advantageous arrangement does not apply, however, in the case of patent income which in Belgium gives the right to the recently introduced special deduction for patent income and for which, as is the case for interest, only the effectively levied withholding tax is credited.

4. Future trends and conclusion

A significant development which has occurred during recent years in Belgium concerning the rules for the avoidance of double taxation is without doubt the fact that a number of specific provisions were added to the Belgian model tax convention 2010 and to the double tax treaties that were recently signed by Belgium. Those provisions should fill certain loopholes in the field of the avoidance of double taxation that were found in the Belgian tax legislation.

Reference is more specifically made to the new treaty rules for the avoidance of double taxation which are explained above and which concern on the one hand some categories of income that were derived by a resident (individual or company) through transparent entities and on the other hand dividends that were derived by a company/resident and did not qualify for the application of the participation exemption regime owing to the fact that the conditions of the domestic law were not met in this regard.

Actually stated in the Belgian provisions for the avoidance of double taxation (treaties and domestic law) there are certainly a number of situations remaining where double taxation cannot be properly eliminated. For example, reference can be made to the non-crediting of the FFT for certain “royalties” which is due to the divergence between the definitions of that term for the application of the article on royalties and of the relevant provisions for the avoidance of double taxation in the Belgian double tax treaties. It can only be hoped that the above-mentioned development will be continued and that the still remaining loopholes will be further eliminated where possible.

At a completely different level, the insertion of the new article 7 (business profits) and of article 25, §5 of the OECD model (arbitration procedure) in the new Belgian double tax treaties will in the long term also contribute to a further reduction of cases of unrelieved double taxation.