Branch Reporters
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Summary and conclusions

Belgium remains an attractive jurisdiction to base financial activities, despite the phase-out of the coordination centre tax regime. Belgian companies are entitled to a tax deduction on equity and it is relatively easy to design hybrid financing structures, for which binding advance rulings can be obtained. There are almost no thin capitalisation rules. However, some planning is required to get around withholding tax.

1. Introduction

The level and complexity of corporate finance activities in Belgium today reflects how the market has grown and matured over the past decade and a half. Corporate deals concluded in Belgium benefit from a high concentration of international firms, domestic companies and debt providers which are also active beyond Belgium's borders. Belgian companies actively export capital and are also successful in attracting funding from abroad. Belgian borrowers and finance providers are familiar with cross-border funding techniques and the accompanying tax and financial structures.

The introduction of the "notional interest deduction" in 2006, a unique and simple tax system, has had a positive impact on attracting financing activities to Belgium.

All but one of Belgium's largest banks are wholly or partly foreign owned, and creditors from France, Germany, the Netherlands and the UK are regularly involved in corporate finance, acquisition finance, real estate finance, structured deals and capital markets transactions in Belgium.

The legal and financial climate for doing business in Belgium is bolstered by Belgium's position in Europe, being both at the heart of the European Union and in the eurozone. The factors that are taken into consideration for financing structures in Belgium similarly apply to Belgium's closest European neighbours.

Debt financing is relatively attractive, given the favourable interest deductibility rules and the almost complete absence of debt–equity restrictions. On the other hand, debt financing often requires interest withholding tax planning,

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due to the growing importance of non-bank creditors (particularly in leveraged finance transactions) who are not generally entitled to a withholding tax exemption.

2. Key tax principles in Belgium

In this section, we briefly summarise the most important tax principles for cross-border interest payments made to and by corporations, focusing on new developments in the last decade.

2.1. Interest definition

Belgian tax law generally defines interest as, "interest, premiums and any other proceeds from loans, including from the granting of collateral on financial instruments, from deposits and from any other receivable".[1] Interest is the compensation borne by a borrower, for funds invested in the borrower in the form of a loan or deposit or in any other form giving rise to a receivable.[2]

The definition of interest does not include the compensation borne by the debtor in exchange for funds made available in the form of a capital contribution (whether or not described as such). An advance of funds will typically be found to be a capital contribution if the invested funds are subject to the success or failure of the debtor's enterprise (*affectio societatis*). This typically means that the investor has no capital protection, that there is no fixed repayment date and that payments are only made to the extent that the debtor has "distributable reserves".

2.2. General tax treatment of a Belgian borrower

At arm's length interest is, as a rule, deductible for tax purposes, provided that the company can demonstrate that the expenses are incurred or borne to generate or maintain taxable income.

The tax authorities require that the interest expenses are linked to the corporate purpose of a company. The fact that all income generated by a company is taxable business income, regardless of the link to the corporate purpose, does not mean that the expenses incurred or borne to generate this income will by definition be tax deductible. In addition, the borrower must have the legitimate expectation that the loan's purpose can generate an income in excess of the expected interest expense. The tax authorities require that this profit expectation is on a pre-tax basis: interest expenses linked to a transaction aimed at "destroying" the tax basis are not tax deductible ("cash drain" theory).

[1] Art. 19, §1, 1° Belgian Income Tax Code 1992 (BITC/92).

[2] Art. 17 BITC/92 requires an investment of funds as a general condition for the classification of all movable income. Belgian tax law further classifies as interest (among others) income generated by arrangements which are aimed at generating a fixed income for the investor (such as "false" swap and *repo* arrangements) – see P. Smet, *Handbook Roerende Voorheffing*, Biblio, Kalmthout, 2003, pp. 113–228.

The fact that the interest expense is linked to an investment in shares and that any future capital gain on those shares would be fully exempt does not affect its deductibility.

Thin capitalisation rules are only applicable in very specific cases.

In 2006, notional interest deduction was introduced. This is a deduction for the cost of equity, calculated by reference to the company's net assets. The deductible amount is based on the interest rate for 10-year Belgian Treasury Bonds.

2.3. Interest withholding tax

As a general rule, Belgian interest withholding tax (WHT), at a rate of 15 per cent, is due on all interest payments made by a Belgian debtor or through a Belgian intermediary.

No general domestic law exemption is available for cross-border payments. Specific exemptions can, however, apply depending on (a) the status of the creditor, (b) the status of the borrower, or (c) the nature of the debt instrument.

As recently as 2005, an important exemption was introduced for interest paid by a Belgian company to a licensed credit institution established abroad in a Member State of the European Economic Area or in a country which has entered into a tax treaty with Belgium. This exemption is available regardless of the status of the borrower.

Prior to the introduction of this exemption, Belgian borrowers could often only avoid paying WHT if they were a coordination centre, a qualifying holding company or an "intra-group bank", or if the interest generating asset was represented by a security (e.g. registered bond or debt security cleared through the X/N clearing system operated by the Belgian National Bank). These exemptions remain important if the creditor is not a licensed credit institution or if the creditor is not established in a "good" tax treaty jurisdiction. Indeed, although Belgium's new treaty policy is that no WHT is due on payment between "enterprises", only a few of the existing treaties entered into by Belgium provide for a 0 per cent WHT for interest.

The entry into force of the EC Interest and Royalty Directive on 1 January 2004 was important for Belgian borrowers because of the limited availability of domestic and treaty exemptions. This directive allows Belgian borrowers to make interest payments to EU-based "associated companies" free of WHT.

2.4. General tax treatment of a Belgian creditor

In principle, the taxable profits of a company are determined on the basis of accounting law (Belgian GAAP), subject to derogations provided in tax law. This rule is typically referred to as the "principle of precedence of accounting law".

Both from an accounting and a tax perspective, interest income received or accrued is included in the Belgian creditor's (taxable) income. The normal corporate income tax rate is 33.99 per cent. This rate applies both to Belgian companies and to Belgian non-resident companies.

The taxable interest can be offset by deductions, such as the actual interest expense borne by the creditor, the notional interest deduction (calculated on the creditor's equity) and carryforward losses. If the creditor is financed by equity,

the notional interest deduction significantly reduces the effective tax rate on interest income received by a Belgian creditor.

A foreign withholding tax credit (FTC) is generally available for non-Belgian source interest that has been subject to a non-Belgian withholding tax. The FTC is typically calculated by reference to a maximum foreign withholding tax of 15 per cent and may be further limited by applying a complex formula that relies on the debt financing ratio of the creditor.

2.5. Classification conflicts in international finance

Belgium generally has a positive attitude towards international tax arbitrage in the context of cross-border financing of Belgian companies. Belgium's policy has always been to attract financing activities to Belgium by offering these activities an attractive tax regime.

As the tax regime for coordination centres has been considered as unlawful state aid by the European Court of Justice (ECJ),[3] and as the phasing out of this tax regime would make Belgium less attractive for financing activities, Belgium introduced a new tax incentive for all Belgian companies and all Belgian establishments: the notional interest deduction (NID).

The NID regime is in fact a "structural" tax arbitrage technique. The NID generates a tax deduction for the Belgian company (to avoid discrimination between debt financing and equity financing), but does not recharacterise equity financing as debt financing. As a result, payments made to the parent company continue to be characterised as dividend distributions and are therefore often eligible for the participation exemption.

Belgium generally applies a "form-over-substance" theory to financing structures. If the Belgian company receiving the financing technically has the legal obligation to pay back the principal amount and to pay a periodic compensation regardless of the availability of distributable reserves, the financing will generally be classified as debt financing, even if the investor's economic position is similar to that of an equity investor. It is possible to obtain binding advance rulings which will confirm whether the financing is classified as debt financing and that the financing cannot be reclassified as equity pursuant to the general anti-abuse provision, regardless of the classification of the financing instrument as equity in the investor's jurisdiction. Advance rulings are issued by the Ruling Commission, created in 2005 as an independent department within the Finance Authority. The creation of the Ruling Commission, staffed by intelligent and business-oriented tax officials, has been crucial in eliminating tax uncertainty in Belgium, which had previously adversely affected investment in Belgium.

3. Deductibility of interest expense

This main section explains how the interest deduction functions from a Belgian borrower's perspective.

[3] 22 June 2006, *State Aid* C-15/02.

3.1. Interest expense versus dividend distributions

Interest expenses paid to a third party are listed as an example of tax deductible costs.[4] Interest is the compensation of a debt instrument. Certain debt instruments may show characteristics that are generally associated with equity instruments (e.g. profit participating, convertible, perpetual, subordinated, etc).

In order to determine whether an instrument is a debt or equity instrument, the instrument must first be classified by comparing the legal characteristics of the instrument or agreement giving rise to the income with the definitions of interest and dividends (see below). Even if the parties have correctly classified a financing instrument as debt financing, it should be considered whether the tax authorities can recharacterise the instrument as another type of instrument on the basis of the general anti-abuse rule.

3.1.1. Classification as debt or equity

Belgian tax law does not define the terms "loans, deposits and receivables". However, the "loan" is a Belgian civil law concept. To interpret the term "loan", one should refer to the Belgian civil law meaning.[5]

The Belgian Civil Code states that "the consumption loan is the agreement whereby a party delivers to another party a certain quantity of goods, which are consumed by their usage, against the obligation on the latter to return the same quantity of goods of same quality".[6] The essential characteristic of a loan is therefore the right to the repayment of the assets or funds delivered to the borrower.

As a result of the amendment of the definition of "interest" in 2004,[7] the definition now includes proceeds from receivables that have not been generated by a loan. On this basis, payments may qualify as interest even though the investor's receivable does not entitle the investor to the repayment of the principal amount invested with the debtor.

However, if the funds put at the disposal of a company are subject to the corporate risks of that company, the payments will not be classified as interest payments from a tax perspective, regardless of the classification given to the payments by the parties. The payments will be viewed as non-deductible dividend distributions, and the company should be able to include this financing in the NID calculation basis.[8]

Funds will typically be viewed as being subject to the corporate risks if (cumulatively, as mentioned above) there is no formal entitlement to repayment of the principal amount, there is no fixed repayment date and the repayment is only due to the extent that the debtor has "distributable reserves" within the meaning of Belgian company law.

4 Art. 52, 2° BITC/92.
5 Answer to parliamentary question no. 1427, Pieters, Chambre, 1998–1999, 22308.
6 Art. 1892 Belgian Civil Code.
7 Act of 15 December 2004 (Collateral Law).
8 The position may be different if a debt instrument is "recharacterised" under the general anti-abuse provision, as such recharacterisation does not affect the Belgian GAAP treatment which determines the basis for the NID calculation.

The following features are "as such" not sufficient to classify a financing instrument as equity financing:[9]

- Perpetual: the existence – or not – of a maturity date is not essential to its characterisation as a loan, as the Belgian Civil Code expressly recognises the perpetual loan. The debtor must, however, have the right to repay the loan at any time.[10]
- Profit-participating remuneration: the administrative guidelines expressly stipulate that a profit-participating interest payment is classified as interest.[11]
- Convertibility into shares in the debtor, including automatic conversion: the administrative guidelines analyse the conversion as an attribution (by the company to the investor) of the principal amount and unpaid interest to the investor, followed by the contribution (by the investor) of its claim (relating to the principal amount and unpaid interest) to the capital of the company in exchange for shares.[12] As the investor is formally entitled to the repayment of the principal amount, the convertible financing instrument is technically debt financing. Furthermore, the Belgian Commission for Accounting Standards has stated that automatically convertible bonds should be analysed as debt instruments until the conversion takes place.[13]
- Payment of interest "in kind", in the form of shares of the issuer: similarly to the conversion of a convertible bond, the payment in kind should be analysed as an attribution of interest (by the company to the investor) followed by a contribution of the interest claim (by the investor) to the capital of the company in exchange for shares. Therefore, the interest is technically paid.
- Subordination and thin capitalisation: the Supreme Court has ruled that funds (which were formally put at the disposal of the company in the form of the subscription of a bond) were not subject to the enterprise risk (and could therefore not be classified as equity), in a case where the bond was not secured. The company was thinly capitalised and the compensation was profit-participating.[14]

These principles have recently been confirmed in several advance rulings issued by the Belgian Ruling Commission.

3.1.1.1. (Reverse) convertible profit participating securities[15]

An important ruling deals with a subordinated profit participating bond issued by a Belgian company forming part of an international group. This ruling considered the following scenario: the Belgian company is a financing company

[9] Smet, *op. cit.*, no. 371 *et seq.*
[10] In addition, the loan is repayable if the debtor fails to meet its obligations during a certain period, does not provide the securities agreed upon or is in a state of bankruptcy. See art. 1911 *et seq.* of the Belgian Civil Code.
[11] ComIR/92, no. 19/3.
[12] Com.IR/92, no. 19/35.
[13] Recommendation 139/8, *Bull. CNC*, 1998, no. 44, 39.
[14] Cass. 11 January 1966, *Pas.* 1966, I, 611; Cass. 15 April 1969, *Pas.,* 1969, I, 721; Brussels, 13 June 2001.
[15] Ruling 600,099 (4 May 2006); A. Huyghe, *Fisc.* 1040, p. 3.

which grants high-risk loans to group companies active in emerging markets, financed by a bond subscribed by the Luxembourg parent company. The remuneration is profit-participating, and can at the option of the issuer be paid in shares of the issuer. The issuer can, at its option, repay the principal amount in cash, in shares (reverse convertible) or by transferring cancelled loan contracts at face value (which means that the bad debt risk is transferred to the subscriber). The subscriber can also opt to be repaid in shares (convertible). It seems that from a Luxembourg tax perspective the payments are classified as dividend distributions.

In the ruling in question, although the bond included several features which could have characterised it as an equity instrument, the Ruling Commission confirmed that these payments were interest payments.

3.1.1.2. (Reverse) convertible profit participating loan[16]

A similar positive ruling was issued in relation to a profit participating loan. The terms and conditions were identical to the above profit participating securities, except that the published summary of the ruling specified that interest accrued on unpaid interest and that the lender could only transfer the loan together with the issuer's shares. Although the published summary did not specify this, it seems that the payments were classified as dividends in the lender's jurisdiction. The Ruling Commission confirmed that the profit participating loan is a debt instrument.

3.1.1.3. Tier 1 securities

Both the central tax authorities and the Ruling Commission have confirmed that tier 1 financing instruments issued by Belgian financial institutions are classified as debt instruments from a Belgian tax perspective, despite being classified as capital from a regulatory perspective.

A recent transaction involved a directly issued perpetual bond which was convertible into profit-sharing certificates, with an optional interest deferral. Interest accrued on the deferred interest. Deferred interest was payable by the so-called alternative coupon satisfaction mechanism: the issuer had to increase its capital, and the proceeds of the capital increase were to be used to pay the deferred interest. If the issuer used the interest deferral option, it was not entitled to distribute dividends ("dividend stopper"). The interest rate was EURIBOR based, but the margin was stepped up after 10 years, which encouraged the issuer to redeem the bonds. The Ruling Commission confirmed that the bonds were to be classified as debt instruments until their potential conversion into profit-sharing certificates.

The relevance of tier 1 securities is not restricted to financial institutions. Corporations show an increasing interest in tier 1 securities.[17]

[16] Ruling 700,065 (5 June 2007).

[17] In this case the tier 1 treatment is assessed by the rating agencies, and not by the banking regulator.

3.1.2. Recharacterisation

Under the general anti-abuse provision, the Belgian tax authorities can disregard the legal characterisation of an act or of a series of interconnected acts (step-by-step transaction), if they can demonstrate that this characterisation has been chosen in order to avoid income tax and if the taxpayer fails to present evidence that the legal characterisation meets "legitimate needs of a financial or economic nature".[18]

The Belgian Supreme Court has recently ruled that this general anti-abuse provision can only be applied if the alternative characterisation given by the tax authorities has similar legal consequences as the original characterisation, which significantly limits the scope of this provision.[19]

In relation to the three decisions described above, the Ruling Commission confirmed each time that the general anti-abuse provision cannot be applied.

3.2. Limitation of deductible interest expense

At arm's length interest is as a rule deductible for tax purposes, provided that the company can demonstrate that the expenses were incurred or borne[20] during the taxable period with a view to generate or maintain taxable income, and provided that the existence and amount of the expenses are properly documented.[21]

3.2.1. Limitation in consideration of the purpose/use of the loan taken out

The interpretation of the requirement that the expenses must be incurred or borne with a view to generating or maintaining taxable income is frequently debated among Belgian legal scholars and in case law.[22]

In the context of transactions aimed at destroying the tax base, the Supreme Court has ruled that expenses are only deductible if these are necessarily linked to the exercise of a business activity. This is referred to as the "causal condition": the business activity of the taxpayer must be the cause of the expense. According to the Supreme Court, the fact that a company is a distinct entity created for business purposes does not mean that all its expenses can be deducted from its gross profits; expenses of a company are business expenses where they are related to

[18] Art. 344, §1 BITC/92. The tax authorities have ruled that a capital reduction without effective repayment of capital, with a view to creating interest expenses, does not meet legitimate business needs (ruling 300,297 dated 19 November 2004).

[19] Cass. 4 November 2005, *TFR* 2006, 304, 558, noot K. Spagnoli.

[20] In relation to convertible bonds and bonds with warrants, the interest expense as shown in the accounts can exceed the interest coupon (Recommendation no. 139/8, *op. cit.*). Based on the precedence of accounting law, such expense should also be deductible for tax purposes (S. Van Crombrugge, "CBN over uitgifte obligaties met inschrijvingsrecht", *Fisc.,* 1998, no. 670, p. 4; P. de Bruyne, "Obligaties terugbetaalbaar in aandelen: boekhoudkundige uitdrukking en fiscale winstbepaling", *V&F,* 1998, p. 386).

[21] Art. 49 BITC/92.

[22] See M. Van Keirsbilck, "Artikel 49 WIB 1992: een nieuwe algemene anti-misbruikbepaling?", TFR, 2004, 257, pp. 223–243.

the exercise of the business, i.e. where they are linked necessarily to the corporate purpose.[23]

Many legal scholars find it very difficult to agree with this interpretation,[24] as in bona fide transactions this leads to an unfair result. For example, an industrial company making a (debt-financed) real estate investment which is entirely unrelated to its business, would be taxed on the income generated by this investment, but would not be entitled to deduct the interest expenses, leading in effect to taxation of its gross profits.

Even if a transaction falls within the company's corporate purpose, the interest expense will nevertheless only be tax deductible if the company has the intention of generating a positive return (the "intentional condition").[25] It is irrelevant whether the effective return exceeds the interest expenses at the end of the investment, as long as the company has a legitimate expectation that a positive return can be generated.[26] According to the tax authorities, the return must be pre-tax positive. On this basis, the tax authorities aim to disallow interest deductions on closed-end transactions without a pre-tax business purpose (the so-called "cash drain" transactions).[27]

It is generally accepted[28] that the interest expense linked to a bona fide investment generating an exempt income or capital gain (such as an investment in shares) is tax deductible as the exempt income is included in the accounting profits and is therefore pre-tax positive.

The tax authorities have not issued any guidance on the tax deductibility of interest incurred by the borrower (in debt push-down situations) to distribute dividends, redeem its own shares or reduce its share capital.[29]

3.2.2. Limitation in consideration of the status of the creditor

Specific deductibility limitations apply in the following cases.

3.2.2.1. Interest paid to same legal entity: non-event

The traditional position is that payments made to a creditor forming part of the same legal entity (head office – branch), cannot be deductible, as the "loan" concept assumes two different legal entities.[30]

[23] Cass, 18 January 2001, F.99.0114.F/1; Cass. 19 June 2003, F.01.0066.F/1; Cass. 12 December 2003.

[24] *Inter alia* J. Kirkpatrick and D. Garabedian, *Le régime fiscal des sociétés en Belgique*, Brussels, Bruylant, 2003, p. 165.

[25] This is also debated, e.g. Tr. Brussels, 17 November 2004, TFR 2005/14, and comment by M. Van Keirsbilck.

[26] This condition is not met in relation to an intra-group acquisition and sale of shares if the sales price is pre-arranged at the time of the acquisition and the capital gain does not exceed the interest expense (Brussels, 10 November 2005, *Fisconet* B05/7).

[27] ComIR/92, no. 192/29. Contra Tr. Brussels, 26 June 2003, FJF, 2005/134 (in relation to FTC transactions).

[28] Apart from an isolated lower court case (Tr. Bruges, 25 February 2003, FJF, 2003/250).

[29] The above-mentioned ruling relating to a capital reduction without effective repayment of capital, with a view to creating interest expenses, was limited to the issue of legitimate business needs for the classification of the transaction as a capital reduction (ruling 300,297 dated 19 November 2004).

[30] Other rules apply to financial institutions.

3.2.2.2. Interest paid to non-resident corporate directors: classification as dividend

Interest paid by a Belgian company on advances granted by a non-resident corporate creditor are classified as (non-deductible) dividend distributions insofar as (a) the total advances exceed the borrower's paid up capital at the end of the year and the taxed reserves at the beginning of the year (i.e. 1:1 debt/equity ratio), or (b) the interest exceeds the arm's length level taking into account the risk of the operation. The dividend classification relates to the interest on the excess amount (in case the debt/equity ratio is exceeded) and on the excess interest (in case the arm's length level is exceeded), but only when the foreign company creditor exercises the role of director, manager, liquidator or a similar function for the borrower.[31]

As this rule does not apply to advances made by Belgian companies exercising the role of a director (or similar) for the borrower, it is hard to see how this rule can be compatible with the EC Treaty, in the case where the creditor is established in the EU. A reference for a preliminary ruling has recently been lodged with the ECJ on this point.[32]

3.2.2.3. Interest paid to low-tax beneficiaries: reversal of burden of proof

If interest is directly or indirectly paid to a non-Belgian creditor who in respect of this interest (a) is not subject to income tax in its home jurisdiction or (b) enjoys a tax regime that is substantially more beneficial than the Belgian tax regime, the borrower has the burden of proof in relation to the financing being both at arm's length and a bona fide business transaction (article 54 BITC/92).

The tax authorities must demonstrate that the beneficiary enjoys a significantly more favourable tax regime. The mere statement by the tax authorities that a certain jurisdiction is a tax haven (in this particular case, Liechtenstein) is not sufficient.[33]

If the beneficiary is established in the EU, it can be argued that this reversal of the burden of proof is not in line with the freedom of establishment as set out in the EC Treaty.

3.2.2.4. Interest paid to low-tax beneficiaries: non-deductibility

Interest on borrowings will be disallowed if the beneficial owner of this interest is (a) not subject to an income tax regime or (b) if this interest is subject to a tax regime that is substantially more beneficial than the Belgian common law regime, to the extent that the total amount of borrowings granted by such low-tax lenders, other than publicly issued bonds and similar securities, exceed a debt-to-equity ratio of 7:1 (equity meaning the sum of taxed reserves at the beginning

[31] Art. 18, 4° BITC/92; Smet, *op. cit.*, pp. 127–132.
[32] Lodged by Tr. Antwerp on 22 February 2007 (Case C-105/07).
[33] Tr. Brussels, 26 January 2005, *Fisconet* B1 05/2.

of the taxable period and paid-up capital at the end of that taxable period) (article 198, 11° BITC/92).

3.2.3. Limitations in consideration of specific contractual terms

3.2.3.1. Excess interest

The entire compensation paid or borne by the borrower, is as a rule tax deductible.

Interest paid in excess of an arm's length level will normally not pass the general tax deductibility test.[34] In addition, interest expenses will be specifically disallowed to the extent they exceed the market rate, taking into account the specific circumstances necessary to assess the risk of the operation, including the financial position of the borrower and the duration of the loan.[35] This specific restriction does not apply to interest on receivables which do not represent a loan.[36]

3.2.3.2. WHT borne by borrower

The Belgian interest WHT borne by the borrower is not deductible for Belgian corporate tax purposes.[37] Gross-up clauses inserted into syndicated credit agreements generally provide for an increase of the interest rate in case of a WHT but they do not, as such, contain a commitment to pay net interest. Therefore, the deduction relating to the full amount of the interest should not be affected.

3.2.3.3. Foreign currency

If interest is paid in a foreign currency, the amount is converted to euro at the exchange rate applicable when the payment or attribution is made.[38] However, if the borrower is entitled to draft its accounts in a foreign currency (functional currency), the foreign currency accounting profit will be converted to euro at the exchange rate applicable either on the last day of the accounting period or the annual average reference exchange rate.[39]

3.3. Thin capitalisation rules

Belgian tax law contains no general thin capitalisation rules, except in limited circumstances where a combination of the debt/equity ratio and the status of the creditor can lead to an interest expense being disallowed (see above).

[34] In addition, expenses are not deductible if these exceed the professional needs in an unreasonable manner (art. 52, 10° BITC/92).

[35] Art. 55 BITC/92.

[36] Interest is considered to be at arm's length if it is paid to Belgian financial institutions (or equivalent), as well as in relation to publicly issued bonds or similar securities (art. 56 BITC/92). This restriction to only Belgian financial institutions is unlikely to be compatible with EC principles.

[37] Art. 198, 1° BITC/92.

[38] Art. 17, §2 BITC/92.

[39] ComIR/92, 183/8; ruling 700,251 dated 10 July 2007.

3.4. Documentation and procedural requirements

For the deduction of interest no specific permission or advance ruling is required. However, the taxpayer bears the burden of proof in showing that all conditions allowing interest to be deducted have been fulfilled.

The existence and amount of the interest must be evidenced by supporting documentation, or if this documentation is not available, by any other evidential method admitted under common law, except under oath. Expenses must in any case be recorded in the books of the taxpayer for the relevant financial year (see below for more details concerning the timing of the deduction).

Evidence that the interest relates to a bona fide business transaction also requires supporting documentation. In practice, supporting documentation does not need to be filed with the tax authorities (except for the financial statements that must be annexed to the tax return) and will only have to be provided to the tax authorities at their request (e.g. request for information, tax audit) or in the case that the deduction is challenged by them.

3.5. Timing of the deduction

From an accounting perspective, liabilities relating to the financial year (or to previous financial years) must be recorded in the accounts, regardless of their actual payment.[40] Liabilities must be connected to the financial year in which they become "certain and liquid", i.e. where their existence is certain and their amount is known. Contingent or conditional liabilities are not "certain and liquid".[41]

Expenses are deductible during a taxable period if they have been incurred or borne by the taxpayer during that taxable period. Expenses are deemed to have been incurred or borne during a taxable period if they were either actually paid or borne during that period or became "certain and liquid" and were recorded as such.

This provision seems to give the taxpayer the choice of deciding when the deduction should take place (creation of the liability or payment). However, according to the Minister of Finance, expenses which become "certain and liquid" during a taxable period but which are not recorded as such cannot be deducted during the taxable period of the payment if they relate to the previous taxable year.[42] This position is in line with the accounting obligation to record the liabilities in the financial year in which they become "certain and liquid".[43]

3.6. Effective taxation of interest income

Belgian tax law does not specifically link the borrower's ability to deduct interest to the effective taxation of the interest income in the hands of the

40 Art. 33, para. 2 RD implementing Company Code.
41 ComIR/92, no. 49/08.
42 Q&R, Senate, no. 1-81, 8 September 1998, p. 4275.
43 This absence of choice on the timing of the deduction has also been confirmed by the Ghent Court of Appeal (5 October 2004, TFR, 2005, 279, p. 341 and comment by I. Van de Woesteyne).

creditor (see also the unilateral excess profit rulings), but there are specific anti-abuse provisions in case the creditor enjoys a significantly more favourable tax regime in relation to interest (see articles 54 and 198, 11° BITC/92 discussed above).

If the creditor is not taxed on the interest because the financing instrument is characterised as an equity instrument (cf. hybrids), the mere fact that the creditor is subject to a normal tax regime in its home jurisdiction is unlikely to put it outside the scope of these articles.[44]

3.7. Notional interest deduction

If a financing instrument cannot be classified as a debt instrument, it will be classified as an equity instrument. The remuneration of an equity instrument is a dividend. Dividends are not tax deductible. However, since 2006 a tax deduction is available for the equity financing, regardless of dividends being paid (NID).[45] The deduction is calculated according to the 10-year Belgian Treasury bond rate (OLO rate), applied to the company's net assets.

Officially, the NID was introduced to eliminate the unequal treatment of equity financing compared to debt financing. The NID was introduced when the favourable tax regime for the Belgian coordination centres regime was considered illegal state aid and had to be phased out (the licences of the coordination centres expire between 31 December 2005 and 31 December 2010). The Belgian government had initially proposed a new coordination centre regime (CC-bis), but restrictions imposed by the European Commission resulted in this tax regime becoming unattractive.

To reduce the risk of multinationals transferring their financing activities abroad, and to attract new investments, the Belgian legislator opted for a simple tax incentive that applies to all Belgian companies (and to Belgian branches of non-Belgian companies), regardless of their activities. The fact that the new deduction is part of the normal Belgian corporate income tax rules eliminates concerns that this deduction could be classified as state aid.

3.7.1. NID calculation basis

The deductible amount is based on the interest rate for 10-year Belgian state bonds (OLO rate), calculated by reference to the company's net assets.

44 In the ruling discussed above, relating to the (reverse) convertible profit-participating securities, the borrower stated that it did not need to comply with the 7:1 debt/equity ratio (set out in art. 198, 11° BITC/92), on the basis that the Luxembourg subscriber for the securities was subject to the normal tax regime in Luxembourg. The ruling was silent on whether the Ruling Commission agreed that the application of a normal tax regime is sufficient if this normal regime leads to a classification difference, which is an indication that the Ruling Commission did not agree. In a more recent ruling relating to a (reverse) convertible profit-participating loan, the Ruling Commission did confirm that art. 198, 11° BITC/92 was not applicable, but this is probably because the borrower had complied with the 7:1 debt/equity ratio.

45 Arts. 205bis to 205novies BITC/92 as introduced by the Act of 22 June 2005. See also A. Huyghe and G. Bombeke, "Het jaar van de Notionele Intrest", TFR, 2005, 292, p. 975 ; P.-P. Hendrickx, "Intérêts notionnels et déduction fiscales pour capital à risque", CFP, 2005, n. 10, p. 345.

For Belgian companies, the deduction is calculated on the net assets as reflected in the annual accounts (established in accordance with Belgian GAAP) for the preceding accounting year. Changes in the assets during the accounting year are taken into account on a pro rata basis (weighted average).

The amount of these net assets is reduced by certain disqualifying assets. The most relevant exclusion relates to equity investments which generate dividends eligible for the participation exemption (to avoid the simultaneous application of the participation exemption and the NID). Other exclusions relate among others, to non-Belgian assets whose income is exempt from taxation in Belgium, and assets which are not normally held by a commercial company.

For non-Belgian companies, similar rules apply in relation to their permanent establishments in Belgium, and in relation to Belgian real estate and real estate rights. As the NID is calculated on the basis of the data reflected in the annual accounts, non-Belgian companies will need to draw up annual accounts on a voluntary basis if they are not already obliged to do so pursuant to Belgian accounting law.

3.7.2. Reference interest rate

For the accounting year 2007 (assessment year 2008), the reference rate is 3.781 per cent. For subsequent accounting years, the reference rate will be the average OLO rate as at 31 December of the preceding year.[46] However, the new rate cannot differ by more than 1 per cent from the previous rate and may not exceed 6.5 per cent. The government can decide to ignore this restriction, in which case another reference rate will apply, which may not exceed the OLO rate. For small companies, the rate is increased by 0.50 per cent.

3.7.3. Carryforward

If the company has no profits or has insufficient profits to deduct the full amount of the NID, a carryforward is available for seven years. If there is a change of control in the company which cannot be justified by legitimate financial or economic reasons, the NID that has already been carried forward can no longer be used. The NID deduction cannot be offset against profits generated by an "abnormal or gratuitous advantage" received by the Belgian company.[47]

3.7.4. Waiver of NID benefit

As a highly capitalised Belgian company may enjoy a very low effective tax rate, it can be caught by controlled foreign company (CFC) legislation or other anti-

[46] A pro rata rule applies for companies with an accounting year longer or shorter than 12 months.

[47] A similar anti-abuse provision applies to other tax elements such as tax losses. The Supreme Court refused on this basis the set-off of carryforward losses by a shell company to which real estate was contributed (with a view to offsetting the income generated by the real estate against these losses), even though the capital contribution was properly remunerated by the issue of new shares (Cass. 29 April 2005, www.cass.be).

abuse provisions in the parent company's jurisdiction.[48] The NID benefit can be waived to prevent the parent company from suffering adverse tax consequences.[49]

4. Withholding tax on cross-border interest income

Belgian WHT rules are extremely complex. Given the scope of this report, only the general rules will be discussed.

Belgian interest WHT (at a rate of 15 per cent) is due on all interest payments made by a Belgian borrower (or through a Belgian intermediary) to a non-Belgian lender. The WHT is levied at source by the borrower. The WHT is the final Belgian income tax liability for a non-Belgian lender who has not allocated the interest-generating assets to a Belgian establishment.

4.1. Definition of interest income

For WHT purposes, the definition of interest set out above is applicable. This means that WHT is due on the compensation borne by a borrower, for funds invested in the borrower in the form of a loan or deposit or in any other form giving rise to a receivable. Late payment interest and interest awarded by the courts are not subject to WHT, as they do not relate to the investment of funds but merely compensate damage.[50] Also, periodic payments to the guarantor of credit are not classified as interest income because the guarantor has not invested any funds.[51]

WHT is due on the amount of interest that is paid or attributed, including "excess" interest. If interest is paid "in kind", e.g. in the form of shares in the borrower, WHT is calculated on the fair market value of the payment in kind. Foreign currency payments are converted to euro based on the exchange rate at the date of payment or attribution.

4.2. WHT exemptions

No general domestic law exemption is available for cross-border payments.

4.2.1. Exemptions – generalities

Belgian domestic law contains various specific WHT exemptions in respect of cross-border interest. These exemptions are generally subject to the following principles:

[48] Based on the ECJ ruling in the *Cadbury Schweppes* case (C-196/04 18 November 2006), EU Member States would normally not be able to apply CFC legislation in relation to Belgian companies, assuming that the exercise of finance activities in Belgium cannot be viewed as a "wholly artificial arrangement".

[49] Ruling 700,306 dated 26 July 2007. The question whether such decision is within the corporate interest of the Belgian company falls outside the scope of the report.

[50] ComIR/92, no. 17/1.1.

[51] Cass. 3 February 1959, *Pas.*, 1959, I, p. 565.

- Exemptions generally depend on (a) the nature of the interest-generating assets as Belgian tax law differentiates on the one hand between interest paid on negotiable instruments such as bonds and on the other, interest on mere receivables not incorporated into a title,[52] and (b) the identity and the nature of either the lender or the borrower.
- Although in most cases, WHT exemptions are not subject to a formal "beneficial ownership" condition, exemptions are only applicable if the recipient of the income is also the "beneficiary" (and not an agent or intermediary acting on behalf of the real beneficiary).
- An exemption, where available, is often subject to formalities. In many cases, the borrower (or the paying agent) must be provided with an affidavit certifying that the conditions for the exemption have been met.

4.2.2. Certain domestic exemptions

Exemptions usually differ for interest paid on "mere receivables" and interest paid on bonds (and other similar securities). Some exemptions apply to both:

- Interest on receivables is exempt if it is paid to a licensed credit institution established in an EEA Member State or in a tax treaty jurisdiction.[53] This important exemption was only introduced as recently as 2005[54] and is available regardless of the status of the borrower.
- Interest on receivables and non-capitalisation securities are exempt if paid by "intra-group banks" and qualifying listed holding companies (including qualifying holding companies controlled by listed companies), regardless of the status of the lender.[55]
- Interest paid on registered non-capitalisation bonds and on securities cleared through the X/N clearing system (managed by the National Bank of Belgium) are generally exempt if the investor is a non-resident. In relation to registered bonds, the lender must hold the bonds during the entire interest period, which restricts liquidity. This condition does not apply to X/N securities.

4.2.3. Treaty exemptions

Belgium has recently published its "standard" tax treaty. This standard tax treaty provides for a WHT exemption on interest paid on a loan granted or a grant of credit by a Belgian "enterprise" to an "enterprise" in another contracting state. This is a recent development, as only a few of Belgium's existing treaties include this kind of exemption,[56] the most relevant being the treaties with Luxembourg, the Netherlands and Germany. The new treaty between Belgium and the United

[52] These receivables can be defined as inter-personal receivables, the beneficiary of which can be identified by the applicable rules.

[53] If the credit institution lends through a branch, the requirement relating to the place of establishment applies to the branch only.

[54] Applicable with retrospective effect to payments made since 5 June 2003.

[55] For details relating to these exemptions see P. Smet, "New withholding tax exemptions for lending into Belgium", *International Banking and Financial Law,* October 2003, p. 360.

[56] The treaty rate is often 15 per cent or 10 per cent.

States (which has not yet entered into force at the time of the drafting of this report – October 2007) also provides for a general WHT exemption.

4.2.4. EU-based exemptions

The entry into force of the EC Council Directive 2003/49 (Interest and Royalty Directive) on 1 January 2004 was important for Belgian borrowers because of the limited availability of domestic and treaty exemptions. This directive allows Belgian borrowers to make interest payments to EU based "associated companies" free of withholding tax.

Belgium has opted for a broader definition of "associated companies" than is set out in the Directive, as payments made between indirectly owned companies are also exempt.

4.3. Back-to-back arrangements – beneficial ownership

The interpretation of the term "beneficiary" (and the related concept "beneficial ownership") is unclear. Belgian legal scholars generally tend to apply a formal legal interpretation and not an economic interpretation. This is supported by the Belgian tax authorities' traditional view that the entitlement to WHT exemptions or reductions must be assessed at the level of the person who is the legal owner (or "usufructuary") of the income generating assets. Based on this formal legal interpretation, the lender is the beneficiary of the interest payments if it is legally entitled to the interest payments. Under Belgian civil law, the legal owner must have the *fructus, usus* and *abusus* (the entitlement to the income and the right to use and misuse the income and the income generating assets). It follows, that a formal lender receiving income as agent or nominee, or in the context of a fiduciary arrangement, will not be viewed as the beneficiary.

Commenting on the new Belgium–Hong Kong tax treaty, the Belgian Minister of Finance recently took the view that the beneficial ownership test for shares was met if the holder of the shares was also the legal owner of those shares. This test would not be met if a person was intervening merely as a representative or agent on behalf of the legal owner. The general anti-abuse provision is not relevant in this context. This position is also confirmed by several recent tax rulings[57] and by case law.[58]

However, this position may not be automatically applicable to debt financing, especially if the intermediary's receivable is not represented by a security. An (unpublished) ruling issued mid-2006 states that the general anti-abuse provision cannot be applied to a specific back-to-back arrangement because of the presence of legitimate business needs in the specific case, but suggests that this arrangement can in principle be recharacterised as a direct financing granted by the ultimate lenders to the Belgian borrower. However, since then, the Brussels Court of First Instance ruled (in relation to an equity investment) that the general anti-abuse provision only allows for the recharacterisation of the (tax-driven) legal

[57] *Inter alia* rulings 600,478 (21 November 2006), 700,053 (17 April 2007) and 700,324 (11 September 2007).

[58] It is being challenged by the Special Tax Inspectorate.

qualification given to it by the tax payer (for one or more legal transactions), which excludes amending the parties.[59]

4.4 Unequal WHT treatment

There are no reported court cases dealing with the unequal WHT treatment of foreign lenders as opposed to domestic lenders, except for a reference to the ECJ for a preliminary ruling on the recharacterisation of interest paid to a non-Belgian lender who exercises a mandate as director, as a dividend.

Foreign lenders could argue that there is an unequal WHT treatment between loans granted on the one hand to coordination centres, qualifying listed holding companies and intra-group banks, and on the other, to other Belgian companies, for which no reasonable justification seems to be available.

5. Belgian tax treatment of creditors

5.1. Taxable interest versus exempt dividends

Interest income is fully taxable. Dividends received by a Belgian company may be eligible for the participation exemption (a 95 per cent exemption) if certain conditions are met.[60]

Belgium does not follow the source country's classification. Therefore, a Belgian company may be able to claim dividend treatment where (cumulatively) (a) its investment is formally an equity investment (e.g. preferred shares), (b) it is not legally entitled to a repayment of the principal amount and (c) payments must only be made if the distributing company has reserves, regardless of whether the distributing company is entitled to deduct the payments because its investment is classified as a debt instrument under its national legislation.

The distributing company must, however, be subject to a normal tax regime (by Belgian standards). The mere fact that the distributing company's national legislation classifies the investment as debt financing for local tax purposes, does not take the distributing company out of the normal tax regime.

The tax authorities may seek to recharacterise a formal equity investment as a debt investment, provided that the alternative characterisation has similar legal consequences.

5.2. Interest amount

If the income is not classified as a dividend, the income will in principle be taxable, regardless of the tax status of the borrower or the nature of the debt financing. Specific rules apply in the following cases.

[59] Tr. Brussels, 1 September 2006.

[60] Generally, the dividend-generating assets must be held in full ownership for at least one year, and booked as financial fixed assets (under Belgian GAAP). The dividend-generating assets must represent at least 10 per cent of the distributing company's equity or must have an acquisition value of at least 1.2 million euro (art. 202, §2 BITC/92).

5.2.1. Interest rate below market rate

If a Belgian creditor grants a loan at an interest rate below the market rate to a related borrower or to a low-tax borrower, the difference between the effective interest and the interest that should have been charged between unrelated parties is added to the creditor's tax base, provided that the tax authorities demonstrate that the applied interest rate constitutes an "abnormal or gratuitous advantage".[61]

5.2.2. Creditor and borrower belonging to same legal entity

If the borrower belongs to the same legal entity as the creditor, no loan can legally be granted. This does not affect the taxation of the payment (as the payment is included in the company's accounting profits), unless the loan has been granted to an entity, established in a tax treaty jurisdiction, that is transparent from a Belgian tax perspective. In that case, it may be possible that from a Belgian tax perspective, the payment is classified as foreign-source income which is exempt from tax in Belgium, on the basis that only the source country is entitled to tax this income.

5.2.3. CFC legislation

Strictly speaking, Belgium has no CFC legislation. However, the Belgian tax authorities can disregard the transfer of assets (including cash and interest-generating assets) to a low-taxed non-Belgian entity, unless the company can demonstrate (a) that it has received, in exchange for the transfer, a remuneration which generates income bearing a normal tax burden in Belgium (as compared to the tax burden if no transfer had taken place), or (b) that the transfer meets legitimate business needs.[62] Based on this anti-abuse provision, a Belgian company may be taxed on interest income received by a low-taxed entity, even if this income has not been distributed to the Belgian company.

5.3. FTC

An FTC is in principle available to non-Belgian WHT on foreign-source interest.[63]

The FTC is subject to anti-channelling rules (no FTC is available if the Belgian creditor is acting for the account of a third party who has put the necessary funds at the disposal of the Belgian creditor) and anti-stripping rules (FTC is available pro rata for the period over which the interest-generating assets are actually held by the Belgian creditor). In addition, the Belgian creditor must comply with complex debt-financing ratio requirements (these are aimed at restricting the FTC to the Belgian tax on the foreign interest income). Furthermore, the FTC is calculated by reference to the effective WHT, but capped at 15

[61] Art. 26 BITC/92. An upwards profit adjustment in case of a transaction that is not on arm's length terms is also possible based on art. 185, §2, but only between two companies belonging to a multinational group.

[62] Art. 344, §2 BITC/92.

[63] See Smet, *op. cit.*, pp. 449 –465. Arts. 285 *et seq*. BITC/92.

per cent. This means that no full credit is available if the effective WHT exceeds 15 per cent.[64]

The above restrictions on the FTC do not take into account Belgium's treaty obligations. Most tax treaties entered into by Belgium simply refer to the rules and limitations set out in Belgian domestic law for the calculation of the FTC. However, other tax treaties deviate from these principles and impose either (a) a minimum credit, or (b) a fixed credit even if no withholding tax is levied in the other contracting state ("tax sparing"), or (c) a credit corresponding to the credit available under the Belgian domestic regime at the time of signature of the treaty, taking into account the amendments to the FTC regime that did not alter its principle.

5.4. Timing of inclusion in (taxable) profits

All proceeds relating to the financial year must be recorded in the profit and loss statement, regardless of the date of payment, unless the actual payment of these proceeds is uncertain. This establishes an obligation to record income as soon as it becomes "certain and liquid".[65] Interest accrued on a receivable during a financial year must therefore be recorded in the books for that financial year.

Based on the precedence of accounting law, the interest income recorded in the books will be included in the company's taxable base as soon as it becomes "certain and liquid".[66]

5.5. NID

The normal corporate income tax rate is 33.99 per cent. However, if the creditor is financed by equity, the NID significantly reduces the effective tax rate on interest income.

Assume a Belgian company grants a loan of 100 to a non-Belgian group company, at an arm's length interest rate of 5 per cent. The Belgian company is financed by 80 equity and 20 debt (at an arm's length interest rate of 4.875 per cent). The accounting profit is 5 – 0.975 = 4.025. The taxable profit is 4.025 – 3.025[67] = 1. The tax due is 1 × 33.99 per cent = 0.3399. The effective tax rate is therefore 8.44 per cent.

6. International tax arbitrage

6.1. Belgium's attitude to tax arbitrage

Belgium's policy has always been to attract financing activities to Belgium through an attractive tax regime, initially through the coordination centre regime,

[64] The FTC is first added to the Belgian creditor's tax base, as a disallowed expense, and is then credited against the Belgian corporate income tax liability. If the FTC exceeds this tax liability, no refund is available.

[65] The certain and liquid character of income must be determined in the same way as for liabilities.

[66] This is also confirmed by art. 362bis BITC/92.

[67] Based on the NID reference rate for income year 2007 (3.781 per cent).

and more recently through the NID. These tax regimes can lead to a double dip situation.

Furthermore, it is relatively easy to design hybrid financing instruments for Belgian borrowers based on the Belgian "form-over-substance" approach, if the financing transaction has an economic justification. It is possible to obtain advance rulings in this respect.

On the other hand, tax arbitrage transactions lacking business motives have been pursued aggressively by the tax authorities "in the field", based on (a) sham, or (b) on the general anti-abuse provision, or (c) on the "cash drain" theory.

6.2. Typical tax planning techniques

6.2.1. "Structural" tax arbitrage: NID techniques

The NID is in fact a "structural" tax arbitrage technique. The NID generates a tax deduction for the Belgian company (to avoid discrimination between debt financing and equity financing), but does not recharacterise equity financing as debt financing. As a result, the "compensation" for the equity financing paid to the parent company continues to be characterised as a dividend, and is therefore often eligible for the participation exemption. The parent company may even be entitled to deduct the interest expense on the financing of the capital increase of the Belgian company.

The Minister of Finance has stated that an NID structure is only acceptable to the tax authorities if the structure has an economic justification. This is in line with the level playing field agreed with the Belgian Banking Association, stipulating that the banks will not grant financing for structures that are only aimed at creating or increasing the NID.

The tax authorities have, however, not yet issued guidelines setting out on what basis NID structures lacking business justification could be challenged.[68] However the following factors may be relevant:

- Where a capital contribution is made to a Belgian company by a Belgian parent company which finances this capital contribution through debt financing, the Belgian tax authorities may try to disallow the interest expense based on the "cash drain" theory, in case the Belgian parent company does not have a realistic expectation that the return (in the form of dividends and capital gain) can exceed the interest expense.
- The application of the general anti-abuse provision assumes that the legal classification ("capital contribution") can be replaced by another legal classification having the same (or at least similar) legal consequences as a capital contribution, which is extremely unlikely. The alternative classification must be able to explain that the company receiving the capital contribution can use the proceeds as it sees fit, and is under no obligation to repay the contributed funds except following a decision at the shareholders' meeting to reduce the capital, in accordance with Belgian company law.

[68] See H. Vanhulle, "Minister bevestigt duurzaamheid van notionele interestaftrek maar viseert mogelijke misbruiken", *Fisc. Act.*, 2006, no. 15.

- A Belgian company cannot offset NID (and *inter alia* tax losses) against profits generated by an abnormal or gratuitous advantage granted to it (including where this advantage has been granted by a non-Belgian company). Many advance rulings confirm that the capital contribution to a Belgian finance company is not an abnormal or gratuitous advantage, provided that there is an economic justification for the creation of such finance company.[69] Taking into account these advance rulings, it can be expected that the tax authorities will try to challenge the availability of NID if the capital contribution is part of a "wholly artificial arrangement".
- Sham can be applied if the parties have not accepted all legal consequences of the chosen transaction, which means, in the case of a capital contribution, that the company receiving the capital contribution must be able to use the proceeds as it sees fit. The tax authorities typically try to apply the sham theory in relation to circular transactions.

6.2.2. Double dip through hybrid financing

The tax deduction generated by the NID is based on the 10-year Belgian Treasury bond rate. If the interest earned by the Belgian company is not significantly higher than this rate, the effective tax rate will be low. However, the NID regime leads to a less attractive result if the Belgian company earns interest at a higher interest rate. Therefore, hybrid financing structures may still be required to achieve a competitive end result.

Rulings relating to (reverse) convertible profit-participating instruments, involving a Luxembourg creditor who could claim equity treatment, have been discussed above. The ruling relating to the profit-participating securities was criticised by a member of an opposition party, who claimed that the Ruling Commission should not issue positive tax rulings in relation to international tax arbitrage structures and that the Ruling Commission should have reclassified the profit-participating securities as profit-sharing certificates. The Minister of Finance replied that the Belgian tax legislation does not allow for this reclassification of profit-participating securities, and that hybrid structures and classification differences under national laws can lead to tax optimisation.[70]

Similar structures are possible in case the creditor is, e.g. a US parent company.

6.2.3. Double dip through permanent establishment structures

A popular double dip structure involved Belgian investments being made through a Belgian permanent establishment of a Luxembourg company, which was itself financed by a loan granted by the Luxembourg parent company. Interest payments are deductible from the operational profits of the Belgian permanent establishment, under normal conditions. Under the Luxembourg fiscal unity rules in force until 2002, the loan was disregarded, resulting in the exempt

[69] *Inter alia* rulings 600,167 (3 October 2006), 700,282 (21 August 2007) and 700,032 (7 August 2007).

[70] Interpellation M. Devlies no. 1064 of 20 March 2007.

income generated by the Belgian permanent establishment being calculated on a gross basis (i.e. without deducting the interest expense).

6.2.4. Double dip through use of hybrid entities

The issue of double non-taxation through the use of hybrid entities/partnerships is well known to the OECD.[71] If a Belgian company is a partner of a partnership established in another tax treaty jurisdiction and grants a loan to the partnership, a double non-taxation may be available if the partnership is taxed as a separate entity in its jurisdiction. The source state will recognise the interest payment to the Belgian partner, and will therefore allow a tax deduction. Belgium will not recognise the loan (as it is a loan granted by the Belgian partner to itself) and will classify the received payments as foreign-source income. Often the treaty requires that Belgium exempts this kind of income.

[71] OECD, "The application of the OECD Model Tax Convention to Partnerships", *Issues in International Taxation*, no. 6.