Belgium

Branch Reporters
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Summary and conclusions

Neither the general, individual, accounting legislation, nor the tax legislation contains a comprehensive set of rules dealing with foreign exchange (FX) issues. Although financial accounts have to be in euro, in specific cases the authorities can grant a derogation. Furthermore, Belgian law allows for the statutory (share) capital of companies to be expressed in the currency of another OECD Member State.

Belgium adopts the principle of nominalism in tax matters. Foreign currencies are traditionally considered to be merchandise, a commodity, as opposed to money (euro).

The euro is freely convertible: no FX controls apply.

For FX purposes, a distinction is made between monetary and non-monetary items. The major consequence is that monetary items will be valued for unrealised FX results at financial year end on a per currency compensated basis (lower of cost or market method), and show FX results at realisation, while non-monetary items will remain booked at their historical acquisition value. Consequently, for the latter items, the FX rate applying at their acquisition prevails for determining future deprecation, value reductions and results upon divestment (without the FX component being identified any longer).

In order to preserve matching, certain foreign currency, debt-funded, non-monetary items, such as assets quoted and traded on the global markets in a foreign currency and foreign shares predominantly quoted and traded on a foreign stock exchange, are treated as monetary assets.

From an accounting perspective, FX results are linked to monetary items. In other words, the source concept or cause concept (*causa*) for FX purposes is assimilated with the nature of the underlying item (as being monetary).

In the same line, Belgian tax law in general is unfamiliar with the concept of source. In general, tax jurisprudence will tend to assimilate the FX result with the intrinsic result.

This is incorrect for monetary items (such as bonds) because the accounting separately identifies FX results and remains an underlying good as such (as illustrated at the time of the euro conversion where a realised FX result was identified, although the debts, receivables, etc. as such were not realised).

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Also for non-monetary items, a more just tax outcome would imply that the FX result was separately identified. For instance, capital gains/losses on shares are respectively non-taxable and non-deductible.[1] Extending this general treatment to the FX results on these shares may in certain cases lead to an unjust refusal of deduction of FX losses or unjust exemption of FX gains.

Belgium's international tax law seems to accept that FX differences as a result of the integration of permanent establishment (PE) accounts into a Belgian resident company's main accounts, are not attributable to the PE, but are attributable to the Belgian head office, where they may have an impact on (other) income taxable in Belgium. These integration differences are thus separate from the PE income as such. They occur yearly.

This conclusion is supported by two rulings of the Court of Appeals in Brussels (one of 1993 and one of 1998). The basic principle behind these rulings was confirmed by the European Court of Justice (ECJ) in its *Deutsche Shell* case, although that case was not on yearly integration differences, but on FX differences upon the termination of a foreign PE and the repatriation of the cash.

According to general principles, the method under which integration differences need to be determined is based on accounting law, i.e. Commission for Accounting Standards (CAS) advice no. 172/1 of 1995.

Notwithstanding the financial interchangeablility of interest and FX results, the Belgian tax authorities accept that FX results on the principal debt amount are of no interest for tax purposes, and are not liable to Belgium's interest withholding tax.

On the other hand, the specific anti-abuse provision of article 19, §3 Income Tax Code (ITC), which applies to various kinds of bilateral arrangements with a guaranteed return in money and which treats that return as interest, may also apply to bilateral combinations of an investment or debt in a foreign currency and of a matching FX hedge.

Little international guidance exists on the treatment of FX effects under the OECD model taxation convention (MTC) or under any other of Belgium's double tax conventions (DTCs). Such guidance would be welcome, mainly on whether FX differences are attributable to a head office or to a PE, and how this affects the scope of (the equivalents of) articles 7 and 23 of the OECD MTC subject-to-tax requirements, recapture provisions, etc.

Finally, Belgium has introduced a variation of the so-called Tobin tax, i.e. the Spahn tax. This tax has not entered into force. It is even very unlikely that it ever will.

Lacking a relevant concept of source in Belgian legislation, FX results are mostly treated as intrinsic results. This may lead to an unjust tax outcome.

Unrealised and realised FX gains or losses on integration differences of PEs as well as on final termination differences of PEs will in principle be considered as taxable gains or deductible losses at head office level.

In contrast, such gains or losses on participations in subsidiaries will be assimilated in principle with the intrinsic results (except foreign currency funded participation) on shares at Belgian resident holding company level. Consequently, the tax regime for shares (participations) will apply, i.e. the exemption for

[1] Except within certain limits upon liquidation.

unrealised and realised gains, the non-deduction of unrealised or realised losses (except in case of liquidation limited to the initially contributed capital) and finally the dividend received deduction.

DTCs or the OECD commentary should preferably explicitly deal with the allocation of taxing authority over the FX result on realised or unrealised integration differences.

1. Introduction

The Belgian income tax system subjects residents to taxation on their worldwide income.

The Belgian resident and non-resident corporate income tax (CIT) is based on the general principle that individual accounting legislation is the basis for determining taxable income (unless the tax law deviates), in the absence of a comprehensive definition of such income in the ITC itself.[2]

Specific accounting rules apply to certain enterprises such as banks and insurance companies.[3] In principle, these specific accounting rules will apply for tax purposes as well.

Furthermore, the taxable income of corporate taxpayers follows the accrual principle as laid down in accounting and tax legislation.

Belgian accounting legislation obliges resident corporate taxpayers to file their individual and consolidated annual accounts with the National Bank of Belgium (NBB), to establish these in euro and to perform their accounting in euro as well.

Non-resident corporate taxpayers need not file separate annual accounts for their Belgian PE with the NBB. However, they must establish separate annual accounts in euro for their activities and perform their accounting in euro, even though their head office accounts are in a different currency. These annual accounts are an integral part of the Belgian non-resident CIT return.

In specific cases, the Belgian Minister of Economic affairs can grant a derogation, after positive advice from the Belgian CAS, to use a currency other than the euro for the accounts.[4] Such derogation requires that (a) most of the activity of the enterprise is performed in a different currency zone; and that (b) the major part of the enterprise's assets and liabilities and of its results relates to that currency zone. Recently, a derogation was granted to a whole economic sector.

Belgian tax returns, taxes and tax payments are determined and effected in euro.

However, in line with the exception mentioned in the commentary to the ITC (Com.ITC), the Belgian Advance Tax Ruling Service has also accepted mitigations to avoid any FX effect due to CIT obligations (see section 3.4).

2 The scope of this report is limited to resident and non-resident corporate taxpayers ("corporate taxpayers", unless a specific rule exists for residents or non-residents).

3 Art. 92 §3 Company Code; Royal Decree of 23 September 1992 (OG 6 October 1992 (Banking RD)) and Royal Decree of 17 November 1994 (OG of 21 December 1994 (Insurance RD)).

4 Art. 125 §1 CC; CAS advice no. 117/2 (see above); communication in Bull. CBN no. 27 of February 1992; communication in Bull. CBN no. 47 of May 2002.

Also, Belgian law allows for the statutory (share) capital of companies (*kapitaalvennootschappen/sociétés de capitaux*), as provided for in the articles of association, to be expressed in the currency of another OECD member state.[5] However, this does not change the accounting obligations, i.e. the capital must continue to be reported in euro for accounting purposes (except for the application of the above-mentioned derogation).

Belgian tax legislation does not contain a comprehensive set of tax rules dealing with FX issues. The general, accounting legislation does not do so either.[6] Apparently, this absence of accounting rules was premeditated.[7] Consequently, in the absence of legislation, the "advice" (standards) of the CAS, the case law and the positions taken by tax authorities constitute a framework of rules affecting tax treatment.[8]

Furthermore, Belgian corporate accounting legislation obliges corporate taxpayers to establish (FX) valuation rules for both monetary and non-monetary items.[9]

Belgium adopts the principle of nominalism in tax matters (as opposed to metallism or valorism).[10]

Although subject to a certain evolution, a foreign currency is traditionally considered to be merchandise, a commodity, as opposed to money (euro). In other words, it is a separate good. Also for corporate law purposes, a contribution of foreign currency (compared to statutory capital) is traditionally analysed as a contribution in kind instead of in cash.

Finally, Belgium has introduced a variation of the so-called Tobin tax, i.e. the Spahn tax.[11] This tax has not entered into force (see section 7).

[5] Law of 12 July 1991 (OG 9 August 1991).

[6] The Banking and Insurance RDs contain more elaborated guidance (art. 36 in both RDs).

[7] Report to the King attached to the Royal Decree of 12 September 1983 (OG 28 September 1983).

[8] CAS advice no. 152/1, Accounting for foreign currency operations and treatment of foreign currency possessions (*tegoeden/avoirs* which is broader than "assets") and "obligations" (*verplichtingen/engagements* which is broader than "liabilities") in the annual accounts, Bulletin CNC, no. 20 December 1987, pp. 1–49; CAS advice no. 152-4, Non-monetary financial assets (participations and treasury investment), Bulletin CNC, no. 23, December 1988, pp. 11–13; CAS advice no. 172/1 on the integration of foreign branch results, Bull. CBN, no. 35, October 1995, p. 18; CAS advice no. 173/1 on the introduction of the euro – accounting aspects, 1997; Brussels Court of Appeal, 21 September 2006, TFR, 2007, no. 320, p. 308, confirming Leuven Tribunal of first instance of 11 October 2002, AFT, 2003, no. 6, p. 318 with note Bogaerts; Leuven Tribunal of first instance,10 January 2003 (TFR, 2003, no. 250, p. 966 with note of C. Chevalier); Tribunal of first instance of Brussels of 7 April 2006, TFR, 2007, no. 313, p. 16 with note M. Van Gils. See also Parliamentary Question no. 880 M. Van Campenhout, 21 January 2002, Q&A, Chamber 2001–2002, no. 50-138, p. 17389; Bull. no. 835, pp. 685–686.

[9] Art. 28 *juncto* art. 34 RDCC.

[10] Art. 1895 Civil Code; for exceptions see art. 2, 7° ITC (revaluation coefficients until 1949); art. 505 ITC states that capital gains resulting from the devaluation law of 30 March 1935 remain exempt; Com. ITC no. 24/106.

[11] The Law of 19 November 2004 on the introduction of a tax on the exchange of currencies, banknotes and bank coins (OG 24 December 2004).

2. FX controls

Since 1 January 1999, the official currency of the Kingdom of Belgium has been the euro, which, as of that date, replaced the Belgian franc (BEF).

No FX controls apply.[12] Belgium's dual exchange rate system in respect of BEFs,[13] in place since 18 July 1955 and still in place at the time of the contribution of the Belgian reporter to the 1986 IFA Congress, was abolished as from 5 March 1990.

3. Tax treatment of gains and losses attributable to currency fluctuations: general considerations

3.1. Accounting principles

As indicated in section 1, accounting rules are crucial for determining the taxable result (including FX results).

3.2. Recognition principles

FX results will only arise as a consequence of a valuation (such a valuation event cannot be considered as an accrual event, nor (exclusively) as a realisation event). Therefore, taxable results will arise if a valuation event arises: i.e. if valuations are either expressed in the accounts or realised.[14]

The mechanics of the FX valuation are based on the following general[15] accounting principles, accepted for tax purposes.

In general, transactions having an FX characteristic will be translated into euro at the spot, bid or offer (ask) rate (but the mid-rate is accepted as well) on the day of the transaction or at the specific hedge rate if the transaction was hedged. In principle, an individual rate applies per transaction. However, average rates per group of transactions or per period are acceptable as well (e.g. fungible items).

For FX purposes a distinction is made between monetary and non-monetary items. The major consequence is that monetary items will be valued for unrealised FX results at financial year end (FX rate on that day or an average rate; however, an average FX rate computed over a period of more than one month before the year end would not be acceptable),[16] and show FX results at realisation, while non-monetary items will remain booked at their historical acquisition value.

The unrealised FX results on monetary items will be compensated on a per currency basis. The balance of unrealised FX profits will be neutralised via a

12 Nonetheless, calculating Belgium's trade balance requires production of data on FX transactions.
13 Shared with the Grand Duchy of Luxembourg.
14 Com.ITC 24/59 and 24/60.
15 Different rules exist for banks and insurers.
16 See Court of Appeal Antwerp, 3 February 1994, *Fiscale Koerier*, 1994, p. 336; CAS advice 152/1, p. 31.

transitional account (untaxed). If the balance shows an FX loss, this will remain a profit and loss expense (tax deductible).This is an application of the LOCOM method.[17] Note that the mark-to-market method is allowed as well (but not preferred by the CAS).

Provisions for FX losses may be established in case of the impossibility of hedging, too expensive hedging and also in the case of debts concluded in a certain currency to benefit from a low interest rate and thus likely to pick up currency value (FX loss).[18]

However, some deviating tax rules in respect of recognition of income exist. They are as follows:

- first, undervaluations of assets or overvaluations of liabilities may be taxed.[19] However, taking into account the principle of unity of the balance sheet and profit and loss accounts for accounting and tax purposes,[20] it is difficult to see how this tax rule can apply to taxpayers subject to the accounting legislation (provided they correctly apply the accounting law);[21]
- secondly, so-called "reconstitution capital gains" need to be included in the taxable income.[22] These are unexpressed and unrealised gains relating exclusively to fixed financial assets and other portfolio securities for which value reductions were recorded previously, and which are capped at the (initial) acquisition or investment value.

3.2.1. Definition of monetary and non-monetary items

In general, monetary items can be defined as those items (assets, liabilities and off balance obligations and entitlements) that effectively have money, i.e. a certain amount of currencies, as their object. It could be further stated that the parties have effective control over the fact that the payment should be in money (e.g. not the case for shares).

Non-monetary assets, the residual category, are those assets for which money or currency is only a measurement unit of the value of the asset, e.g. trade commodities, but also for instance a bond mandatorily repayable in shares should for FX purposes be treated as a non-monetary asset.[23]

17 Lower of cost or market.

18 Liège Court of Appeal, 29 June 1983, FJF, 1984, no. 84/70 also accepted a provision for receivables in a weak currency.

19 Art. 24, 4° ITC.

20 Com.ITC no. 183/2.

21 In general, art. 24, 4° ITC is not applicable for cases of correct application of the accounting law or its effects can be realised by other articles of the ITC (e.g. art. 48 ITC dealing with value reductions and provisions). In the same sense J. Kirkpatrick and D. Garabedian, *Le régime fiscal des sociétés en Belgique*, Bruylant, Brussels, 2003, p. 187; W. Defoor, annotation under Antwerp Court of Appeal, 3 February 1994, *Fiscale Koerier*, 1994, p. 336; Liège Tribunal of First Instance, of 9 September 2003, Fisconet, no. L1 03/04. Both court cases condemned an incorrect application of the accounting law.

22 Art. 24, 3° *juncto* arts. 183 and 190 ITC.

23 Note that the CAS advice no. 139-8 considers such a bond still as a debt instrument (Bull. CBN, no. 44, June 1998, pp. 32–40). In the same sense, C. Cheruy and C. Laurent, *Le régime fiscal des sociétés holdings en Belgique*, Larcier, Brussels, 2008, p. 786.

The distinction between monetary and non-monetary items is accepted for tax purposes.[24]

3.2.2. Classification of specific items as monetary or non-monetary

Typical monetary items are currency accounts with banks, cash receivables (also via repos), cash liabilities represented or not by securities, provisions relating to obligations payable in a foreign currency,[25] derivatives relating to monetary assets (e.g. interest or FX futures, options). Also derivatives relating to non-monetary assets (e.g. equity options) which are cash settled should qualify as monetary assets.

Furthermore, the following items are treated as monetary assets:

- assets quoted and traded on the global markets in a foreign currency and debt funded in foreign currency;
- foreign shares, predominantly quoted and traded on a foreign stock exchange, held as portfolio investments and debt funded in foreign currency.

Also foreign currency funded investments abroad and foreign currency invested participations in companies having their major activity abroad are treated following the matching principle as monetary assets.[26]

Note that the list of items qualifying as monetary items is larger for certain enterprises such as banks[27] and insurers.[28]

Non-monetary items are the residual category.

Shares have attracted the specific attention of the CAS and of the courts. The CAS considers that shares are non-monetary assets. They do not offer the shareholder control over a precise amount of money to be received.[29] Indeed, dividends, capital reimbursements or liquidation proceeds can either be in kind or in money.

On 21 September 2006, the Brussels Court of Appeal, in line with the CAS, ruled explicitly that shares were non-monetary assets.

As indicated above, the valuation will determine the existence of an FX result. A loan in a foreign currency which funds a business conducted in or with a foreign currency zone will automatically lead to FX results on the liabilities given that the loan is a monetary item that will be valued at financial year end. If the business is exclusively monetary, the FX result on the assets will compensate for the result on the liabilities side. If not, discrepancies will arise.

In order to solve these discrepancies, certain mitigations are available whereby non-monetary assets are treated as monetary assets and vice versa (see section 3.2.1 above).

[24] E.g. see para. 20 of the ACL no. Ci.RH.421/494.543 of 8 October 1997 regarding accounting and FX results linked to the introduction of the euro.

[25] CAS advice no. 149/4, Bull. CBN, no. 45, February 1999, p. 15.

[26] CAS advice no. 152/1 is unclear (rather treats loans as non-monetary), but CAS advice no. 172/1 is more inclined to treat assets as monetary.

[27] Art. 36 §1, second alinea, (a) Banking RD.

[28] Art. 36 §1, (a) Insurance RD.

[29] Compare Brussels Court of Appeal, 8 January 1964, Bull., 1965, p. 290. The situation would probably be different for shares with nominal value if the articles of association of the company provided that its distributions would only take the form of cash payments.

As indicated in section 1 and section 3.4, the Minister of Economic Affairs can grant permission to keep accounts in a functional currency. Likewise, the Advance Tax Ruling Service has accepted neutralising FX effects when transferring the functional currency accounts into the Belgian euro denominated CIT return.

3.2.3. Separate accounting and tax treatment of FX results

3.2.3.1. Accounting treatment

Accountingwise, the CAS has clearly indicated that the FX results (a subcategory of financial results) should be separated from the other results in order to maintain a correct view of the situation of the enterprise.

In line with the above principles, the CAS considered the 1 January 1999 conversion into the euro of monetary items referring to the national currencies of other EU monetary union members as a separate, realised FX result. Also the tax authorities considered it as a taxable FX result for the taxable period that included 31 December 1998,[30] even though the underlying monetary item (e.g. debt, receivable) itself was not realised. The currency as such that underlay the monetary item had changed *ex autoritate* due to European legislation.[31]

3.2.3.2. Tax treatment

As mentioned in section 1, the determination of taxable profit generally follows the accounting treatment (see, however, section 3.2.1). This accounting treatment separates out FX results from other results.

In this respect, tax case law, in accordance with tax authority's viewpoint, shows the following decisions:

- reconstitution of capital gains on bonds including also FX gains (thus not limited to intrinsic value fluctuations) in the context of a fiscal anti-abuse correction,[32] i.e. if the taxpayer's accounts have not expressed the FX gain;
- non-deductible (unrealised) capital losses on shares include also FX losses;[33]
- exempt capital gains on shares also include FX gains;[34]
- the dividend received deduction also covers the FX gain.[35]

30 CAS advice no. 173-1, Transition to euro – accounting aspects, Bulletin CNC, no. 37, 1997, pp. 4–24; ACL no. Ci.RH 421/494,543 of 8 October 1997, no. 20, p. 4; *contra* taxation J.P. Lagae, "De Overgang naar de EURO-fiscale aspecten", AFT, 1998, p. 71 (we do not support the thesis of Lagae).

31 Regulation EC 1103/97 of 17 June 1997 (PB 1997, L162, p. 1); see also foreign currency as a separate good (see section 1).

32 Art. 24, 3° ITC; Brussels Court of Appeal, 21 September 2006 (see above).

33 Art. 198, 7° ITC; Brussels Court of Appeal, 21 September 2006 (see above), although slightly confusing because art. 198, 7° deals with capital losses on shares, while the taxpayers did not use the capital loss account (no. 651 – value reductions), but profit and loss account (no. 655 – FX expense/result). Furthermore, the Court added that the cause of the value reduction, whether an intrinsic value change or an FX change, was irrelevant for the application of art. 198, 7° ITC.

34 Parliamentary Question no. 880 of M. Van Campenhout, 21 January 2002 (see above).

35 Liège Tribunal of First Instance, 14 April 2008, *Fiskoloog*, no. 1125, p. 9. This decision cannot be accepted insofar as the FX component would still be included in the dividend income

Because bonds are monetary items, the FX result cannot be assimilated with the intrinsic result for accounting purposes. Therefore, and for the reasons explained below, the above case law regarding bonds can certainly be criticised.[36]

As far as the shares are concerned, given *inter alia* their status of non-monetary items for accounting purposes, the above case law does not identify a separate FX result. The FX result follows the tax treatment of the underlying item. It becomes an intrinsic result.

First, the above jurisprudence could be criticised if shares or other non-monetary assets still had to be analysed as some kind of carrier of the initial (foreign) currency in exchange for which the shares were acquired. Under this analysis, the above jurisprudence would ignore the clear text of the ITC referring to "shares", "securities", etc., thereby disregarding the separate existence of the foreign currency. However, it would appear that the acquisition of (non-monetary) goods in exchange for a foreign currency is a realisation whereby one good, a foreign currency, is definitively replaced by another, the share. In other words, the continued coexistence of a separate foreign currency in the (non-monetary) good would not be assumed.

Another criticism of the above jurisprudence could still be based on the fact that the cause or source of the value changes of non-monetary items can still very much depend on the FX evolution (see section 3.6).[37] For instance, US real estate acquired when USD1 equalled 1 euro, which was sold when USD1 equalled 0.66 euro, will most probably also result in a capital loss.[38]

This would imply that for ITC purposes (results related to) items defined as such in the ITC should be separated from (results related to) the foreign currency. Consequently, these items would also be treated as monetary items for ITC purposes.[39]

Secondly, the distinction between monetary and non-monetary items is only an accounting convention. It has not been incorporated into the general, individual, accounting legislation[40] (nor tax legislation) as such. Stronger even, the RDCC does not limit the realised FX result profit and loss accounts to certain items[41] (such as monetary versus non-monetary, etc.) and this is in contrast with the other results of the profit and loss account.[42]

Nevertheless, under prevailing tax legislation, it is questionable whether the above criticism has sufficient legal basis.

cont.

although the dividend has become payable. As from that moment it becomes a debt of the company and a receivable for the shareholder.

36 See also section 1: foreign currency as a separate good.

37 In the same sense Cheruy and Laurent, *op. cit*., p. 1208, no. 2104 and p. 1209, no. 2106.

38 Unless the purchase parity mechanism would have resulted in the house being worth 150 per cent in present dollar value.

39 This would not lead to taxation on unrealised results (cf. Com.ITC nos. 44/18 and 44/19).

40 Contrary to the specific legislation for banking and insurance enterprises.

41 Art. 96, IV.C, 3° and V.C. 3°. The RDCC does not restrict realised FX to certain assets. This is reflected in the title of account nos. 654 and 754. In contrast the unrealised results are limited to *valuta/devises*. This is reflected in the title of account nos. 655 and 755.

42 Art. 96, I.D last al. (commercial receivables); II.D (tangible and intangible fixed assets), II.E (stock, commercial receivables), II.G (commercial receivables), V.B.(floating assets), V.C.1° receivables, cash and cash investments), VII.D (fixed assets), VIII. A. (tangible and intangible fixed assets), VIII.D. (fixed assets), RDCC.

3.3. Nature of FX results

The CIT uses the concept of "profit". This concept includes both genuine income and capital result.[43] FX results are considered to be taxable profit (or loss) within the sub-category capital results.[44]

However, specific rules exist for capital gains/losses realised on certain assets. Since FX results are valuation results, the question arises whether these specific rules are applicable to intrinsic results only or to FX results as well (see sections 3.2.3.1 and 3.2.3.2).

3.4. Presentation and calculating currency

Accounting and tax reporting needs to be done in euro. However, as indicated under section 1, the Ministry of Economic Affairs may approve financial statements being presented in a foreign (functional) currency.

The Com.ITC accepts that only the net equity increase is converted to euro[45] (and constitutes the taxable basis), provided that the following conditions are met: the company is exclusively active abroad, concludes and settles all its transactions in foreign currency and keeps its accounting in foreign currency.

Pursuant to this commentary, the Belgian Advance Tax Ruling Service has accepted that enterprises having obtained the approval of the Ministry of Economic Affairs to account in a foreign currency may neutralise the FX effects by using one single FX rate (foreign currency versus the euro) for filling out the entire CIT return.[46] Consequently, no FX result will be triggered by the financial accounts or by the CIT return.

If a company shifted from a euro accounting regime to a functional currency regime, the most obvious timing would be for the shift to coincide with a financial year end. This would allow for all monetary balance sheet items to undergo a final FX valuation, undergo their tax regime and start with a carry value that would be FX neutral as from the new financial year.

3.5. Currency revaluation and devaluation

As indicated under section 3.2.1, currency results are netted on a per currency basis. So the comments below apply to this net balance.

Expressed, but unrealised capital gains (on assets) and capital losses (on liabilities),[47] except on stocks and orders, are exempt provided the condition of intangibility is met, i.e. setting up a separate reserve account which remains

43 Art. 24, 2° ITC.

44 Lagae, *op. cit.*, p. 77.

45 Com.ITC no. 183/8.

46 Note that the tax return must still be filled out in euro; decisions no. 700,251 of 10 July 2007 and no. 700,395 of 23 October 2007.

47 Com.ITC nos. 44/8, 24/51 and 24/52; Liège Tribunal of first instance (9 September 2003, see above) judged that the unrealised FX result on technical provisions for obligations payable in foreign currency of insurance companies did not qualify for this exemption because *inter alia* the exemption would be limited to debts.

untouched.[48] The tax authorities also apply this general principle to FX gains: the Com.ITC holds that the legal or factual revaluation or devaluation of a foreign currency is non-taxable for a taxpayer who has outstanding assets or debts in that currency.[49] Taxation would only arise in case of realisation.

Mutatis mutandis, expressed, but unrealised capital losses (on assets) and capital gains (on liabilities) constitute expenses for accounting purposes. For ITC purposes, a controversy exists as to whether an unrealised value reduction is simply the negative corollary of determining the profit or constitutes a professional expense.[50] Based on an autonomous interpretation of the ITC and its article 48, we believe that it needs to be considered as a negative corollary and thus rather as a value reduction[51] instead of as a professional expense.

Subsequently, these value reductions, constituting a negative corollary of the profit, are excluded from the taxable income.[52]

3.6. Source

Belgian income tax legislation has no detailed set of rules for determining the source or the cause of certain income. In general it simply refers to the income generating assets as such. However, certain rules have an implicit concept of source or cause, e.g. when real estate or other asset income is considered as professional or speculative income because the income from these items arises within a professional or speculative activity.[53]

For accounting purposes, we have seen that FX results are simply linked to monetary items. In other words, the source concept for FX purposes is assimilated with the nature of the underlying items as monetary items. We have seen that this assimilation can be criticised (see section 3.2.3.2).

The Belgian Advance Tax Ruling Service has admitted that FX results, unless speculative, also benefit from the specific Belgian tonnage tax regime for seagoing ships.[54]

48 Art. 44 §1,1° and 190 ITC.

49 Com.ITC nos. 24/59, 44/18 and 44/19.

50 Y. Verdingh, *Bestendig Handboek Vennootschapsbelasting*, Kluwer, Mechelen, loose-leaf, V, 3, §2, p. V-2 90, no. 2265.

51 Supreme Court, 13 May 2002, TFR, 2002, no. 232, p. 1115 (implicitly excludes application of art. 49 ITC); Supreme Court, 23 February 1990, FJF, 1990, no. 90/172; Supreme Court, 2 March 1990, *Pas.*, I., p. 775; Supreme Court, 28 January 1982, JT,1982, p. 600; RW 1982–83, p. 1451.

52 Art. 48 ITC; note that in an isolated decision the Supreme Court ruled that unrealised losses under art. 48 ITC only covered debt claims not represented by securities (Supreme Court, 13 May 2002, TFR, 2002, no. 232, p. 1115). However, the Supreme Court decision lacks legal basis, has been unanimously rejected by the tax scholars and its outcome would be totally unbalanced. Furthermore, given the aggregated computation method, the use of specific accounting posts and the fact that art. 48 ITC is intended to cover credit risk (intrinsic results), this article should not apply in the case at hand.

53 Arts. 37 and 90.1° ITC.

54 Advance ruling no. 500,011 of 16 June 2005.

3.7. Transfer pricing

Transfer legislation does not contain specific rules dealing with FX. Belgium closely adheres to the OECD transfer pricing documentation and practices.

The Belgian Advance Tax Ruling Service has allowed that both positive and negative FX results, both realised and unrealised compensated, as arising in the individual financial accounts (according to Belgian GAAP) of a Belgian coordination centre, were on a quarterly basis paid to/received from a Swiss related company that performed the overall FX management for the group and took on the FX risk.[55]

4. Typical transactions

4.1. Purchase and sale of goods

Goods qualify as non-monetary items. Purchase or sale transactions of such goods in foreign currencies will be converted into euro as explained under section 3.2, i.e. in principle at the spot bid/offer rate but other alternatives are available as well. For instance, goods frequently traded in foreign currency may be kept in non-euro accounts which are only converted into euro once per month using a monthly average FX rate.

Since goods are non-monetary assets and are converted into euro at a specified rate, they no longer undergo FX changes. However, exceptions exist for certain goods (see section 3.2.1). The latter goods, the value of which is strongly influenced by FX changes, may be marked to market[56] in order to mirror the mark-to-market treatment of the related (monetary) hedge. Note that the FX results of these goods and related funding are not compensated under the mechanism described under section 3.2.1.

In contrast to the goods, the debts and receivables resulting from the aforementioned transactions qualify as monetary assets. Upon realisation, they may lead to a taxable/deductible) accounting FX result. If unrealised at year end, they will be netted on a per currency bases (see section 3.2.1). A positive or a negative net balance will be treated as explained under section 3.5.

4.2. Depreciable property

Since depreciable property – including advance payments – is a non-monetary asset, it is converted into euro when acquired. Consequently, it no longer undergoes FX changes after this conversion.

The annual depreciation charge will also be calculated on this initial euro conversion value regardless of future FX changes. This remains applicable to property belonging to a foreign branch for determining the profit contribution to the Belgian taxable base (see section 5).

55 Advance Ruling no. 500,306 of 15 December 2005.
56 Instead of being subject to the LOCOM method (art. 70 RDCC).

The acquisition debt is a monetary asset and will lead to an FX result as is the case for the debt funding of goods discussed under section 4.1.

For real estate[57] the same FX treatment applies as for depreciable property.

4.3. Investments in securities

Securities representing debt are monetary assets. They undergo FX changes. However, for accounting purposes intrinsic value changes have to be added/ deducted first from the acquisition value. This intrinsic value change will be calculated at the initial (i.e. at acquisition) FX rate. In a second stage only, the FX change is computed on this adapted acquisition value.[58] We refer to section 3.2 regarding reconstitution of capital gains.

4.4. Intangible property

Intangible assets – including advance payments – are non-monetary assets. Therefore, they are converted into euro when acquired. Consequently, they no longer undergo FX evolution thereafter. These assets are also depreciable.[59]

4.5. Financing (borrowing and lending)

Loans and debts qualify as monetary assets. They are converted into euro as explained under section 3.2.1 at the conversion rate of the transaction. In general, the future/forward rate will not be used even though the loan/debt matures only at such a future date.

The foreign currency interest rate will be deductible under normal arm's length conditions at the prevailing foreign interest currency rates. No specific interest ceilings are set.[60]

Given that FX developments are external elements beyond the control of the lender/borrower they cannot be considered as a discount or a premium on the loan/debt.[61] In contrast, where contracting parties intend to capture the FX change within a structure or a product (e.g. FX linked interest deposit), the FX will become taxable interest (see also section 7.1).

A loan issued below or above nominal value (*pari*) will cause the nominal interest amount reportable in the profit and loss account to be increased or decreased on the basis of the effective actuarial interest. This notional interest differential between the actuarial and the nominal interest rate will be added or subtracted from the amount of the loan on an annual basis throughout the lifetime of the loan.[62] This interest differential will on a yearly basis be converted into

57 Note that land (except rights *in rem* on it) is not depreciable.

58 Compare also the treatment of FX transactions where the "deport/report" is separately treated from the intrinsic value change (see section 3.2.3.1).

59 Arts. 52,6° and 63 ITC.

60 Art. 55 ITC, first alinea, as amended by art. 9 of the Law of 28 July 1992 (OG 31 July1992) abolishing previously existing deductibility ceilings; Com.ITC no. 52/78.

61 See Com.ITC no. 19/5: see also ACL no. Ci.D.19/416.334 of 30 August 1993, *Bull.Bel.*, 1993, no. 731, p. 2802.

62 Arts. 67, 73, 77 RDCC.

euro, as explained in section 3. This can lead to distortions with the FX rate used initially for the loan.

We refer to section 3 as to the method for determining FX results on loans. Obviously, the repayment of a loan is a realisation event for tax purposes.

Belgian CIT does not make a fundamental distinction between capital and genuine income (see section 3.3). The FX result on the repayment of a debt obligation constitutes a realised gain. It follows the general rule and is taxable or deductible for CIT purposes.

A change in the terms of a debt obligation will only lead to taxation if the change triggers a realisation of the debt obligation (e.g. early (partial) redemption, early (partial) conversion, novation), a change in the underlying currency,[63] or affects the valuation at the financial year end (e.g. fixed interest increase due to non-respect of loan covenants). Furthermore, some administrative guidance exists under which:

- a renewal of a term deposit is not a realisation,[64] and nor is the legal or factual re- or devaluation of a foreign currency[65] (see section 3.5);
- a conversion of a commercial receivable in a long-term loan is considered by the tax authorities as a realisation.[66] The latter position cannot be supported.[67]

4.6. Hedging (including derivatives)

In contrast to the accounting legislation, the tax legislation does not have a concept of hedging. However, as explained under section 1, the principle of unity of the balance sheet and profit and loss account for accounting and tax implies that the existing accounting rules will be adopted in tax matters. Under these accounting rules, hedges neutralise/stabilise the value and thus the accounting/taxable result of the hedged monetary items. Such hedges must be specific and concluded at the same time as the hedged transaction that creates the monetary items. If a hedge is prior or posterior, the hedge or the item/transaction will during the open period undergo their respective FX change. General accounting legislation (CAS) accepts that afterwards the neutralising impact of the hedge may still be recognised.[68]

On top of the above-mentioned hedges, the CAS admits on the basis of the "matching principle" that certain non-monetary assets are treated as monetary and vice versa (forming as such a natural hedge) (see section 3.2).

63 As was the case with the introduction of the euro (see section 3.2.3.1; see section 1, separate good).
64 P.Q no. 339, Peeters of 27 August 1984 (BC no. 635, p. 113); Decrem, *op. cit.*, p. 607.
65 Com.ITC nos. 44/18 and 44/19.
66 Com.ITC no. 44/21.
67 Lagae, *op. cit.*, p. 516.
68 More stringent rules exist for banking and insurance enterprises.

5. Foreign currency issues related to foreign branches or PEs

Although Belgian tax law is relatively unfamiliar with the notion of territorial "source" in this specific context (see section 3.6), the source of FX effects in connection with a foreign branch or PE is established independently of that branch's or PE's transactions for the purposes of computing income attributable to the branch or PE.

5.1. Principles and main supporting Belgian case law

As indicated in section 1, Belgium's CIT applies to Belgian resident companies in respect of their worldwide taxable income, determined according to Belgian accounting law (unless Belgian tax law explicitly deviates), and irrespective of the source of that income. Only in a second step is foreign PE income isolated in order for it to benefit from an exemption on the basis of the relevant DTC.

Specific guidance on how, under Belgian accounting law, foreign branch income is integrated into a company's worldwide income, is to be found not so much in legislation, but in CAS advice no. 172/1.

5.1.1. CAS advice 172/1 of 1995

CAS advice 172/1 aims at providing such guidance in respect of the legal obligations for enterprises, under Belgian accounting law, to

- keep a comprehensive accounting system in euro (unless derogation is granted) (see section 1); and
- integrate its accounts in respect of its foreign (i.e. non-Belgian) branches, into the main accounts relating to the enterprise as a whole.[69]

In this context, it extensively discusses the potential currency translation difficulties as a result of such integration, i.e. if foreign branch accounts are held (locally) in a currency other than the euro.

The CAS advice refers to two integration methods:

- the monetary/non-monetary method, under which balance sheet items of the foreign branch are integrated in the company's main accounts and translated into euro following the different rules for monetary and non-monetary items (see section 3.2);
- the net investment closing rate method, under which balance sheet items of the foreign branch are integrated into the company's main accounts and are all translated at the closing FX rate at the balance sheet date.

CAS advice 172/1 expresses a clear preference for the monetary/non-monetary method. The consequence under current Belgian tax law is that in principle, and in the absence of explicit derogation by tax law, this method also determines the worldwide income in respect of which a Belgian company is subject to CIT, as well as the integration of the balance sheet and profit and loss items of a foreign

[69] Art. 4 of the Royal Decree of 12 September 1983 implementing the Law of 17 July 1975 on the Accounting System of the Enterprises.

branch into a company's main accounts, i.e. the contribution of that branch to the worldwide income.

5.1.2. Case law: rulings of the Brussels Court of Appeal

The second step in the CIT calculation is that within a company's worldwide income, foreign PE income is isolated from the income of the head office.[70] Rules on how to deal with FX related integration differences on a PE are entirely based on case law, *inter alia* on two decisions by the Brussels Court of Appeal.

In a 1993 ruling, *re Solvay*,[71] the Court followed the taxpayer who, as local currency had lost value against the BEF, and as the depreciation of the assets of its foreign branches was higher in its BEF denominated main accounts (where the historical acquisition value in BEF prevailed) than in its local currency denominated local branch accounts, had deducted this so-called additional depreciation from its head office income. The Court held that a company was entitled over time to deduct depreciations up to the entire acquisition value of business assets, and that, because branches from their own local currency perspective would not be able to depreciate the entire acquisition value, a deduction of the additional depreciation should be accepted at the level of the head office.

In a 1998 ruling,[72] in a context very similar to that of the previous case, the Court again followed a taxpayer who had used a method in between the monetary/non-monetary method and the net investment closing rate method. The Court this time relied on the DTC notion of the "profits attributable to a PE" under which Belgium had to provide treaty relief: according to the Court, these "profits attributable to a PE" did not include the FX related integration differences that were only visible from a head office perspective. As a result, those differences actually affect – and are deductible from – the Belgian profits.

5.2. Critical analysis of case law

5.2.1. Integration differences as a separate source of FX gains/losses – practical difficulties

The currency related integration differences which were under debate in both cases, are not one of the two sources of FX results labelled as such in CAS advice 152/1, i.e.:

- (realised) FX gains/losses;[73] and
- (unrealised) FX conversion/translation differences.[74]

[70] Art. 75 RDITC, in turn based on the exemption method which Belgium commits itself to in its DTCs.

[71] Brussels Court of Appeal, 23 February 1993, *re Solvay*, FJF, 1993, no. 93/240, p. 508; AFT, 1994, p. 68 with note R. Beltjens; *Fiscale Koerier*, 1993, p. 409. See IBFD's online "Tax Treaty Case Law".

[72] Brussels Court of Appeal, 19 March 1998, not published. Discussed by B. Philippart de Foy and O. Lamalle, AFT, 1999, p. 151; and in *Fiscale Koerier*, 1998, p. 292, with comment from I. Behaeghe. See IBFD's online "Tax Treaty Case Law".

[73] *Wisselresultaten – différences de change*.

[74] *Omrekeningsverschillen – écarts de conversion*.

Instead, they represent the difference between:
- the impact, in euro, of the integration of the foreign branch (contribution of the branch to the company's worldwide income) (see section 5.1.1); and
- the (taxable) PE income that is visible locally, and that at least in the interpretation of the Brussels Court of Appeal corresponds to the DTC notion of "profits attributable to a PE".

This also is the practical difficulty and main criticism on the case law: as many as three sets of figures in respect of the results of the branch may be needed for correct reporting at all levels.

5.2.2. Principle charging FX related integration differences to head office

Both decisions of the Brussels Court of Appeal accept that FX related integration differences affect (other) head office income.

The point the reporters want to make in this respect is that this is less obvious than it seems, as it hides a fundamental choice in favour of accepting that FX related tax adjustments in connection with a company's foreign operations affect the Belgian income of the company as well, in a way that on at least one level conflicts with the capital import neutrality principle (CIN), i.e. that under this approach the local taxation of a foreign PE is not the PE's final taxation, but needs to be seen in combination with additional taxation effects (either increasing or lowering the aggregate taxation) under the tax laws of the state of the head office.

It is all the more remarkable that although globally the political support for the CIN principle seems to overtake that for the CEN principle, this approach has even gained momentum as it was confirmed (or even imposed) by the *Deutsche Shell* decision of the ECJ (see below section 5.3).

5.2.3. Theoretical justification

Arguments in support of this principle can be summarised.

5.2.3.1. Non-visibility of differences locally – local nominalism

The view supported by both cases of the Brussels Court of Appeal, is that:
- a company's worldwide income, as determined by accounting law (and therefore in principle also according to tax law) is determined after integration, and therefore already takes into account the integration differences (see CAS advice 172/1);
- it is impossible, if not unfair, to attribute those integration differences to the PE profits themselves (which benefit from an exemption) for the good reason that they are not visible locally;
- so that – and this is the theoretical key consideration – those differences must be charged to head office, and are not covered by (the equivalent of) article 7 (and article 23) of the OECD MTC.

Theoretically, the absence of visibility of the integration differences locally, is not convincing as an argument. Instead, the correct reference should be to nominalism:

both cases of the Court of Appeal in Brussels accept that nominalism for local tax purposes affects head office taxation, as a result of an interpretation of (the equivalent of) articles 7 and 23 of the OECD MTC, which again follows local nominalism.

The most important criticism against this is that not all of the steps of this reasoning find support in tax theory.[75] No rule of international tax law requires PE income to only consist of income that is immediately visible locally or that is confined to local nominalism; on the contrary, the notion of PE income is at least as relevant in the state of residence (country of head office), especially if that state adopts the exemption method and needs to determine the scope of this exemption.

On the other hand, it is in line with recognising the separate existence of the foreign currency (see section 3.2.3.2), which in this context is separate from the "profits attributable to the PE" and gets a different tax treatment.

5.2.3.2. Capital operations – functional analysis

An often heard theory is that the translation of branch accounts into the main accounts is a process of the head office, causing integration differences to be head office gains and losses. This goes back to an older case before the Brussels Court of Appeal of 1943, *re Wagons-Lits*,[76] but is, if read as an abstract principle, an exaggerated interpretation thereof.

The case concerned GBP debt contracted by a taxpayer's head office, but exclusively used in order to fund its UK branch's acquisition of equipment. The Court held that the gain as a result of the repayment of the debt at a time of a weakened GBP was taxable at the level of the head office; it saw a capital operation performed at head office, because the head office had contracted the debt and had been actively looking for the best time and opportunity to buy GBP and (anticipatively) repay the debt.

The authors believe that the correct interpretation of this court case is not to focus on the nature of the capital operations as such, but on the degree of actual involvement of the head office,[77] as if in an OECD inspired functional analysis.

In this interpretation, the 1943 ruling of the Court is not entirely consistent with its 1993 and 1998 rulings, where integration differences affect the head office by definition.[78]

5.2.4. Only losses?

Although case law referred to under section 5 only treated negative integration differences, i.e. additional head office losses, nothing in the arguments permits us

[75] B. Philippart de Foy and O. Lamalle, note under Brussels Court of Appeal, 19 March 1998, *AFT*, 1999, p. 157.

[76] Brussels Court of Appeal, 17 March 1943, *re Compagnie Internationale des Wagons-Lits et des Grands Express européens*, *Bull. Contributions*, 1943, no. 185, p. 141. Com.ITC no. 199/12, seems to follow the exaggerated interpretation.

[77] See Lagae, *op. cit.*, para. 20, p. 513.

[78] Another aspect the 1993 and 1998 rulings disregard is the IFRS criterion of autonomy of the branch.

to consider that the outcome would have been different in the case of positive integration differences, i.e. additional head office profits.

Deferral of positive integration differences depends on their underlying nature: if they consist of unrealised FX results on monetary items, they should qualify for a deferral; if they consist of other underlying items (like e.g. differences on depreciation), a deferral does not seem obvious.

5.3. Consistency with *Deutsche Shell*

5.3.1. The Deutsche Shell *case*

This case[79] is one of a handful of recent cases on tax losses in the light of the EU's principle of freedom of establishment, together with the *Marks & Spencer* case[80] and with the *Lidl Belgium* case.[81]

The specific circumstances of the *Deutsche Shell* case were that the company incorporated its Italian PE into an Italian subsidiary; it then sold the shares in the subsidiary to a third party (with a gain), eventually unwound the PE and repatriated the cash to its German head office. It then decomposed the results from those transactions into:

- a gain on the sale of the shares, which it claimed was taxable in Italy and exempt in Germany on the basis of the relevant DTC; and
- an FX related loss on the repatriation of money (Italian lira) upon termination of the PE, for which it claimed a deduction in Germany.

The ECJ ruled that refusing this deduction was a measure which unjustifiedly restricted the freedom of establishment of the German company, seen from the home state, in order to establish itself through a branch in another jurisdiction.

The similarity between the Belgian case law discussed in section 5.1 and the ECJ case law on *Deutsche Shell* are striking: both judicial instances agree on the obligation for the tax jurisdiction of head office to take into account the (negative) FX related integration differences in connection with a foreign PE.

A difference is that *Deutsche Shell* case reviewed the repatriation of a net investment upon termination of the PE.

5.3.2. Older Belgian case law about the net investment method

Older Belgian case law seems to oppose recognising a net investment closing rate method for tax purposes.

In a 1958 ruling, *re Usines Métallurgiques St-Eloi*,[82] the Supreme Court held that the deduction a Belgian head office had claimed in respect of the FX loss on a French franc denominated "debt claim" on its French PE could only be granted if it were established that the loss was actual and was not compensated by other

79 ECJ, 28 February 2008, Case C-293/06.

80 ECJ, 13 December 2005, Case C-446/03.

81 ECJ, 15 May 2008, Case C-414/06.

82 Supreme Court, 27 May 1958, *re Usines Métallurgiques St-Eloi*, *Pasicrisie*, 1958, I, 1063; referred to Supreme Court after decision by Liège Court of Appeal, 19 February 1957, *Revue Fiscale*, 1957, 480; and referred back to Brussels Court of Appeal, 30 June 1966, *Revue Fiscale*, 1967, 663. See also Com.ITC 195/114.

transactions with the same PE. As the company had failed and even refused to deliver that proof, the deduction could be not granted.

Because of its procedural flavour, this Supreme Court case must not to be seen as a precedent denying a head office the ability to deduct an integration difference, but merely as a confirmation of the need for a detailed justification.

In a 1979 ruling, *re Comptoir du Bois Daniel Sabbe*,[83] the Supreme Court decided on a similar but slightly more sophisticated case, in which the taxpayer had applied a method similar to the net investment closing rate method, and which, as of a certain point in the procedure, focused on the stocks of commercial goods only. Nonetheless, the Supreme Court repeated its 1958 decision.

Unlike in the 1958 case, the taxpayer in the 1979 case had produced the financial statements of its foreign operations. The decision of the Court to still see insufficient evidence for the loss on commercial stock must then mean that a weakened foreign currency does not justify *per se* a deductible loss.

In this respect, the ruling can be seen as challenging the net investment closing rate method, where any FX variation indeed automatically creates integration differences.

But the reporters believe that only seemingly is there a conflict between this and the ECJ decision on *Deutsche Shell*. Obviously, the concern the Belgian case law expresses about insufficient evidence is substantially reduced if only the tax recognition of realised currency gains upon termination of the PE and upon repatriation of cash is at stake, as in *Deutsche Shell*.

This also shows that the timing of the tax recognition, as at stake in *Deutsche Shell*, is different from the timing for which the 1993 and 1998 rulings of the Brussels Court of Appeal were willing to accept that FX related integration differences affect head office income. The reporters suggest that a deferred timing of the tax recognition, as at stake in the *Deutsche Shell* case (i.e. upon termination of the PE), may avoid many of the practical problems referred to in section 5.2.1.

5.4. Consistency with Belgian position on mirror case of Belgian branch

For the sake of completeness, Belgian case law on the recognition of FX effects between a Belgian PE of a foreign company consists of three court cases,[84] and two Parliamentary Questions.[85] The most recent Question of 1998 led to the current

[83] Supreme Court, 21 March 1979, *re Comptoir du Bois Daniel Sabbe*, *Journal Droit Fiscal*, 1979, p. 311; after Brussels Court of Appeal, 30 June 1978, not published, but discussed by J. Kirkpatrick, “Examen de Jurisprudence de 1968 à 1982”, RCJB, 1988, no. 184, p. 695.

[84] The three court cases are: (a) Brussels Court of Appeal, 17 April 1935, *re Compagnie Générale des Industries Textile*, *Journal Pratique du Droit Fiscal*, 1936, p. 15, Bull. Contr. 1935, no. 114, p. 5. See Com.ITC 235/39; (b) Brussels Court of Appeal, 10 June 1942, *re Etablissements Périgné & Cie*, previously quoted in (former) Com.ITC 140/126; (c) Supreme Court, 1 March 1949, *re Dreyfus on Brussels*, 8 July 1947, *Pasicrisie*, 1949, I, 1950; *Journal Pratique de Droit Fiscal*, 1949, p. 194, with note of Jean Van Bastelaer.

[85] The two Parliamentary Questions are: (a) Parliamentary Question of Senator Friederichs, 27 February 1986, *Bull. Q&A, Senate*, 1 April 1986, Session 1985–86, no. 13, p. 661; Bull. Contr., 1986, no. 652, p. 1559; (b) Parliamentary Question of Senator De Clippele, 17 June 1988, *Bull.*

position of the Belgian tax authorities, i.e. that FX results in connection with the funding relation between a Belgian PE and a foreign head office must be disregarded for purposes of determining the taxable income of the Belgian PE.

This looks like the consistent mirror of accepting integration differences at the level of a Belgian head office. In addition, this policy connects to a broader international consensus to not necessarily accept the deduction of interest charges on "domestic loans", notwithstanding the obligation to consider the PE as a "distinct and separate enterprise".[86]

6. Issues related to foreign subsidiaries

Belgian tax legislation does not have a controlled foreign company (CFC) regime. A specific rule[87] tackles outbound transfers of assets to non-residents. Application of this rule would imply that the general principles as mentioned under section 3 would apply.

Under Belgian tax law, capital gains on shares are exempt provided a number of conditions are met[88] (see sections 3.2.3.2 and 3.6), on the one hand, while capital losses on shares are non-deductible, except in case of liquidation under certain limitations, on the other hand.

As to deductible liquidation losses on shares, specific situations can occur in case of FX differences arising between the time at which the shares were acquired and the time at which the liquidation occurs. According to article 198, 7° ITC, a loss on the shares/participation can be claimed by the shareholder at the time of the liquidation, but it is capped by the amount of capital represented by these shares.

The shareholders' perspective should prevail. The purpose of this article 198, 7° is to ensure that what is effectively contributed to the company and not returned qualifies for a capital loss. Consequently, to measure the effective contribution to the company and the amount of the capital, the initial exchange rate at contribution should be used.

7. Other foreign currency issues

7.1. Interference with interest definition

Given the theory of the interest/exchange rate parity, there is a certain financial interchangeability between "interest" and "FX results" in connection with foreign currency denominated investments or loans.

cont.
Q&A, Senate, 9 August 1988, Extra-ordinary Session 1988, no. 14, p. 623; *Bull.Bel.*, 1988, no. 678, p. 2015.

86 Art. 7, §2 of the OECD MTC.

87 Art. 344, §2, ITC.

88 Art. 192 ITC.

7.1.1. Base case: "interest" on a foreign currency denominated investment or debt

If a Belgian company issues notes denominated in a strong currency and with a low nominal coupon, the Com.ITC explicitly admits that the FX differences upon repayment of the notes are not to be treated as interest.[89] Consequently they are not liable to withholding tax.

This statement of Com.ITC adds to the definition of "interest" in the ITC.[90] Under that definition, "interest" is any income or proceed from a loan, deposit or a debt claim, but which can only arise as a result of the "use of capital"[91] (meaning an investment of an actual principal amount, not only referring to a notional principal).

7.1.2. Impact of third party hedge

Here, the addition to the above base case example is that both the issuing company and the investor hedge themselves against their respective currency exposure with their own bank.

In principle, under Belgian tax law, tax follows the legal characteristics of the building blocks of a complex transaction. As a result, the tax treatment in this case still is that of a note on the one hand, and a swap on the other hand.

On the note issue, see section 7.1.1.

If the hedge is a swap, the tax consequences of such a swap apply. In this respect, authors agree that a swap payment is not an interest, if there has been no "use of capital", i.e. if there has been no investment of a principal amount.[92] However, specifically in the case of an FX swap it is likely that principal amounts of currencies are exchanged as well, both at closing and at maturity of the swap. In that respect, authors have defended the fact that the exchange of principal amounts of currencies is not the essence of the FX swap, because the FX swap is a *sui generis* contract which does not have financing or funding as its *causa*.

7.1.3. Impact of a mutual hedge or of a hedge intrinsic to the transaction

A typical example in this respect concerns an individual who enters into a spot purchase with his/her bank in respect of an amount of strong currencies with a low nominal interest, and who at the same time enters into a forward sale with his/her bank in respect of the same amount of strong currencies.

89 Com.ITC 19/5. The comment is indeed only on "bonds".
90 Art. 19, §1, 1° ITC.
91 Art. 17, §1 ITC.
92 P. Smet, "'Collateral'-wet voorziet in fiscale neutraliteit", *Fiscoloog*, 2005, no. 967, p. 3. Since the Law of 15 December 2004, the tax law notion of "interest" not only depends on the legal notion of "loan or deposit", but also of that of debt claim. As the obligations under a swap may constitute a debt claim, the argument to say that swap payments are still not "interest", now refers to art. 17 ITC.

Here, the above principle of recognising the separate building blocks may be set aside by a specific anti-abuse provision,[93] i.e. article 19 §3 ITC. This provision applies to all kinds of arrangements as a result of which one party transfers an amount of money to another party, in return for the obligation of that other party to transfer back an agreed-upon higher amount of money to the first party, at a time or after a period also agreed upon.[94] It provides that the difference between the lower amount of money at the outset and the higher amount of money that is paid back is interest.

On this basis, the Belgian tax authorities consider that the difference between the spot purchase price and forward sales price of the strong currency, as in the example, provided it fits into a two party agreement, is taxable deposit interest.[95]

7.2. Tobin tax and Spahn tax[96]

Entry into force of this tax is subject to adoption by all EU and European monetary union members of such a tax.

The tax has been introduced for funding purposes and in order to counter speculation against certain currencies. The proceeds of the tax would be contributed to an EU fund for development aid.

The tax rate is 0.2 pro mille. A second tax rate of maximum 80 per cent could apply if the FX rate exceeded a certain broad band fixed by Royal Decree. The above-mentioned tax rates apply on the gross amount of the exchange transaction inclusive of additional expenses.

8. FX results and DTCs

8.1. Existing situation

None of Belgium's DTCs contains any special provision on how to treat FX results. Also the official commentary of the Belgian tax authorities on DTCs does not provide further guidance.

One very useful reference, but with no clear answers, is in paragraphs 16 and 17 of the 2005 OECD commentary on article 13 of the OECD MTC.

8.2. Room for further treaty guidance

Specifically in respect of the discussion in section 5, official and international treaty guidance would be welcome on whether integration differences must be allocated to an enterprise's head office or to its foreign PE. If they are allocated to head office, guidance on the interpretation of (the equivalent of) articles 7 and

93 The general anti-abuse provision of Belgian tax law, in art. 344 §1 ITC, is not discussed here.

94 Smet, *Handboek Roerende Voorheffing*, Biblo, 2003, no. 442 *et seq.*, pp. 186 *et seq.*; Cheruy and Laurent, *op. cit.*, no. 1389 *et seq.*, pp. 818 *et seq.*

95 Com.ITC 19/21.10, second para.

96 See section 1.

23 of the OECD MTC is needed to confirm this. If, in contrast, they are allocated to the PE but remain invisible and untaxed locally, other issues arise.

While it is fair to say that under this approach such invisible and untaxed positive differences meet the condition that they "may be taxed" in the state of the PE, as required under the exemption method of article 23 of the OECD MTC, are they also "taxed", as required by some of Belgium's DTCs?

Belgium generally accepts that net PE losses may be immediately deducted from Belgian income, subject to future recapture under the relevant DTC. If negative FX related integration differences create a PE loss, invisible locally but visible from head office, how then would recapture work?

Another item for which guidance may be needed relates to what method for determining FX related integration differences should be preferred internationally.