Belgium

Branch Reporter
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Summary and conclusions

Because of the size of the country and its central EU location, the Belgian economy is by its very nature open and exposed to international trade.[1]

In this context, considering the current economic climate, Belgium will be faced with considerable changes in the coming years and it is expected that business restructuring will be a key topic. Belgium's lawmakers are conscious that this has always been so and Belgian tax law provides for numerous incentives aimed at encouraging the maintenance of key intangibles and headquarters in Belgium.

The outflow of profits, mostly entailing relocation of production capacity in the context of supply-chain conversions or in the wider context of globalisation, is now a very hot topic for the Belgian government. The Belgian tax authorities have no specific guidelines in this respect and commonly adhere to the OECD guidance on the transfer pricing aspects of business restructuring.[2] In this respect, taxpayers can apply for specific advance pricing agreements (APAs) from the Belgian Service for Advanced Decisions (Rulings Commission).

While analysing a restructuring, the Belgian tax authorities carefully investigate whether a Belgian company subject to a change in function or risk should have received or paid any consideration. To determine whether or not consideration is due, all the circumstances at the precise time of the conversion should be considered; the Belgian tax authorities may not take account of subsequent information to reassess past operations.

The Belgian transfer pricing unit is very alert in cases of business restructuring, especially when scaling-down costs are reallocated to limited risk entities. It is therefore highly advisable to prepare solid business-conversion documentation in advance for the purpose of a transfer pricing defence file, or to request an APA. Such documentation is not mandatory by law but is a must when a company is faced with a tax investigation.

The need for robust documentation should also be considered in the light of the current economic climate. Because governments are under pressure to raise revenue, they will inevitably increase the pressure on transfer pricing audits.

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1 European Commission, Enterprise and Industry, *Internationalisation of European SMEs*, EIM Business and Policy Research, 2010, pp. 23–24.

2 New Chapter IX to the OECD transfer pricing guidelines for multinational enterprises and tax administrations as approved by the Committee on Fiscal Affairs and by the OECD Council on 22 July 2010.

When looking into a restructuring, the Belgian tax authorities cannot disregard the conversion if the substance requirements are complied with. Assessment of the restructuring therefore relies solely on transfer pricing considerations and reference to the direction taken by the Belgian Rulings Commission offers useful guidance in this respect.

1. Domestic provisions of international scope applying in business restructuring cases

1.1. General overview

As with most of the EU27, Belgium has battled through turbulent times following the 2008 crisis. While analysts are now confident that Belgium will be able to climb out of the recession, there is still a prospect that the coming years will bring limited growth. It is therefore expected that business restructuring will affect the Belgian economy with positive and negative effects.

As already stated, Belgium has taken a proactive approach towards business restructuring trends and over the years a number of legislative measures have been taken to create a tax-friendly environment attractive to inbound investment to Belgium (such as several types of research and development (R&D) deductions, patent box or notional relief on equity). In an outbound context, Belgium's lawmakers recognise the need for multinational enterprises (MNEs) to organise their business in a competitive context and do not intervene by taking protectionist measures against outbound migrations.

In some cases, relocations cannot be avoided and, like most European countries, Belgium has also had to face up to outbound relocations of production capacity to lower-cost (lower-taxed) countries, whereby the problem arises as to whether or not compensation or a so-called exit tax might be due.

Over the past few years, the Rulings Commission has issued several APAs dealing with both in- and outbound reorganisations. The reporter observes that the Belgian tax authorities tend to attach great importance to the underlying business rationale in taking such decisions. When they investigate whether consideration is due in the case of an outbound restructuring, all realistic options will be considered in order to determine whether this is a mere opportunistic act or a necessity for survival.

1.2. The arm's length principle and cross-border business restructuring (CBBR)

As is the case with most members of the OECD, Belgium has endorsed the principle of the arm's length standard as set forth in article 9 OECD model convention (MC) and the OECD guidance.

Historically, Belgian tax law has recognised this principle by introducing anti-abuse rules for transfer pricing purposes[3] and under its administrative guidelines.[4]

[3] Ss. 26 and 79 ITC.
[4] Com. ITC, nos. 26/17; practice note of 28 June 1999, Cir. AAF/98-003.

Until 2004, the anti-avoidance transfer pricing provisions were structured around the notion of "abnormal or gratuitous benefits received", which was open to widely subjective interpretations.

Where an undertaking established in Belgium grants "abnormal or gratuitous benefits", section 26 ITC[5] provides that they are added to its own profits unless the benefits play a role in determining the taxable income of the recipients.[6] This provision does not apply where the transaction is effected between two Belgian companies as, in this case, the benefit will fall to be included in the tax base of the recipient.[7]

One specific anti-abuse provision laid down in sections 79 and 207 ITC prevents the use of current and carried-forward tax deductions (participation exemption, carryover tax losses, investment deduction, gifts, etc.) for set-off against amounts equivalent to benefits or profits that derive from "abnormal or gratuitous benefits" that the taxpayer has obtained from an undertaking with which it has interdependent links. This limitation was extended in 2002 to current-year losses[8] and to cases where the abnormal or gratuitous benefit is received from abroad.[9] This specific anti-avoidance measure is aimed at catching transfers of resources from a beneficiary company to a company that has specific tax deductions available to it.[10]

In order to clarify these fragmented pieces of legislation and make a clear break with the subjective notion of "abnormal or gratuitous benefits", in 2004 the arm's length principle was explicitly translated into a separate section 185(2)(a) ITC,[11] which covers both paragraphs 1 and 2 of article 9 OECD MC; a similar provision was laid down in section 235(2) for transactions involving permanent establishments (PEs).[12] This latter section provides for the application of the arm's length standard to MNEs in a cross-border context as well as to tax relief for profits in the case of concomitant (or unilateral) adjustments further to an application for an APA or if the company is involved in mutual agreement procedures under tax treaties or under the EC Arbitration Convention.[13]

5 Income Tax Code.

6 The benefit need not necessarily be effectively taxed. It may, for instance, concern a reduction in the amount of the beneficiary's loss carryover (Brussels Court of First Instance, 19 May 2005, *Fiscologue*, 2005, no. 985, p. 9).

7 PQ no. 17 (Cooreman), 26 April 1999, Bull. ITC, p. 3257; also no. 916 (De Seny), 9 December 1994, Bull. ITC, p. 1298; this principle does not apply where the operation results in tax relief for the parties; PQ of 14 July 1995 (Nelis-Van Liedekerke), Senate, 1996, p. 559.

8 Change to s. 207(2) ITC.

9 Repeal of the official tolerance provided for under Com. ITC, no. 79/12.

10 Following a statement by the Belgian Ministry of Finance, this new provision results in the taxation of any advantage or benefit received, regardless of the accounting result of the company. In the reporter's view, this statement would not hold up in court where the advantage was not accounted and derived from a cost saving (P. Lion and L. Meeus, no. 952, 8 October 2004, pp. 2–5).

11 Act of 9 July 2004 amending the Act of 24 December 2004 and introducing s. 185(2) ITC, which came into force on 19 July 2004; prior to this legal provision, the Belgian tax authorities allowed similar adjustments by way of administrative decisions ("informal capital rulings"); this practice was condemned by the EU Council as constituting a harmful tax measure (*Primarolo Code of Conduct Report*, Ref. SN 4901/99 of 23 November 1999).

12 This is relevant as s. 26 ITC does not deal with relations between a head office and a PE.

13 OJ L 255, 20 August 1990, also commented on in practice notes nos. AAF/98-0170 of 7 July 2000 and AAF/98-0170 of 25 March 2003. See I. Verlinden and P. Boone, *Tax Management Transfer Pricing Report*, 23 August 2000, vol. 9, no. 9, and T. Vanwelkenhuyzen, Larcier, Brussels, 2009, p. 109.

The "unilateral" downward adjustment of article 9(2) OECD MC as introduced into Belgian tax law is a fairly unique feature since very few countries have thus far provided for this possibility.[14] In view of the unilateral character of the adjustment, the portion of accounting profit exceeding the arm's length taxable profit should be agreed in a formal APA with the Belgian tax authorities (a so-called "excess profit ruling" – see section 2.1.1). In this way, the Belgian Rulings Commission does not require a tax adjustment in another country.[15]

Section 185(2) ITC is only applicable to cross-border commercial or financial relations between related companies, meaning that it does not cover domestic situations, cross-border transactions between an enterprise and a physical person or transactions between unrelated parties, which (may) continue to fall under section 26 ITC.[16]

1.3. General and specific provisions with an international focus or effect in business restructuring cases

Apart from the APA practice and the general transfer pricing provisions described above, there are no specific business restructuring provisions available in Belgian tax law. Belgian practice mainly relies on the OECD guidance and this report therefore refers extensively to the guidance and APA practice, particularly as applied since late 2004.

It is important to note that the Belgian practice note explicitly rejects the use of insight.[17] The same approach is taken by the Belgian courts.[18]

1.4. Business restructuring and domestic anti-abuse rules

As a starting point, it should be pointed out that the Belgian tax system does not recognise the substance-over-form principle in the strict sense (also called the abuse of law principle) as recognised in the tax legislation of several neighbouring countries (e.g. the UK, France, the Netherlands). On a more accurate tack, the legal reality of a transaction prevails over its economic substance and mere legal form.

14 Belgium has tax treaties with over 80 countries, most of which contain provisions in line with art. 9(2) OECD MC as well as art. 25 on MAP clauses.

15 See PQ of 13 April 2005 (Tommelein), Commission des Finances de la Chambre, no. 51, p. 29. De Meunter, "Ajustement des bénéfices vers le bas sans correction préalable vers le haut", *Fiscologue*, no. 1077, 3 August 2001, p. 9 as well as PR, Chamber 2003–2004, no. 49, of 8 October 2004, pp. 7451–7455; P. Cauwenberg, *Fiscologue*, no. 254, 28 February 2005, p. 7.

16 Practice note 4 July 2006, Ci.RH.421/569.019 (AOIF 25/2006). The interactions between the downward adjustment provided for in s. 185(2) ITC may conflict with ss. 79 and 207 ITC, which provide that deductions may not be allowed against an abnormal profit received from abroad. This question is covered in most APAs on excess profits (see Decisions 2010.100 of 30 March 2010, 900,147 of 22 December 2009, 900,309 of 8 December 2009 and 900,261 of 17 November 2009).

17 Practice note no. AAF/98-003 dated 28 June 1999 reports, in terms of intangibles, that "provided the analysis at the time of the transaction is supported by contemporaneous evidential documentation, no factors need to be taken into account that might show a higher valuation". A similar approach is recommended by the OECD guidance, 6.2.9.

18 The Belgian Court of Cassation has ruled on several occasions that the tax authorities cannot rely on information collected from one unnamed taxpayer to assess another taxpayer (Cass., 20 December 1991, *Pennatz*, Com. ITC, no. 26/43); Antwerp Court of First Instance, 4 June 2003, *FJF*, 2004/130; see also Vanwelkenhuyzen, *op. cit.*, p. 88.

This legal reality principle is a fundament of Belgian tax law, having its roots in the Belgian Constitution[19] and general law.[20] The principle is embodied in an old decision by the Court of Cassation which recognises the right of parties to choose the least taxed route.[21]

This decision has been confirmed in several subsequent cases in which the Belgian Court of Cassation has held that Belgian tax law does not set forth an economic reality principle.[22]

However, while there is no general abuse of law principle, Belgian tax law does contain (a) a general anti-abuse rule and (b) a specific anti-abuse rule. Below are analysed their practical implications in cases of business restructuring.

1.4.1. Sham doctrine

The doctrine of statutory breach (a civil law principle) is also applicable in Belgian tax law. Also referred to as the sham doctrine, this civil law principle should not, however, be confused with the economic reality concept discussed above.

There is said to be a sham where the parties make an apparent deed whose effects they agree to change or eliminate by use of another deed that remains secret (a sham transaction). In that case, there is only one real agreement, the secret one. Here, there is said to be tax fraud (and not an abuse of tax law or choice of the least taxed route – see above), which entails dissimulation and runs counter to the principle of genuineness.[23]

It is noted that the Court of Cassation has held that the tax authorities cannot interfere in how companies are managed.[24] Following this principle, the abnormal character of a transaction is not relevant in assessing whether it is sham; the tax authorities still need to demonstrate the existence of a secret agreement in order to invoke dissimulation.

1.4.2. General anti-abuse measure

However, Belgian tax law does contain a general anti-avoidance provision applicable to income tax. The Registration Duties Code also includes similar anti-abuse provisions.[25]

The initial purpose of this general anti-avoidance clause, introduced in 1993, was to enable the tax authorities to combat certain manoeuvres aimed at reducing

19 Principle of "legality of tax" (art. 170 of the Belgian Constitution). T. Afschrift, Larcier, Brussels, 1994, pp. 82 *et seq.*; S. Van Crombrugge, 5th edn, 1999, p. 163.

20 Belgium is a civil law country.

21 The so-called "Brepols" doctrine of 6 June 1961, Court of Cassation, June 1961, Pas., 1961, I, 1082.

22 Court of Cassation, 27 February 1987, Pas., I, p. 177, Bull. ITC, 1988, no. 668, p. 156, *FJF*, no. 87/68 (case of *Maas International*) and Court of Cassation, 22 March 1990, *JDF*, 1990, p. 116 (case of *Aux Vieux Saint Martin*).

23 M. Dassesse and P. Minne, *Droit*, 5th edn, Bruylant, 2001, pp. 67 *et seq.*

24 Court of Cassation, 26 March 1968, Pas., I, 913; Court of Cassation, 20 October 1959, Pas., 1960, I, 216; Liège Court of Appeal, 18 December 1985, *FJF*, no. 86/194; Antwerp Court of Appeal, 10 September 1990, Bull. ITC, 1992, 863, and Brussels Court of Appeal, 9 September 1994, *FJF*, no. 95/11.

25 S. 18 RDC.

tax liability by means of legal constructions. The measure is general because it covers all types of transactions.

It is embodied in section 344(1) ITC, in application of which the tax authorities may give a different legal characterisation to a deed or collection of deeds (step-by-step approach) where the characterisation given by the parties is aimed at avoiding tax.[26]

By amending the legal characterisation of a transaction,[27] the tax authorities also bring the deal under different tax rules, characterising the transaction in such a manner as to enable them to raise (more) tax revenue.

Because of its restrictive conditions, the practical implications of section 344(1) ITC in business restructuring is relatively limited, it being very unlikely that a reorganisation might be characterised so differently as to alter or affect the legal consequences of the act(s) entered into among the parties. Indeed, a restructuring involving, say, relocation of a production facility to a "low-cost country" cannot be discounted, since it is outright impossible to find another legal classification for the transaction (see section 2.8).

1.4.3. Specific anti-abuse measure

On top of the general anti-abuse provision, the Belgian ITC also contains several specific anti-abuse provisions designed to prevent taxpayers unwarrantedly benefiting from certain provisions in the ITC that enable them to contrive a reduction in their tax liability.

These specific anti-avoidances measures are for the most part characterised by a requirement to prove the existence of sound financial or economic reasons (the former anti-abuse provision) or the absence of tax evasion or tax avoidance as the transaction's principal objective or one of its principal objectives (new anti-abuse provisions inserted in section 183 ITC)[28] in order to be able to benefit from an advantageous tax regime (e.g. relating to tax attributes, the tax-neutral character of reorganisations, etc.).

To analyse all of these measures would be beyond the scope of this report and comments are therefore limited to the following two provisions, which are relevant in the case of business restructuring.

A first limitation which may be relevant in the case of an outbound transfer provides that the transfer of certain assets cannot be upheld against the Belgian tax authorities where the transfer is to a non-Belgian resident taxpayer benefiting from a significantly more advantageous tax regime than the Belgian tax

26 Parl. Doc., Chamber, 1992–1993, no. 1072/8, no. 26, p. 102; O. Bertin, *RGF*, 1994, pp. 44 *et seq.*; Brussels Court of First Instance, 7 March 2002 *Courrier fiscal*, 2002, pp. 418 *et seq.*

27 The tax courts can only disallow the legal classification of a transaction or several transactions, which implies that the legal effects of the new qualification cannot be modified (e.g. a redemption of shares cannot be recharacterised as a distribution of dividends: Court of Cassation, 4 November 2005: the legal effects of a lease and those of a usufruct are different: Court of Cassation, 22 November 2007, *FJF*, 2008, p. 541).

28 New anti-abuse provisions introduced into Belgian law based on the general anti-abuse provisions of the EC Merger Directive and applicable to qualifying reorganisations carried out on or after 12 January 2009. D. Garabedian, *Fiscologue*, 10 October 2008, no. 1132, p. 3; De Broe, *op. cit.*, Doctorate Series, 2008, p. 219.

regime.[29] In the reporter's view, this is the only case where the Belgian tax authorities may effectively not recognise the transaction that has taken place (e.g. in the case of a transfer of valuable intangibles from a Belgian company to a Cayman Islands company).

Another limitation which is relevant in the case of a restructuring relates to the change of control rules, whereby tax losses carried forward may be lost if the change of control is not motivated by legitimate financial and economic reasons. This provision has been subject to numerous APAs in the case of third-party transactions where, in most cases, maintenance of the tax losses was subject to employment conditions.[30] The limitation does not, however, apply in the case of a change of control within a consolidated group and is therefore of limited impact in related-party transactions.[31]

2. Tax effects of CBBR

2.1. General overview

In order to gauge the tax consequences of a CBBR, it is key to first determine whether the restructuring involves a transfer of function, assets and/or risk associated with profit/loss potential between associated enterprises.

If this is so, in a subsequent stage,[32] the taxpayer should analyse whether or not compensation would have been due between independent parties further to the relocation or conversion.

2.1.1. Inbound relocation

In the case of an inbound relocation, the Belgian entity or PE is allowed to depreciate the assets transferred at their acquisition/transfer value for tax purposes.[33]

If the taxpayer is able to demonstrate that part of the profit potential transferred to Belgium would not have been generated in a stand-alone situation (i.e. had the company not been part of an MNE), the taxpayer can negotiate a unilateral APA with the Belgian tax authorities in order to exempt the "excess profit part" from Belgian taxation in application of section 185(2) ITC.

29 S. 344 ITC. In such a case, the tax authorities may not disregard the legal effects of the transaction but may tax the income derived from the transfer as if it had not taken place: P. Lion, *RGF*, 1995, p. 359 *et seq.*; J. Thilmany, Ced Samsom, 1994, p. 126.

30 S. 207 ITC amended by the RD of 20 December 1996; Bull. ITC, no. 811, January 2001. The reference to an employment condition is not laid down in the law but is based solely on legislative history. This has been severely criticised by the courts and legal writers: Ghent Court of Appeal, 9 September 2008 (2006/AR/1280); Antwerp Court of First Instance, 31 March 2008 (2006/4453/A).

31 Report to the King, RD of 31 December 1996; PQ, Van Hasendonck, 5 January 1998.

32 The revised OECD guidance provides for a nine-step process as an example for conducting a qualitative comparability and benchmarking analysis (OECD guidance, 3.1 *et seq.*).

33 S. 21(1) and (4) ITC, defining acquisition value for tax purposes by reference to the accounting legislation (s. 35 RD/CD).

The rationale for downward adjustment is that the taxpayer is able to demonstrate that the adjusted profits correctly reflect what they would have been had the transaction been at arm's length. While this adjustment is unilateral[34] and can be obtained outside the judicial context of a mutual agreement procedure (MAP), the law has been drafted so as to emphasise that it was not the intention of the Belgian tax authorities to subsidise the tax income of another state.[35] In other words, if the contracting state increases the profits of the associated enterprise to a level exceeding an arm's length profit, this provision will not apply as regards the excess.[36]

2.1.2. Outbound relocation

In the case of an outbound relocation, any compensation received is subject to corporate income tax at the rate of 33.99 per cent (exit tax).

If it is agreed between affiliates that no, or limited, compensation will be paid, the Belgian tax authorities can still reintegrate a "deemed compensation" into the tax base of the Belgian company, representing the difference between the compensation effectively paid or payable and the arm's length compensation that would have been payable between independent parties. Such an adjustment is based on the general transfer pricing provision in application of the arm's length principle as laid down in section 185(1) ITC or section 26 ITC (see section 1.3).[37] If the Belgian transferor has prior carryover tax losses, these can be used to offset the benefit granted, which thus does not result in a tax cash-out but mere annulment of (part of) the tax losses available.[38]

Furthermore, the question arises as to which party should bear the costs of an outbound relocation. This could be the company itself, the parent company or the principal. The answer can be found in the contractual arrangements – in so far as they are contracted at arm's length – on the one hand, and by looking to the party taking the decision for the relocation and benefiting from that decision, on the other. As Belgian tax law adheres to the principle of "form", the company bearing the costs should formally take all the relevant decisions (e.g. board minutes) and make the required notification (see section 3).[39]

2.1.3. Documentation

There is no formal requirement for Belgian corporations to maintain (contemporaneous) documentation in any format. The general rule under Belgian tax law is that a duly, timely filed tax return is deemed to be correct unless the tax authorities

34 This has been confirmed in an answer by the Minister of Finance to a parliamentary question (P. Cauwenberg, *Fiscologue*, no. 254, p. 7).

35 Decision 600,460 of 30 January 2007, M. De Munter, *Fiscologue*, 2007, 1077, pp. 5–7.

36 This situation, reported by Cauwenberg, is unlikely in the reporter's view to apply in a treaty context in the light of art. 9(1) OECD MC (see Chapter IX on associated enterprises): P. Cauwenberg and A. Gaublomme, Larcier, 2009, pp. 155 *et seq.*

37 S. 185 ITC. Belgian tax law does not recognise the principle of deemed dividends or contributions and does not provide for secondary tax adjustments in the case of transfer pricing adjustments.

38 The gain cannot be exempt in the case of an outbound transfer to a related party as regards compensation exceeding the arm's length value in application of ss. 79 and 207 ITC (see section 1.2).

39 I. Verlinden and K. Smits, *International Transfer Pricing Journal*, July/August 2009, p. 258.

can prove mistakes or under-reported income.[40] In order to allow tax inspectors to do their review or audit work, both the taxpayer and third parties[41] are under an obligation to cooperate and provide all relevant information and documentation they are requested to produce.

Considering the taxpayer's obligation to cooperate, the Belgian transfer pricing unit requires taxpayers to produce transfer pricing information that is in line with the EU Code of Conduct of 27 June 2006 within one month of a request by the authorities (say, two months, if an extension is obtained). This requirement and other guidance regarding transfer pricing audits is detailed in a practice note of November 2006.[42]

The practice note issued by the Belgian tax authorities recognises the principle of the "prudent manager", prudence implying that – depending on the nature of the transactions – the manager should[43] have written documentation of related-party deals in order to substantiate the arm's length character of the transfer pricing applied.

In practice, considering the time available for a response and the expectations of the tax authorities, it is highly advisable to prepare robust transfer pricing documentation in advance. The documentation should cover the contractual terms of the arrangement that lay out the key relationship between the parties, under which they assume the risk associated with the new operational structure. Importance is also attached to the economic substance of the risk allocation (see section 2.2) as well as to the description of the rationale for the restructuring and the options realistically available to the parties involved (see section 2.7).

2.1.4. APA/guidance from the Belgian tax authorities

There are very limited cases involving litigated transfer pricing adjustments that have been challenged by Belgian taxpayers. This is merely a result of field investigations and practice, whereby most transfer pricing adjustments come in the form of a settlement reached between the tax authorities and the taxpayer at the administrative level of an investigation (before embarking upon the "judicial" level).

In this context, in the absence of detailed legislative guidelines on transfer pricing, the practice note issued by the Belgian tax authorities and the unilateral APAs rendered by the Belgian Rulings Commission play an important role in the Belgian transfer pricing landscape.

Over the last few years, the Belgian rulings practice has evolved very business-mindedly and proactively in terms of transfer pricing. While APAs are still unilateral written decisions communicated to the taxpayer by the tax authorities, they are typically rendered after a no-name consultation phase and incorporate a series of assumptions, facts and, sometimes, undertakings given by taxpayers, resulting from close collaboration between taxpayer and tax authority.[44]

40 S. 339(1) ITC.

41 S. 315 ITC (taxpayer obligation to cooperate) and s. 322 ITC (collection of information by the tax authorities).

42 Practice note of 28 June 1999, Dutch version no. AFZ/98-0003, French version no. AAF/98-0003.

43 *International Transfer Pricing*, 2009, PricewaterhouseCoopers, Belgium section, p. 271.

44 D. Van Stappen and Y. de Groote, *Transfer Pricing International Journal*, no. 7 (2010), pp. 4–7.

2.2. Transfers of risks

Risk is an important factor closely linked to profit generation and the expected return on an investment. The question therefore arises of whether compensation is due when the risk profile of a company is switched to a low- or high-risk entity.

Between third parties, contractual arrangements will be the starting point for determining the risks borne by each of them. Therefore, what has been contractually agreed – whether a transfer of risks or functions, termination of a contract or renegotiation of its terms – will govern whether a certain compensation or "cooling-down" period needs to be adhered to.

The Belgian Rulings Commission ruled in the case of conversion of a manufacturing entity and full-risk buy–sell entity into a toll manufacturer/commissionaire of a Swiss principal that there should be no phase-out costs.[45] The analysis essentially relied on the transfer of intellectual property rights and the contractual terms pre-conversion as well as the fact that similar transactions had occurred between independent parties without any consideration (see section 3.3).[46]

Similar to in an open-market environment, contractual arrangements will be the starting point for determining which party bears the risk of certain transactions in a related-party transaction. In order to provide an arm's length yardstick, it will be necessary for (a) the contractual arrangements agreed between the related parties to reflect economic reality and (b) risk to be allocated in conformity with the terms of the contract.

If there is a mismatch between the contractual location of risk and the location where control over the risk is exercised, a transfer pricing adjustment may be considered. As indicated below, Belgian tax legislation does not provide for ways of disregarding a business restructuring,[47] and the recharacterisation of contractual terms tends rather to be done on the basis of transfer pricing adjustments (see section 2.8).

In determining the arm's length character of the allocation of risk, the key factor will be which party in reality "controls" the risk and has the economic substance to do so. Although the contractual relationship may provide that the risk is borne by one of the parties in a given location, this is not sufficient to conclude that the risks are *de facto* allocated there. It should also be ensured that the party bearing this risk has the ability to manage and control it and the financial capacity to assume it.

The notion of "control over risk" is one of the key features of the OECD guidance in relation to article 9 OECD MC. This notion should somehow be related to the "function over risk" approach applied in relation to article 7 of the OECD MC, albeit with a focus on the risk approach rather than day-to-day management of the risk; control of a risk may be a different matter from managing it on a daily basis.

The "personal" aspect of the control of risk requires the entity bearing the risk to have the necessary personnel in terms of skills and numbers to assume the risk, as well as the requisite authority and decision-making power. "Financial" control over the risk also has an important impact on the risk's location. The party assuming the

45 Rulings Ci.D132/001 and Ci.D132/002 of 13 December 1999, commented on by T. Vanwelkenhuyzen and R. Willems, *International Transfer Pricing Journal*, July/August 2000, pp. 114–116.

46 Decision 600,085 of 13 April 2006.

47 This approach is in line with the last version of the OECD guidance, which ultimately removed assertions 1.48–1.56, which granted licence for the recharacterisation of contractual terms.

risk should have the capacity to bear the consequences of the risk should it materialise or put a mechanism in place to cover it (e.g. by hedging it).[48]

The capacity to bear risk is critical in the current market environment, where very great pressure may be brought to bear on the principal. While entrepreneur structures located in low-tax jurisdictions may generate savings in normal business conditions, it may well be that they are not efficient from a tax standpoint in times of recession, as limited risk entities cannot fall into a loss position.[49]

In the reporter's view, aligning an entrepreneurial structure requires redefining the decision-making process to ensure that the principal has the people with the expertise and authority to perform "risk-control" functions credibly.[50] As indicated above, risk control should still nonetheless be distinguished from the day-to-day management of risk.[51] Control over risk should be attributed to the party that has the authority and substance to determine and monitor the strategy and management of the risk, i.e. the party that takes the decision to acquire the capital for assuming the risk.[52] Finally, the reporter would note that, even if there is an outbound transfer of risks, this does not necessarily require consideration to be paid to the transferring Belgian entity. Whereas it is normal for a company bearing a high risk to realise a large profit, the uncertainty of realising this profit is key.[53]

2.3. Transfers of functions

As far as a transfer of functions is concerned, it has to be analysed whether a third party would be willing to pay for such a transfer; in other words, whether this function will generate a certain (expected) return for the receiving entity. If so, this will trigger capital gains, taxed at 33.99 per cent. Obviously, it should be possible to transfer the functions and to transfer the protected right over them.

Setting up an entrepreneur structure mainly relies on the centralisation of risks and key people functions in one principal location. It is commonly accepted that assigning employees to a centre of excellence does not generate the transfer of an intangible. Employees are free to choose their employer and companies have no ownership rights over their employees.[54] Failing any such right, there is no intangible to be paid for or consideration to be paid where functions are relocated.

48 OECD guidance, 9.25.

49 R. Schatan, *International Transfer Pricing Journal*, January 2010; Van Stappen and de Groote, *op. cit.*

50 See the example of fund manager and contract R & D provided in 9.25 and 9.26 of the OECD guidance, where services may be provided at low risk if significant decisions are taken over risk by the principal, plus the graph on the allocation of risk in 9.33.

51 The "function-over-risk" approach links in to the OECD PE report (OECD, *The Attribution of Profits to Permanent Establishments*, Parts I–IV, Paris, OECD), which introduced the concept of the "significant people function" (replacing the notion of the "key entrepreneurial risk-taking function" – KERT). Francine Barreiros Rosalem, *International Transfer Pricing Journal*, IBFD, January 2010, pp. 12–33.

52 See the example of a tolling arrangement provided in W. J. Murphy and G. Armstrong, *Tax Planning International Transfer Pricing*, 06/07, p. 3.

53 This notion is also reflected in the OECD guidance: "In the open market, the assumption of increased risk will also be compensated by an increase in the expected return."

54 I. Verlinden, Belgian Report, 61st IFA Congress (*Intangibles*), Kyoto 2007, *Cahiers de droit fiscal international*, vol. 92a, p. 114.

2.4. Transfers of tangible assets

The transfer of tangible assets between related parties should generally be done at market value and generate a capital gain in the amount in excess of their fiscal value.[55] Business restructuring can involve such transfers (e.g. equipment, inventory) by the restructured entity to a foreign associated enterprise. They do not trigger significant transfer pricing difficulties as, in most cases, unrelated-party market prices are available to fix the arm's length consideration.

The question may be trickier in the absence of open-market references, as would be the case with a sale of inventory. While there may be yardsticks for raw materials and finished goods, work in progress and semi-finished products or spare parts pose greater difficulty. In some cases, the Belgian accounting rules applied to value inventory can result in significant gains in cases of disposal. This can be so for slow-moving stock where the last in first out method is used or if the indirect cost is expensed directly.[56] This question has been addressed in some APAs involving the conversion of a fully fledged toll-manufacturing entity into a toll manufacturer.[57]

2.5. Transfers of intangible assets

In terms of business restructuring, the key issue is to decide whether the transfer entails a migration of assets to which there attach specific rights stemming from law or contract (e.g. a patent or design). The rationale is that acquirers only pay for assets that are protected.

Furthermore, in the case of a transfer of intangibles built up by the transferor company, there is a quite legitimate question as to their value. Certain intangible assets such as patents, trademarks, etc., clearly qualify as intangible assets as they are protected by law. However, other types of intangibles such as market share, human capital, etc., will not always qualify as an intangible requiring consideration (so-called "soft intangibles").

As indicated, it should also be checked whether certain profit potential/profit drivers also qualify as intangibles. This aspect was subject to numerous debates during the consultation on the OECD guidance on business restructuring, which ultimately states that an independent enterprise does not necessarily receive compensation when a change in its business arrangements results in a reduction in its profit potential or expected future profits. The arm's length principle does not require compensation for a mere decrease in the expectation of an entity's future profits.[58] The question is whether there is a "transfer of something of value"[59] (rights or other assets) or termination or substantial renegotiation, and whether that would be compensated between independent parties in comparable circumstances.

55 S. 43 ITC.
56 S. 37 RD/Companies Code. Belgium allows direct cost accounting for stock resulting in an undervaluation of inventory.
57 Decision 800,456 of 31 March 2009.
58 OECD guidance, 9.65.
59 The term "something of value" referred to in the OECD guidance is rather vague and subject to interpretation, as it is broader than transfers of property interests.

In view of the above, a "business opportunity" or transfer of "profit potential" does not constitute a protected intangible as, in an open market environment, all business opportunities are open to all parties as long as they do not rely on proprietary rights. This approach is also taken by the Rulings Commission (see section 3.2).[60]

In order to value an intangible, one needs to have the right to use it, and this right should qualify for protection. If a company is not able to claim ownership of an intangible, a third party will not be willing to pay to acquire it as the freedom to use it cannot be guaranteed.[61] Such reasoning is especially relevant with respect to the human capital of an organisation and its embedded knowhow (see above).

OECD and Belgian tax law do not lay down specific provisions relating to the valuation of intangibles.[62] Valuation should therefore rely on reference to an open market value, bearing in mind the fact that intangibles such as knowhow, experience, etc., may be so specific that they are unlikely to have a reliable third-party benchmark.

The rulings practice surrounding patent-box deductions offers useful guidance for fixing arm's length royalty fees that can be used as the basis for a royalty-flow valuation.[63] The Belgian Rulings Commission accepts the valuation of intangible rights either on a cost-plus basis (e.g. by reference to the R&D cost of investment) or using the comparable uncontrolled price method (comparison with third-party licences, the most favoured approach) or the transactional net margin method (TNMM) and residual profit split method, which basically fix royalty rates by reference to the added value of the licence on a particular product.[64]

In the case of a transfer or trade of client base or goodwill, Belgian case law and APAs contain numerous references depending on the underlying industry and business. A discounted-cash-flow based methodology is commonly accepted by the Belgian Rulings Commission[65] and the use of third-party valuations is also preferred, but not mandatory (this is more commonly applied in the case of a going concern transfer – see below).[66]

2.6. Transfer of a going concern

In some cases, a business restructuring involves transfer of an activity, a "going concern". These transfers cover all the assets and liabilities (on and off the balance sheet) attaching to a certain business activity, including the ability to operate and bear certain risks. As is generally the case in such a transfer, the value should take

60 Decisions 900,417 of 22 December 2009 and 2010,100 of 30 March 2010.

61 I. Verlinden and Y. Mondelaers, *International Transfer Pricing Journal*, January/February 2010, p. 49.

62 Verlinden, *op. cit.*, p. 109.

63 See the several APAs discussed in section 3.4.

64 Decision 700,541 of 4 November 2008; B. Springeal, *Fiscologue*, no. 1202, p. 6; Decision 800,311 refers to the "contribution relative to the R&D personnel"; I. Onkelinx and P. Rens, *Fiscologue*, no. 1180, p. 3.

65 Decisions 400,295 of 9 June 2005, 300,244 of 19 February 2004, 2010,089 of 27 April 2010 and 900,309 of 8 December 2009. Recently, the Rulings Commission agreed to the use of a royalty data base (Decision 900,084 of 21 April 2009).

66 Decisions 400,184 of 13 October 2005 and 900,309 of 8 December 2009.

into account all items of value associated with the business, but need not necessarily cover the sum of all the assets transferred.[67]

In the case of an outbound transfer of activities (without a Belgian PE being maintained to carry on the Belgian activities),[68] the goodwill is taxable at the rate of 33.99 per cent in Belgium. In the case of an inbound transfer of activities, the Belgian company/PE can benefit from a step-up in its taxable basis and depreciate its assets (including goodwill) on an accelerated basis.

In some cases, goodwill (e.g. the transfer of a client base) will have to be identified, as is the case between unrelated parties. In the reporter's experience, in most third-party acquisition deals, this value is determined on the basis of a discounted cash flow method or EBITDA multiple.[69]

It may sometimes happen that the restructured entity is being safeguarded from future losses by having its business restructured. The loss of certain assets, functions and risks may be a better option than going out of business altogether.[70] In such a situation, the question may arise whether the transferor should compensate the transferee for taking over the loss-making going concern (there may be circumstances where an independent party would be willing to pay to terminate loss-making activities, e.g. to avoid paying the financial and lay-off costs of closing down the business).

Again, this will depend on whether a third party would be willing to pay in similar circumstances. This may be so if the transferee can benefit from synergies by taking over the business. In the reporter's experience, this is extremely unlikely to happen in an open market. In this respect, the Belgian tax authorities take a very pragmatic approach and consider that a loss-making company can expense the restructuring costs without a mark-up (see section 3.4).[71] It is also expected that, even if the anticipated savings were greater than the restructuring costs, no compensation would be paid by independent parties, as is also the case with outsourcing.[72]

Furthermore, it may be that the transferee is able to generate a profitable business out of the transferred activity thanks to so-called location savings. In some cases, MNEs may derive certain location savings from the fact that, in some countries, they benefit from a lower cost base (labour cost, property costs, etc.), also taking account of the possible termination costs in the country of origin. Again, in such situations, a restructuring aimed at mitigating losses incurred by carrying on business activities might entail the payment of compensation, if this would also be the case between unrelated parties.[73] In an unrelated-party situation, the conditions agreed would depend greatly on the assets, functions and risks taken on by each party.

67 OECD guidance, 9.94. The valuation cannot be made up of the aggregated value of each separate element forming the business unit. The guidance gives the example of a business restructuring involving transfer of a business unit that includes a research facility with experienced staff. This component should be going-concern-valued with reference to the value that would be agreed between third parties for the facility (equipment) and the workforce.

68 S. 228(2) ITC.

69 De Crem, Massart, Lamon and Van Bavel, *op. cit.*, pp. 108–109; Decision 2010,089 of 27 April 2010.

70 OECD guidance, 9.96.

71 Decision 900,369 of 17 November 2009.

72 OECD guidance, 9.99.

73 Verlinden, *op. cit.*, p. 116.

2.7. Termination or substantial renegotiation of existing arrangements

Upon the termination or substantial renegotiation of existing arrangements, the restructured entity faces the possibility of restructuring costs (write-offs of assets, lay-offs of personnel) or reconversion costs. Furthermore, future profit potential may be withdrawn.

The need for a consideration will depend on the factual circumstances, such as the timing of the restructuring, the (contractual) rights of the parties and, most importantly, the options that were realistically available. Furthermore, attention should be paid to whether, apart from what has been agreed contractually, there is commercial law dealing with this issue.[74]

The concept of "realistically available options" plays a more central role in fixing the consideration for the restructuring itself. The concept has its most important application at the level of the individual entity, and the alternatives theoretically available to each party should be taken into account in fixing the appropriate levels of consideration to be paid.

The concept of realistically available options seems to build on the economic theory of the opportunity cost and rational decision-making. This approach can potentially cause problems for MNEs, in which the reasoning is done at the level of the entire organisation, and may be difficult to reconcile entity by entity (the level at which the arm's length test should be done). While, at a group level, a decision may be rational, it may not necessarily be so at an entity level: e.g. a decision to streamline is probably rational as it is expected to produce a positive net present value (NPV) and makes sense from an opportunity cost perspective.

In the reporter's view, the nature of MNEs should be taken into account in assessing the options rationally available to the parties engaged in a business restructuring. This would imply that both parties need to value the transaction on an NPV basis and then engage in it only if neither is worse off than under their respective next-best alternatives.

The precise nature of MNEs and the rationale for a restructuring are matters well understood by the Belgian tax authorities, who recognise their freedom to decide on certain aspects of business restructuring at a group level.[75] The OECD guidance also takes the same view and recognises the unique feature of MNEs, which in many cases operate differently from unrelated parties without *in se* acting on a non-arm's length basis.

2.8. Recognition of the actual transactions undertaken

Belgian tax law does not lay down many measures the authorities can cite in order not to recognise restructuring. Only when a restructuring is considered "abusive" or where it has no economic substance will they be able to apply domestic anti-abuse rules.

74 The Rulings Commission assesses the terms of a notice on termination on the basis of the contractual arrangements taking into account the "expected" decision that would have been taken in similar circumstances between unrelated parties (see, for instance, Decision 900,369 of 17 November 2009).

75 OECD guidance 9.5–9.9 and 9.173 (see also next section).

Non-recognition of a restructuring most likely requires economic arguments to be lacking to such a degree that none of the legal acts could have been completed. As a result, therefore, a restructuring should first be assessed from the perspective of the rules and practices on artificial profit-shifting as laid down in article 9 OECD MC.

The guidance emphasises that tax administrations should not interfere with a business decision taken by a taxpayer, even if it is motivated by the aim of obtaining a tax benefit. This approach is also followed by the Belgian courts.[76]

The mere fact that associated-enterprise arrangements are non-existent as between independent parties is not evidence of the fact that they are not at arm's length or commercially rational. Here, again, the basis for determining what independent parties might have been expected to do should be based on realistically available options, i.e. on the assumption that the restructured entity would not have entered into the transaction as structured if an alternative option had been clearly more attractive, including not entering into the arrangement.

While the OECD guidance recognises the unique features of MNEs and their right to freely structure their operations, the reference to realistically available options to "test" the commercial rationale of a transaction can always lead to interpretation. This is especially relevant for MNCs, where a transaction may be commercially rationale at a group level whereas it should be at arm's length at the level of each entity involved.[77]

2.9. PE issues

A business restructuring may involve the conversion of local entities into agent or toll-manufacturing entities, which may entail PE issues. A restructuring will therefore demand a sound understanding and analysis of the domestic and treaty provisions applicable in this respect, which we go into below.

To determine whether or not a PE exists in Belgium, first, it should be considered whether a PE would be deemed to exist under Belgian internal tax law and, subsequently, the double taxation treaty should be verified to check how charging power and possible relief are allocated. Considering that Belgian domestic tax law defines a Belgian PE much more broadly than the OECD MC,[78] there could arise a conflict in this respect. In the case of such conflicts, international tax law will

76 This is based on the following principles ruled on by the Court of Cassation: (a) "non-eviction", whereby the tax authorities may not judge the opportuness of a transaction carried out by a taxpayer (Cass., 26 March 1968, Pas., 1968, I, p. 913.; Cass. 3 March 1970, I, p. 575); and (b) non-interference, whereby the tax authorities may not interfere in how a company is managed (Cass. 26 March 1968, Pas., I, 913; Cass., 20 October 1959, Pas., 1960, I, 216).

77 OECD guidance, 9.178.

78 The most important differences are the following: (a) s. 229(1) ITC adds "agency, warehouse and inventory" to the list of establishments; (b) s. 229 ITC does not exempt the negative PEs referred to in art. 5(4) of the OECD MC and thus does not exempt solely auxiliary or preparatory activities; (c) s. 229(2) ITC extends personal PEs to representatives other than independent intermediaries acting in the ordinary course of business, even if the representative does not have authority to contract; (d) s. 229(3) ITC deems the members of a business partnership (or similar entity without legal personality) to have a Belgian establishment where the entity is a Belgian resident or a non-Belgian resident receiving Belgian-source taxable income.

prevail over Belgian domestic law.[79] This will be so even if the domestic rules are more recent in date.[80]

If the Belgian tax authorities consider that, further to a business restructuring, a company is deemed to have a PE in Belgium, the taxable result attributable to it is liable to tax in Belgium at a rate of 33.99 per cent. In general, the tax base is determined on the basis of evidencing accounting for the Belgian PE. Should no evidencing accounting be kept for the Belgian PE, the Belgian tax authorities will be able to tax a deemed "minimum tax base" under domestic Belgian tax law,[81] equal to 10 per cent of the gross turnover of the foreign entity realised though the Belgian PE. These amounts can be increased by penalties and a tax surcharge for insufficient tax pre-payments.

A factual understanding of, and the substance behind, the allocation of key people functions play a very important role in assessing the attribution of profits to a PE as, contrary to a legal-entity situation, there are generally no contractual arrangements in the context of a head office/PE relationship. As for the assessment of "control over risk" in the context of a separate entity under article 9 OECD MC (see section 2.2), the significant-people-functions analysis will greatly rely on quality rather than quantity. Active decision-making and management should prevail over saying "yes or no" to a proposal.[82]

In the reporter's view, if the same level of importance is accorded to the "substance" of the relationship, application of the "control-over-risk approach" or the "risk-follows-functions approach" should lead to the same outcome and it would be welcome if the OECD could clarify this in finalising the guidance on the interpretation of article 7 OECD MC.[83]

In particular, the term "significant" may lead to differences in interpretation, as MNEs often engage in "matrix models", in which the segregation between "senior management" and "layers below" still leaves important scope for decision-making up to operational management.[84] Here, again, the traditional thinking by which the management of risk and the assumption of risk should be connected cannot be adhered to, as no such concept exists in most MNEs.

3. Tax effects of typical business restructuring cases

3.1. General overview

This last section elaborates on specific APAs rendered in relation to business restructuring, as they offer useful illustrations of the mindset and approach adopted by the Belgian tax authorities in this respect.

79 Belgian Court of Cassation, 27 May 1971.
80 Antwerp Court of Appeal, 3 June 2008.
81 S. 182(1)(3)(a) RD/ITC.
82 OECD *Report on the Attribution of Profits to Permanent Establishments*, parts I (General Considerations), II (Banks) and III (Global Trading), para. 118.
83 Rosalem, *op. cit.*, p. 22.
84 A. Smith and I. Verlinden, PricewaterhouseCoopers, 2009, p. 156.

As will be seen, an APA mainly relies on critical assumptions made by the Rulings Commission, which mostly reflect discussions held between it and the taxpayer. When looking at APAs issued prior to the financial turmoil of 2008, account needs to be taken of adjustments that might have to be made to benchmarks and methodology to reflect the changed economic conditions (see section 2.1.4),[85] so that it is doubtful whether "old" rulings still reflect today's arm's length criteria.[86]

3.2. Change of a fully fledged distributor into a low-risk distributor, commissionaire or agent

The first transfer pricing practice note[87] describes the characteristics of the different forms of distributors, i.e. agent, commissionaire, limited distributor, fully fledged distributor and marketing/sales company. Many APAs have been issued by the Belgian Rulings Commission in relation to such conversions.

Most APAs relating to conversion of a fully fledged distributor into a commissionaire look to the contract terms as a basis for the termination period. Some APAs also elaborate on the arm's length compensation for early termination of a distribution agreement.[88] The reasoning followed by the Rulings Commission relies on Belgian commercial law,[89] which stipulates that, if an exclusive distribution agreement is terminated unilaterally, the supplier must either give a reasonable notice period or pay corresponding compensation.[90] Considering these factors, the Rulings Commission is of the opinion that the conversion did not result in a transfer of assets or functions to the principal but rather a transfer of risk (stock, credit and bad debt), for which there should not be any consideration.

In a recent APA,[91] the Rulings Commission has explicitly quoted the OECD guidance. Most APAs issued in relation to conversion from a fully fledged distributor into a commissionaire also cover the fact that the commissionaire should not give rise to a PE in Belgium as it is the commissionaire that does the buying and selling, and does so independently and in its own name.[92]

3.3. Change of manufacturing activity

The first transfer pricing practice note[93] differentiates different forms of manufacturing entities: either fully fledged production entities or toll/contract manufacturers.

85 For instance, reference to adjustments of margins based on developments in GDP.

86 This is especially relevant for financing arrangements still modelled on pre-financial-crisis margins and base Euribor rates that may now have to be drastically revised; D. Ledure, P. Bertrand, M. van der Bregge, M. Hardy, *Intertax*, vol. 38, issue 6/7.

87 Practice note of 28 June 1999, no. AFZ/98-0003, Bull. ITC, no. 796, 2483.

88 Decision 400,382 of 17 February 2005. E.g. Decision 600,332 of 19 June 2007.

89 Act of 27 July 1961 on the Unilateral Termination of Open-ended Distribution Agreements.

90 Brussels Commercial Court, 8 March 1963; Brussels Commercial Court, 30 June 1971.

91 Decisions 900,417 of 22 December 2009 and 2010,100 of 30 March 2010.

92 Pursuant to art. 5(5) OECD MC, an enterprise of one contracting state cannot be deemed to have a PE in the other state merely because it carries on business in that state through a broker, general commission agent or any other agent of independent status, where such persons act in the ordinary course of their business.

93 Practice note of 28 June 1999, no. AFZ/98-0003, Bull. ITC, no. 796, 2483.

There have been several APAs dealing with conversion of fully fledged production and distribution activities into a toll-manufacturing/commissionaire arrangement by centralising the principal function in a foreign entity (e.g. Swiss entities).[94]

The remuneration policy in these cases is mostly determined using a functional and benchmarking analysis based on a return on asset/cost-plus remuneration for the tolling entity and a return on sales for the distributing company. It was also concluded that any restructuring cost resulting from a group decision would be charged on to the Swiss principal (see also the specific ruling in this respect under section 3.5).[95]

In most cases, the Rulings Commission also ruled on the absence of a material PE in Belgium for a toll-manufacturing entity since the material presence was limited to the maintenance of inventory with the sole purpose of having it processed by another company.[96] Furthermore, the principal would also have no personal PE in Belgium as there would be no dependent agent in Belgium and the Belgian entity would act independently on the basis of a contractual relationship, whereby the daily toll-manufacturing activities would not be controlled or organised by the Swiss principal (which also requires a strict separation of the manufacturing function to a discrete legal entity to avoid a full business cycle in Belgium).[97]

The Rulings Commission agreed that, in principle, no phase-out costs (taxable goodwill) should arise in a conversion from a fully fledged manufacturer into a toll manufacturer, as there was no transfer of intellectual property. However, in this particular APA, as a number of licences were being terminated, the Rulings Commission did rule that the tax base should be corrected as a compensation payment.

In another, similar case in which no licence agreements were terminated, the Commission ruled that no conversion charge should be recognised.[98]

3.4. Centralisation of intangible property (IP) rights and R&D activities in a discrete IP company

As explained in section 2, the Belgian tax legislation provides for a unilateral downward profit-adjustment in application of article 9(2) OECD MC of what is referred to as "excess profit". Several APAs have been issued in relation to excess profits in the context of implementation of the global central entrepreneur model in Belgium or of centralised finance centres.

As it is almost impossible in these cases to find a benchmark for the central entrepreneur, the excess profit is calculated on the basis of indirect benchmarking. The excess profit is calculated by attributing an arm's length remuneration to the

94 Decision 400,382 of 17 February 2005.

95 Decision 900,181 of 28 July 2009.

96 Negative PE based on the Belgian-Swiss double taxation treaty (art. 5(4)(c)).

97 In accordance with arts. 5(5) and (6) of the Belgian-Swiss double taxation treaty. Decisions 300,331 of 17 May 2004, 400,382 of 17 February 2005 and 132/001 and 132/002 of 13 December 1999. In this respect, the Belgian tax authorities take a legal view and consider that there is no PE as long as a strict segregation of the manufacturing activities is adhered to within a single, separate legal entity.

98 Decisions nos. Ci.D132/001 and Ci.D 132/002 dated 13 December 1999; Vanwelkenhuyzen and Willems, *op. cit.*, pp. 114–116.

central entrepreneur and subsequently deducting the routine arm's length remunerations for the other entities. The remaining profit resulting from certain intangibles benefits from an excess profit exemption in Belgium.

The underlying reasoning behind this is based on the residual-profit approach, recognising the fact that the profit derived for group synergies or "industrial organisational intangibles" (i.e. knowhow, procurement, client list, etc.) will be automatically and wholly attributed to the party that performs the most complex functions, i.e. the central entrepreneur.[99]

In practice, the industrial organisation intangible is assessed either as an informal tax deduction (off-balance-sheet, tax-depreciable intangible) or as a percentage of EBIT.[100] In most cases, a percentage of EBIT is applied and defined on the basis of the budgeted number of less-complex parties (e.g. distributors, tolling entities, service providers) used to isolate the marginal additional benefit attributable to the central entrepreneur,[101] and, hence, to define the "notional royalty" rate representing the "licence right" granted by the group for the benefit of the more complex party in the group, the central entrepreneur.

Several APAs have been reported in this respect dealing with the methodology for determining/valuing the proceeds eligible for the patent income deduction. This valuation is done, for instance, to determine inter-company licensing streams or when patent remuneration is included in the overall product price.

In one recent APA, the Rulings Commission considered that the classic transfer pricing methods (comparable uncontrolled price, resale price, cost plus, TNMM) could not be used owing to the non-comparability of most patents. Therefore, the residual profit split method was taken as the only practicable solution, whereby the remaining net margin (i.e. sales price minus sales margin minus direct costs minus indirect costs) is to be considered the arm's length remuneration for an R&D/patent.[102]

In another APA, the remuneration for the R&D included in the sale price of a machine was fixed using the cost-plus method as being the most appropriate, since detailed cost information was available and that method ensured proper cost recovery of the investments made, considering the limited life cycle of the machines.[103]

3.5. Substitution or discontinuation of a specific product/activity

Several APAs have also been issued in the context of the outbound relocation of production or important turnarounds involving Belgian-based entities. The questions addressed mainly related to the deductibility of restructuring costs.

In a recent APA involving the termination of a trading activity,[104] the Rulings Commission agreed that a 100 per cent recharge of the restructuring costs could be

99 Decision 600,460 of 30 January 2007; for an analysis of this type of APA, see Vanwelkenhuyzen and Willems, *op. cit.*, Seminar Forum 187, 7 June 2007.

100 Decision 700,075 of 10 July 2007; Decision 800,231 of 13 January 2009.

101 Decision 2010,106 of 20 April 2010. A buy-in payment for any transfer of intangibles (e.g. customer list) may be provided, see Decision 2010,106 of 20 April 2010. In a recent APA, this remuneration was fixed at 4 per cent of the entrepreneur's margin: see Decision 800,044, 12 August 2008.

102 Decision 900,377 of 1 December 2009.

103 Decision 700,541 of 4 November 2008.

104 Decision 900,181 of 28 July 2009.

accepted (without a mark-up) as the company did not make material investments to develop major intangibles and because the employees dismissed by the subsidiary would not be "re-hired" by the parent company.[105]

In another APA involving the conversion of an EU import entity sold to independent agents that provided services, the Rulings Commission agreed that (a) the agent would not have a PE in Belgium and that (b) no termination compensation should be paid as the import contract would be immediately replaced by the service contract, which would not entail any adverse financial consequences (e.g. no restructuring costs due to lay-offs).[106]

105 In most similar APAs, the Ruling Commission considers that (a) the restructuring costs qualify as tax-deductible business expenses within the meaning of s. 49 ITC, but that (b) these costs should be recharged to the parent company that decided upon the restructuring, in application of s. 26 ITC (see Decision 900,369 of 17 November 2009).

106 Decision no. 600,085, 13 April 2000.