Branch Reporter
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Summary and conclusions

As one of the most globalized countries, Belgium takes part in the internationalization of the value chain through cross-border outsourcing of goods and services. Today, outsourcing of services is growing rapidly and faster than the import of material inputs. Belgian companies have a rather conservative approach to the selection of offshore locations (in more than 50 per cent of cases, Belgian companies outsource to Europe) and outsourcing models. Given the broad scope of R&D tax incentives foreign companies outsource R&D activities to Belgium.

Relevant domestic legislation for cross-border outsourcing includes rules on the tax deductibility of service fee payments (including payments to tax havens), transfer pricing (TP) rules, a provision on withholding tax on service fees, the participation exemption and rules on the exemption of branch profits.

An important consequence of outsourcing is that the service recipient may use a permanent establishment (PE) in the country of the service provider. In a treaty context, if the service recipient does not have its own employees who perform the activities of the service recipient in the country of the service provider, there is no fixed place PE. If the service provider – other than an agent of independent status that is acting in the ordinary course of its business – is acting on behalf of the service recipient and has, and habitually exercises, in the source state, authority to conclude contracts in the name of the service recipient, an agency PE is deemed to be present. The notion of a Belgian establishment (BE) under Belgian law is broader than the PE definition under double taxation treaties (DTTs). It includes a definition of a service establishment. This allows Belgium to tax the income of such a service establishment where a DTT provides that services which are performed in Belgium without the intervention of a (fixed place or agency) PE should be considered to be deemed performed with the intervention of a PE.

In the case of a PE, its taxable profit should be determined in line with the arm's length principle. In a treaty context, the principles of profit allocation to a PE can be found in article 7 OECD model convention (versions 2005 and 2010). There is no formal standpoint of the Belgian tax authorities (BTA) as to whether the principles of the report of the OECD on the allocation of profits to permanent establishments of 22 July 2010 can be followed in a DTT context where the DTT is based on the OECD model convention prior to 2010. The Belgian Ruling

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Commission, however, follows the principles of the report. The OECD approach is the "functionally separate entity approach", on the basis of which the profits to be attributed to a PE are the profits that the PE would have earned at arm's length if it were a legally distinct and separate enterprise performing the same or similar functions under the same or similar conditions, determined by applying the arm's length principle. In the case of an agency PE, a current discussion in international tax practice is whether additional profit could be allocated to the PE of the principal in the jurisdiction of the agent. Are there situations where certain risks and functions of the principal could be attributed to the PE as a result of which the profit of the PE would exceed the arm's length remuneration of the agent?

On the basis of Belgian TP rules, where the outsourcing entity or the service provider is a Belgian taxpayer, the remuneration of the service provider should be arm's length to avoid adverse Belgian tax consequences in the hands of the Belgian outsourcing entity or the Belgian service provider. Other TP aspects might also come into play in the case of cross-border outsourcing, such as restructuring issues and allocation of possible anticipated savings (such as location savings). The OECD TP guidelines, including the principles of Chapter IX on business restructuring, are officially accepted and followed by the BTA.

Under certain circumstances, Belgian withholding tax might be due on service fee payments made by a Belgian taxpayer to a non-resident service provider (i.e. where a tax treaty has granted the right to tax to Belgium or in the absence of a treaty, where payments are not taxed in the residence country of the recipient).

There is currently not much discussion or litigation on cross-border outsourcing structures in Belgian tax practice. Clarity on a few topics might, however, be useful. In line with the current international discussion, the agency PE definition and related profit allocation in commissionaire structures is a topic of discussion in Belgian tax practice and currently leads to some uncertainty. Also, different approaches between countries to location savings and attribution of the additional profit realized by such savings might trigger discussions and could lead to double taxation. Given the importance of R&D activities for Belgium, the OECD's viewpoint on intangibles and the impact of BEPS on this, will also be relevant for Belgium.

Case law on cross-border outsourcing and the above issues does not exist in Belgium. Since the number of TP audits is increasing substantially in Belgium, more case law may be expected in the years to come. Advance pricing agreements (APAs) play an important role, as taxpayers are looking for guidance and certainty.

1. Introduction[1]

Belgium has developed into one of the most globalized countries in the world, in terms of trade, foreign investment, migration, and as a host country for important international organizations.

[1] The picture of outbound international sourcing trends in Belgium is gathered from a study commissioned by VBO-FEB and Deloitte Belgium ("Belgium in the new global economy: Export and international sourcing", August 2012).

As Belgium has become an attractive location for R&D activities due to its R&D tax incentives, foreign companies outsource R&D functions in particular to companies located in Belgium. But Belgian business rather acts as a service recipient outsourcing production and assembly operations and services offshore. Today, outsourcing of services is growing rapidly and faster than the import of material inputs. Typical services that Belgian companies outsource are administration (including finance and accounting, human resources, marketing and sales, and procurement processing), IT and software services, technology services and call centers.

The five strategic drivers for outsourcing are basically labor cost savings, access to qualified personnel offshore, increase of organizational flexibility, growth strategy and other cost savings.

Belgian companies have a rather conservative approach to the selection of offshore locations. More than 50 per cent of international outsourcing cases from Belgian companies concern the neighboring countries of western and eastern Europe (including Russia). While India is the favorite location of many EU companies and the USA, only 17 per cent of Belgian outsourcing is to India.

Also in its choice of outsourcing models, Belgium appears to be rather conservative. Belgian companies prefer to keep full or at least partial ownership and control of the process, through the captive model (54 per cent) or the joint venture or partnering model (20 per cent). Only a few Belgian companies are willing to give up control to third party service providers (the third party outsourcing model).

The major outcomes of outsourcing are an increase in the enterprise's overall competitiveness and in productivity and efficiency, a better focus on core competencies, improved organizational flexibility, and better access to qualified personnel. However, although the type of functions that are outsourced is relatively similar between Belgian and other EU and US enterprises, the gains that Belgian enterprises derive tend to be lower. The main reason is the conservative approach of Belgian enterprises in terms of selecting the offshore location and the outsourcing model. This prevents Belgian enterprises from benefiting from the deep expertise and the scale economies that external providers are able to achieve as well as from the location advantages of more distant countries. Lack of an international sourcing strategy and a weak global service delivery structure have been identified as the main reasons.

2. Domestic law provisions

In the case of outsourcing by a Belgian service recipient, various domestic provisions may have an impact on the tax deductibility of the service fee payment. By virtue of article 49 of the Belgian Income Tax Code 1992 (ITC), expenses are tax deductible if made or borne during the taxable period with the purpose of acquiring or preserving taxable income and provided that the reality of the expense and the amount are justified.

In the case of cross-border outsourcing structures involving entities not subject to tax or subject to a significantly more advantageous tax regime, attention should in particular be paid to articles 54 and 198(10) ITC. By virtue of article 54 ITC,

payments to entities not subject to tax or subject to a significantly more advantageous tax regime are not tax deductible unless the taxpayer demonstrates that the payment is a consideration for an actual and true transaction and the payment is arm's length (reversal of burden of proof). Articles 198(10) and 307 ITC provide for a disclosure requirement if payments exceeding €100,000 per year are made by a Belgian taxpayer to an entity located in a state that is mentioned on the list of states with no or low taxation (or that is considered by the OECD's Global Forum on transparency and exchange of information as a state that does not comply with the standards). As well as the disclosure, the taxpayer will have to deliver proof that the payment is consideration for a real and genuine transaction and that the tax haven entity is not a mere artificial construction.

Also, in certain circumstances, withholding tax might be imposed on the payments made by the Belgian service recipient (see section 6).

Obviously, TP rules should be respected in the case of outsourcing, where the service recipient or service provider is a Belgian taxpayer (see section 5).

If a Belgian enterprise outsources activities to a branch located in a non-treaty country, no exemption of the branch profits in Belgium is available, which may trigger double taxation (see section 4). If activities were outsourced to a subsidiary that did not meet the subject-to-tax requirement of article 203§1 ITC, the dividends received by the Belgian taxpayer or the capital gains realized would not be eligible for the participation exemption and would therefore be fully taxable in Belgium. The participation exemption would, however, apply if the subsidiary were located in a geographic zone with certain tax measures to encourage investment or development (e.g. certain tax free trade zones).[2]

Belgian domestic legislation provides for a full range of R&D tax incentives to encourage multinational enterprises (MNEs) to outsource R&D activities to Belgium or to locate the ownership of intangible property (IP) in Belgium while part of the R&D activities are outsourced. As a result, Belgium is an attractive location for R&D centers owning IP as well as for contract R&D centers. The following incentives are the most important:

- increased R&D investment deduction/tax credit: for acquired or self-developed patents and fixed assets that tend to promote R&D on new products and advanced technologies that are environment friendly, a one-time investment deduction of 14.5 per cent of the investment cost or a spread investment deduction of 21.5 per cent on the depreciation amount can be claimed. Alternatively, the taxpayer can opt for a tax credit equal to the tax saving linked with the investment deduction (i.e. tax rate of 33.99 per cent × 14.5 per cent or × 21.5 per cent).[3] Certain formalities need to be fulfilled;[4]
- payroll wage tax reduction: certain taxpayers that employ scientific researchers engaged in R&D programs benefit from an exemption of 80 per cent of the wage withholding tax on the salary of those researchers. While they withhold 100 per cent of the wage withholding tax, 80 per cent need not be paid to the treasury;[5]

2 *Parl.Works* Chamber 2002–2003, 50.1918/001, p. 49.
3 The 14.5 per cent and 21.5 per cent rates apply to the tax year 2014.
4 Arts. 69, 201 and 289quater ITC.
5 Art. 275[3] ITC.

- expat status for foreign executives and researchers temporarily assigned to Belgium, which provides for a reduction of employment costs;[6]
- foreign tax credit on royalty income: a foreign tax credit equal to 15/85 of the net royalty income received, irrespective of the actual withholding tax levied abroad, is available;[7]
- patent income deduction (PID): Belgian taxpayers are entitled to an 80 per cent deduction of their patent income from their taxable basis, resulting in an effective tax rate of a maximum of 6.8 per cent.[8] PID applies to patents or supplementary protection certificates that are (a) self-developed by a Belgian taxpayer in an R&D center in Belgium or abroad or (b) acquired by the taxpayer and further improved in its R&D center. Patent income is considered to be income derived from the licensing of patents and income derived from the use thereof in the production process of patented goods or services. For the PID to apply, the Belgian R&D center must be a branch of activity, i.e. "all assets which are invested in a division of the enterprise and which constitute, from a technical point of view, an independent business able to work autonomously". The Belgian taxpayer must have the relevant substance to perform and supervise the R&D activities, but part of the R&D activities may be outsourced under its supervision; expenses should be borne by the taxpayer (e.g. recharged with cost plus).[9] A coordination and administrative function or a small division of all of the activities of an R&D center in Belgium should be sufficient.[10]

Other R&D incentives are (a) exemption from regional R&D premiums and subsidies; (b) a tax allowance for additional employees; (c) an innovation premium; and (d) an accelerated depreciation on certain assets. While the PID does not apply to contract R&D service providers, all other incentives do.

3. PE in source country as a result of outsourcing

In most of Belgium's DTTs, the PE definition is based on the OECD model convention. Belgium has its own administrative commentary on DTTs (Com.DTT) which has, however, not been updated since 1996. The BTA have explicitly announced that the OECD commentary will be followed even if a previous interpretation or standpoint of the BTA is contradictory to the OECD commentary.[11]

Belgian domestic tax law has its own definition of a BE under article 229 ITC which is generally broader than the PE definition under the DTTs. Where no DTT is available, the BE definition will be relevant to determining whether the foreign

6 Circular no. Ci.RH.624/325.294, 8 August 1983.
7 Art. 286 ITC.
8 Art. 205[1] ITC.
9 Ruling no. 2011.382, 29 November 2011, Ruling no. 2012.121, 19 June 2012 and Ruling no. 2012.149, 19 June 2012.
10 "The Belgian Patent Income Deduction", *European Taxation*, February 2008, p. 75.
11 M. Devillet, *Les nouveaux commentaires OCDE sur les conventions fiscales de la double imposition et leurs conséquences en Belgique*, IFA Seminar of the Belgian Branch, Brussels, 6 December 2005, p. 2.

company is taxable in Belgium. Also, if a BE under Belgian law is available while there is no PE under the relevant DTT, a non-resident tax return should be filed (blank).

3.1. Fixed place PE

In an outsourcing context, a service recipient will be deemed to have a fixed place PE in the country of the service provider under article 5 of the OECD model convention if a place of business in that country is (a) at the disposal of the service recipient, (b) fixed, and (c) used to carry on wholly or partly the business of the service recipient.

It is not required that the service recipient has any formal legal right to the place of business as owner or as lessor. It is sufficient that he can use the place of business in any other way.[12] This is the case if the service recipient has a factual and economic right to use the place of business, for instance through the presence of an employee.[13] The place of business may be situated on the premises of another enterprise.[14] It would not be sufficient if the service recipient only had the authority to visit from time to time the premises of the service provider to supervise the activities of the latter.[15]

The mere temporary presence of employees of the service recipient who support a subcontractor is not sufficient for the place of business to be considered as fixed.[16]

It is the business of the service recipient itself that should be carried on in the place of business, meaning that there should be intervention of the latter, by means of its own employees or dependent representatives. In the case of outsourcing, without intervention of the service recipient, the business of the service provider will be deemed to be carried on (unless in the case of an agency PE). If the service recipient does not have its own employees who perform the activities of the service recipient in the country of the service provider, there is no fixed place PE.[17] If employees of the service recipient were sent to the service provider and worked under the supervision of the latter, no PE should exist.

It is not required that the activities performed in the fixed place of business (by the service recipient) are the same as those of the head office.[18] If the activities can, however, be considered to be preparatory and auxiliary for the benefit of the enterprise itself, no PE would be deemed to exist. The decisive criterion to determine whether an activity is preparatory and auxiliary is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activities of the enterprise as a whole.[19] If the activity of the employee(s) were limited to

12 Com.DTT, no. 5/103.

13 T. Wustenberghs, *De vaste inrichting op de helling*, Ghent, Larcier, 2005, no. 49.

14 OECD commentary, art. 5, no. 4.

15 Wustenberghs, *op. cit.*, no. 50.

16 Ruling no. 800,028, 1 April 2008. In the case at hand, the value of the assistance was very limited compared to the total financial volume of the contract.

17 Ruling, no. 2012,156, 19 June 2012: in case of outsourcing of IT services, no PE was deemed to exist since the IT services were performed with the personnel and equipment of the service provider and the service recipient did not have employees who were present in the country of the service provider.

18 Wustenberghs, *op. cit.*, no. 68.

19 OECD commentary, art. 5, no. 24.

supervision and coordination without interference in the management and without decision power with respect to the business of the service recipient, no PE would exist.[20]

Where the service provider maintains a warehouse for storing and delivering goods of the service recipient and the latter does not have the use of a fixed place of business, the general conditions for the existence of a fixed place PE are not fulfilled. If the service recipient does have a fixed place of business, an exemption from a PE exists on the basis of article 5 §4(a) and (b) of the OECD model convention.[21] Under Belgian domestic tax law, a storage facility and the maintenance of a stock do qualify as a BE (article 229 §1, section 2(9) and (10) ITC).

In the case of toll manufacturing, the service recipient maintains a stock of goods on the premises of the toll manufacturer for processing by the latter. If the service recipient does not have the use of the premises, no PE exists under the normal conditions of a fixed place PE. If it does have the use of the premises, an exemption exists on the basis of article 5 §4(c) of the OECD model convention.[22] If the service recipient itself is involved in the processing of the goods (with its own personnel), beyond coordination and supervision, a PE would exist. Where a contract manufacturer purchases, produces, stocks and sells the goods of the service recipient under the substantial control and permanent supervision of and for the account of the latter, this would give rise to a PE. Such a situation entails much more than a mere outsourcing of production to an independent enterprise. By the supervision and control, the service provider loses its independence.[23]

In the case of outsourcing of construction works, the activities performed by the subcontractor are allocated to the service recipient for the assessment of the PE, i.e. determination of the minimum duration.[24] The proposed revision of the OECD commentary to article 5, paragraph 19 ("subcontracts all or parts of such a project") seems to suggest that no activity of the service recipient is required to trigger the existence of a PE. It is uncertain whether this new interpretation could also be applied to DTTs that entered into force prior to the new OECD commentary.[25]

In the case of outsourcing of back-office activities, no PE would exist if there were no intervention of the service recipient itself. In the case of intervention, a PE exists to the extent that back-office activities are preparatory and auxiliary for the benefit of the service recipient. Note that, according to the BTA, certain headquarters functions, i.e. the activities of so-called "coordination offices", are considered to be preparatory and auxiliary activities (coordination of methodologies,

20 Com.DTT, no. 5/324 and 325.

21 Com.DTT, nos. 5/312 and 5/236. Ghent 16 January 2007, *F.J.F.* 2008, p. 136: the court confirmed that the mere maintenance of the stock in Belgium for the account of a Dutch entity did not constitute a PE. The Belgian entity purchased the goods from the Dutch entity for further delivery on the Belgian market. The presence of the goods was limited to storage and delivering; no commercial activity of the Dutch entity in Belgium was deemed to take place.

22 See e.g. Ruling no. 2011,532, 31 January 2012.

23 Wustenberghs, *op. cit.*, no. 200; Brussels 27 February 1962, *Rev. Fisc.* 1962, p. 456; Brussels 12 June 1965, *Bull. Bel.* 1966, no. 430.

24 Com.DTT, no. 5/217.

25 T. Wustenberghs, G. Boone and E. Puncher, "Artikel 5: OESO poogt bijkomend te verduidelijken (bis) – bouwwerken", *Fisc. Int.* 346, p. 6. *Contra* some authors defend the ambulatory interpretation (see further section 4.1).

programs, policies re budget, accounting, commercialization, advertising and public relations, financing and credit, research re organization and regulations, advice re organization, participation in fairs, sales techniques, legal issues).[26] Management of an enterprise cannot be considered to be preparatory and auxiliary.[27]

In the case of outsourcing of procurement and sales related activities, with the intervention of the service recipient, it has been ruled that procurement does not trigger the existence of a PE.[28] Where there is direct customer contact with a view to entering into an agreement,[29] or if employees of the service recipient are involved in the commercial sales process,[30] a PE exists.

3.2. Agency PE

In an outsourcing context, a service recipient will be deemed to have an agency PE in the country of the service provider under article 5 of the OECD model convention if the service provider, other than an agent of an independent status that is acting in the ordinary course of its business, (a) is acting on behalf of the service recipient and (b) has, and habitually exercises, in the source state the authority to conclude contracts in the name of the service recipient. No PE would exist if the outsourced activities were merely preparatory and auxiliary for the benefit of the service recipient.

Habitually means "repeatedly and not only incidentally".[31] No further guidelines exist under Belgian law.

Participation in negotiations is in itself not sufficient to consider that the agent is entitled to conclude contracts in the name of the enterprise.[32] On the other hand, where the agent is entitled to negotiate all elements and details of a contract, even if the contract is not signed by him (and this is just a formality for the principal), an agency PE is deemed to be present.[33] It is required that the principal is legally bound. This is the case if the agent is entitled to sign the (standard) contract on behalf of the principal, while the agent is bound to deliver the goods at the prices and under the conditions set by the principal.[34] However, a PE only exists if the agent is entitled to bind the principal as regards the latter's core business.[35] "Conclude contracts in the name of" refers to a direct representation. As the commissionaire under Belgian law acts in its own name, he cannot in principle trigger the existence of a PE for the principal.[36] For a dependent agent (or independent agent acting beyond the ordinary course of its business) to constitute a BE under Belgian

26 Com.DTT, no. 5/324.
27 Com.DTT, no. 5/325.
28 Ghent 30 November 2004, *T.F.R.* 2005, 458.
29 Com.DTT, no. 5/322; Brussels 2 May 2001, *F.J.F.* 2001, p. 275.
30 Brussels 19 January 2011, *Fisc. Int.* 337, p. 5.
31 Com.DTT, no. 5/403.
32 P. Cauwenbergh and A. Claes, *Definition of permanent establishment*, IFA 2009, p. 147.
33 Com.DTT, no. 5/402; Ruling no. 2012,019, 28 February 2012.
34 Com.DTT, no. 5/402
35 Ruling no. 2011,476, 20 December 2011.
36 Com.DTT, nos. 5/402 and 5/502; T. Wustenberghs, "De 'Zimmer-case' revisited: commissionair creëert geen vaste inrichting", *Fisc. Int.* 2010, p. 1.

domestic law, it is not required that the agent has the authority to conclude contracts for the principal.[37]

An agent who merely takes orders on terms decided by the principal with no authority to negotiate the terms and conditions of the contract, can generally not be considered to exercise the authority to conclude contracts. However, exceptions exist in a number of treaties, where taking orders creates a PE if the agent delivers the goods out of a stock which is at the agent's disposal (even without having the authority to conclude contracts).

According to the BTA, an agent is dependent if he is both legally and economically dependent.[38] As this is not in line with the current OECD commentary, one might wonder whether this interpretation still has to be followed.[39] Whether or not related enterprises are independent should be assessed on the basis of the same criteria as applicable between non-related enterprises. The Belgian Supreme Court has stated that a subsidiary should not necessarily be considered as dependent on its parent.[40] Financial control by the parent through its participation and even management by the parent should be disregarded.

An agent is legally independent when it is not subject to significant control by the principal or to detailed instructions as regards the way in which it should perform his assignment.[41] Instructions from the principal re orders, negotiations, the collection of invoices and the appointment of subcontractors are generally not sufficient to conclude that an agent has no independent status.[42] An agent is legally independent if, within the general guidelines set by the principal, it has sufficient discretionary power with respect to the local organization of sales activities.[43]

Economically independent means that the agent should bear its own business risk. The way in which the agent will be remunerated is an important but not essential element in the assessment. Even if the agent is entitled to a guaranteed profit margin, it will still be responsible for organizing and managing its business properly to manage its business risk.[44] Also, the fact that the agent is only working for one principal is a strong indication that it is economically dependent but this should not be considered to be a decisive criterion. The Belgian Court of Appeal has confirmed that an agent was considered to be independent in a situation where an exclusive agency agreement did not prevent the agent from acting on behalf of other enterprises.[45]

Independent agents (i.e. those who act in their own names, and on their own risk without interference from the principal, such as brokers and commissionaires) do not form a PE if they act within the normal course of their activity. This should be assessed on the basis of the normal activity and normal obligations within the sec-

37 Com.DTT, no. 5/502.
38 Com.DTT, no. 5/401.
39 G. Bombeke, "De commissionair als hybride figuur in de wereld der directe belastingen", *T.F.R.* 2011, p. 299.
40 Cass. 22 October 1963, *Rev. Fisc.* 1963, p. 542.
41 Bombeke, *op. cit.*, p. 299; Brussels 4 February 1970, *Rev. Fisc.* 1970, p. 597; Ruling no. 2012,380, 20 November 2012.
42 Brussels 20 June 1960, *Rev. Fisc.* 1961, 509.
43 Ruling no. 2012,055, 23 October 2012.
44 Bombeke, *op. cit.*, p. 301.
45 Brussels 21 October 2004, *J.D.F.* 2005, p. 104, with comments of Caroline Docclo.

tor or business.[46] According to the BTA, an independent agent is considered to operate beyond the normal scope of its operations if (a) it performs a full cycle of transactions for the account of the service recipient (purchase of raw materials, production, sale of finished goods) or (b) converts and processes goods into finished goods for the account of the service recipient.[47] On the basis of the full cycle theory under (a), if an agent also acted as contract manufacturer, a PE could only be avoided if the agent did not bind the principal. The situation in (b), where reference is made to a toll manufacturer, would probably only refer to situations where the toll manufacturer also sold the products.[48]

Agents that maintain a stock of goods trigger a higher risk of a PE in a number of DTTs.

3.3. Service PE

The application of the PE definitions under paragraphs 1, 5 and 6 of article 5 is not always easy in the case of outsourcing of services. Except for the application of §5 and §6, a PE would only exist if the service recipient had a fixed place of business through which its own activities were performed. It follows from the practice that in the case of services, the conditions of a PE are not always fulfilled. Therefore, inspired by the UN model, the OECD commentary provides for the possibility for states to include in their DTTs an alternative definition of a service PE.

The definition of a BE under Belgian tax law includes the notion of a service establishment (article 229 §2/1 ITC):

> "When a foreign enterprise performs services in Belgium for the same or connected projects through one or more individuals who are present in Belgium and perform services during a period or periods exceeding 30 days within a period of 12 months, the activities carried on in Belgium in performing these services form a Belgian establishment."

This allows Belgium to tax income of such a service establishment where a DTT contains a service PE provision, or in non-treaty situations. Belgium has, however, only a few DTTs (based on the UN model) with a service PE provision (e.g. those with China, the Philippines, Korea and Singapore).

3.4. Illustrations

3.4.1. Case study 1 – Outsourced contract manufacturing[49]

Under Belgian domestic tax law, where SUBCAR would be located in Belgium, CARCO will have a BE in Belgium.[50] Where a DTT is available between Belgium and the residence country of CARCO, CARCO will not have a PE in Belgium.[51]

46 Wustenberghs, *op. cit.*, no. 189.
47 Com.DTT no. 5/313-503.
48 Bombeke, *op. cit.*, p. 305.
49 For full discussion of the facts, please refer to the General Report.
50 Art. 229 §1/2(10) ITC.
51 Art. 5 §4(c) OECD model convention.

The existence of a BE triggers the obligation for CARCO to file annually a non-residence tax return and to reply to a request for information from the BTA.[52]

If CARCO were located in Belgium and a PE were deemed available under the relevant DTT (in exceptional circumstances), Belgium would provide exemption for PE profits. If no treaty was available and a taxable presence of CARCO in state S were available under the domestic laws of the latter, Belgium would not provide for the exemption of PE profits. Nor would a tax credit be available.

3.4.2. Case study 2 – Outsourced call center services[53]

Since OCO is acting within a broad set of instructions by ICO, only on behalf of ICO and is remunerated on a cost plus basis, OCO should be considered to be legally and economically dependent on ICO. If OCO were located in Belgium, ICO would have a Belgian BE.[54] In a treaty context, OCO would be considered the PE of ICO if OCO had the authority to bind ICO and habitually exercised this authority by concluding insurance contracts on behalf of ICO without asking for its prior approval. If OCO were independent, e.g. if OCO provided the same services to other clients as well, a PE would still be deemed to exist since OCO would then be considered to act beyond the normal scope of its operations.[55] The authority to bind the principal is deemed present even if this is only factual, e.g. if standard contracts or blank insurance policies are available and the agent delivers these to customers.[56] The same would be the case if the agent could decide and sign on the renewal of the policy. If the activities of OCO were limited to the maintenance of a database and giving information to prospective clients (preparatory and auxiliary activities), no PE would exist.

If ICO were located in Belgium, the same would apply under a typical treaty.

4. Attribution of profits to a PE arising from outsourced activities

4.1. Belgium as source state

On the basis of article 228 §2(3) ITC, the profits realized with the intervention of a BE are taxable in Belgium. It is not relevant whether the transaction is initiated by the BE or whether it is only performed with the (secondary or intermediary) intervention of the BE.[57] It is sufficient that the transaction has contributed to the profit of the BE.[58]

52 Com.DTT no. 5/05.
53 For full discussion of the facts, please refer to the General Report.
54 Art. 229 §2 ITC.
55 Com.DTT no. 5/505.
56 *Ibid.*
57 Com.IB no. 228/15; H. Vanhulle, "La détermination des bénéfices d'un établissement stable", in I. Richelle and E. Traversa, *Fiscalité internationale en Belgique*, Brussels, Larcier, 2013, p. 103.
58 Administrative Guidelines to ITC (Com.IB) no. 228/16.

Only the net amount of the profit is taxable in Belgium. The net amount is to be determined on the basis of Belgian domestic corporate income tax rules.[59] Only expenses which exclusively relate to Belgian taxable income can be allocated to the BE.[60] It is not relevant whether the expenses are paid by the BE or by the head office.[61] Expenses of the BE are normal expenses which are actually incurred by the BE and expenses made incurred by the head office for the control and account of the BE. If so allowed by the DTT, a proportional part of the general headquarters expenses of the head office may be allocated to the BE.[62] On the basis of articles 185 §2 and 235 §2 ITC, the taxable profit of the BE should be determined in line with the arm's length principle.

The starting point for the allocation of profits to a BE are the Belgian accounts of the BE drafted in accordance with Belgian accounting law. When no such Belgian accounts are available (e.g. if the BE does not constitute a formal branch under Belgian company law), non-Belgian accounts could be used as the starting point.

In a treaty context, the principles of profit allocation to a PE can be found in article 7 OECD model convention. On the basis of article 7 §2 (version as it read before 22 July 2010), the profits of the PE are "the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently". Recent developments have taken place at OECD level in order to resolve interpretation issues between the member states of the OECD. This has resulted in a 2008 report of the OECD on the allocation of profits to permanent establishments as updated and published on 22 July 2010 (OECD PE report) and a 2010 update of the OECD commentary to the model convention in line with the PE report, including a new version of article 7.

Under the "functionally separate entity approach", which is the authorized OECD approach (AOA), the attribution of profits to a PE should be based on the arm's length principle as laid down in article 9. A two-step analysis is required. First, a functional and factual analysis, conducted in accordance with the guidance found in the OECD TP guidelines, must be performed in order to hypothesize the PE and the remainder of the enterprise appropriately as if they were associated enterprises, each undertaking functions, owning and/or using assets, assuming risks, and entering into dealings with each other and transactions with other related and unrelated parties. The activities performed by the enterprise will be attributed to the PE or the head office according to whether the people functions relating to these activities are performed by the PE or the head office. It may also be relevant and useful in identifying and comparing the functions performed to consider the assets that are employed or to be employed. The assignment of risks to the head office or the PE is a rather hypothetical exercise since it is the enterprise as a whole which legally bears the risk. The head office or the PE should be considered as assuming any risks for which the significant people functions rel-

[59] Com.IB no. 235/31.
[60] Art. 237 ITC.
[61] Com.IB no. 235/37.
[62] Com.IB no. 235/38.

evant to the assumption of risk are performed by the personnel of the head office or PE.

As a step two, the profits of the hypothesized distinct and separate enterprise should be determined based upon a comparability analysis. This includes the application of one of the TP methods to arrive at an arm's length compensation for the dealings between the PE and the rest of the enterprise.

The DTTs that are currently in force in Belgium contain a version of article 7 as it read before 22 July 2010. The BTA have not made any official commentary to the AOA on profit attribution to PEs. It is accepted by certain authors that the new OECD commentaries on article 7 should also be applied and followed by the BTA in the application of the current DTTs (also in DTT situations where the current article 7 is not yet aligned with the new version). The reason is that Belgian case law has applied the ambulatory interpretation.[63] On this basis, DTTs should be interpreted on the basis of the circumstances and regulations that exist at the time the treaty is applied (and not on the basis of the intention of the parties at the time of conclusion of the treaty as is the case under the static interpretation). This is particularly the case where the OECD PE report contains clarifications to the principles that previously formed the basis for article 7. The Belgian Ruling Commission follows the new insights from the OECD and applies the AOA.[64]

Particularly in case of an agency PE, if the agent is remunerated on an arm's length basis, the fact that the agent would constitute a PE of the principal might at first sight not have any impact. Indeed, the profit to be allocated to that PE would be neutralized by the arm's length remuneration for the agent which is allocated as an expense of the PE. However, the question arises of whether there are situations where certain risks and functions of the principal could be attributed to the PE as a result of which the profit of the PE would exceed the arm's length remuneration of the agent. On the basis of the so-called "dual taxpayer approach" as set forth by the OECD in the PE report, the OECD states that there are circumstances where "there would remain any profits to be attributed to the dependent agent PE after an arm's length reward has been given to the dependent agent enterprise".[65] Under this approach, it would be possible that on the basis of a functional and factual analysis, certain risks and the economic ownership of certain goods, which legally belong to the principal and not to the agent, were deemed to be allocated to the jurisdiction of the agent as a result of the "significant people functions" of the latter, not at the level of the agent, but at the level of the PE of the principal.

Although this has not yet been tested in Belgian case law, there might be situations where additional profit could be allocated to the PE of the principal in the jurisdiction of the agent: for instance where the agent only assumes limited risks while the agent (and thus the PE) has more the profile of a fully fledged distributor assuming such risks or where a risk is practically not manageable.[66] In such situation, a TP adjustment in accordance with article 9 could also be applied, but it might appear easier in practice to apply a profit allocation on the basis of article 7.

63 Vanhulle, *op. cit.*, p. 127.
64 See e.g. Ruling no. 2011,289, 9 August 2011 and Ruling no. 2011,378, 8 November 2011.
65 PE Report, p. 60, para. 234.
66 Bombeke, *op. cit.*, p. 329.

Indeed, as compared to article 9, where the starting point is the contractual and legal allocation of risks between parties as reflected in e.g. the contractual documentation, the allocation to a PE under article 7 starts from the economic reality and the significant people functions (absent legally binding contracts). This "risk follows functions" approach of the OECD means that the economic ownership of assets belongs to that part of the enterprise where significant people functions related to those assets are performed. A PE that performs a production or sales activity can in principle not be stripped from the risks that relate to those functions (unlike a subsidiary where the contractual allocation of risk would in principle be sufficient).

Where risks exist over which no one has control but which are contractually allocated to a party, the issue is even more complicated. In that case, it is not possible to challenge the contractual risk allocation. The function of control cannot be used as a test to determine whether the contractual risk allocation is in line with the behavior of the parties. A TP adjustment in accordance with article 9 would not be possible. It might, however, be justified to allocate the risk, and thus the profit, to the PE on the basis of article 7; the functional and risk profile of the PE might not justify a qualification as a routine business. In practice this would probably occur only in very exceptional circumstances.

The Belgian Ruling Commission has confirmed that the performance of the activity by the agent does not lead to additional taxable income in Belgium in the hands of the PE of the principal as long as the agent is remunerated on an arm's length basis taking into account the functions performed, risks assumed and assets used and no other functions, risks or assets are deemed present in the Belgian PE.[67]

4.2. Belgium as home state

A Belgian company is liable to tax on its worldwide income. However, if exemption of PE profits is provided for in a treaty context, the non-Belgian PE profit is deducted from the worldwide net profit of the Belgian company on the basis of article 199 ITC. Belgian domestic tax law provides for a deduction of PE income (no credit). The net profit that is exempt in Belgium is calculated on the basis of Belgian domestic rules on the determination of the taxable basis.

5. Transfer pricing

Belgian tax law currently contains two different versions of the arm's length principle, that is, the internationally accepted arm's length standard through article 185 §2 ITC and the abnormal or benevolent advantage set forth in article 26 ITC and articles 79 and 207 ITC. On the basis of articles 26 and 185 §2(a) ITC an upward TP adjustment can be made. On the basis of article 185 §2(b) ITC, a Belgian taxpayer is, under certain conditions, allowed to make a downward profit adjustment for corporate income tax purposes. If it can be justified that the accounting result

[67] Ruling no. 2012,141, 12 June 2012.

exceeds the arm's length result, this difference can be exempt from tax. Articles 79 and 207 ITC disallow certain deductions (such as current losses for the year and losses carried forward from prior years, etc.) that would have applied to that part of the result that arose from abnormal or benevolent advantages received by a Belgian taxpayer from a related enterprise.

The OECD guidelines are officially accepted and followed by the BTA. The fact that no deviating rules exist in Belgium insures as much as possible against double taxation (if the other jurisdiction also applies the OECD guidelines). Moreover, the BTA accept the use of pan-European databases,[68] and, in practice as the case may be, also non-European databases. In line with the OECD guidelines, the BTA accept that a price is arm's length if it falls within the inter-quartile range of results. The use of the median is generally not a requirement.

To obtain certainty in advance, APAs can be obtained. Unilateral APAs can be obtained from the Ruling Commission. In its decision-making process, the Ruling Commission takes account of the treatment in the other country to avoid double taxation as much as possible (and to the extent acceptable under the arm's length standard). Copies of the APAs obtained in other countries relating to the same transaction should be provided to the Ruling Commission. Bilateral or multilateral APAs can be obtained with the Belgian competent authority. APAs are generally valid for a maximum period of five years.

Where double taxation arises, the mutual agreement procedure (MAP) under article 25 of the OECD model convention is available. The BTA follow the OECD commentary to article 25, which provides that TP adjustments fall within the scope of application of the MAP under the treaties.[69] Under the MAP, competent authorities are not, however, obliged to reach an agreement. Belgian taxpayers are also entitled to the Arbitration Convention,[70] which provides for a mandatory relief from double taxation in a situation where the tax authorities of a contracting state unilaterally adjust the profit of a taxpayer in its state with respect to a transaction that the taxpayer entered into with a related taxpayer situated in another contracting state.[71]

In both situations, where the outsourcing entity or the service provider is a Belgian taxpayer, the remuneration of the service provider should be arm's length to avoid adverse Belgian tax consequences in the hands of the Belgian outsourcing entity or the Belgian service provider. If the outsourcing entity is a Belgian taxpayer, that part of the fee that would exceed the arm's length fee will not be tax deductible in the hands of the outsourcing entity under articles 49 and 26 ITC. If the fee were below the arm's length price, this might also lead to adverse tax consequences in the hands of a Belgian outsourcing entity on the basis of articles 79 and 207 ITC. If the service provider is a Belgian taxpayer, a profit adjustment could be made on the basis of article 26 ITC if the fee received were below the

68 Circular no. AFZ/98-0003, 28 June 1999, III, 2, C and Circular no. Ci.RH.421/580.456, 14 November 2006, 23.

69 Circular no. AFZ/Intern.IB/98-0170, 25 March 2003 and OECD commentary, 25/9 and 25/10.

70 Convention 90/463/EEC of 23 July 1990 on the elimination of double taxation in connection with the adjustment of profits of associated enterprises.

71 Circular no. AFZ/INTERN.IB/98-0170, 7 July 2000 and Circular no. AFZ/INTERN.IB/98-0170, 25 March 2003.

arm's length standard. If the fee received exceeded the arm's length price, certain deductions could be disallowed by the BTC in accordance with article 207 ITC.

Where a business undergoes a restructuring in view of outsourcing, other points of attention from a TP perspective come into play, in particular the TP aspects of the restructuring itself and the allocation of possible anticipated savings (such as location savings) to the appropriate entity.

The principles of Chapter IX of the OECD guidelines on business restructuring are followed by the BTA. If an enterprise or a group decides to outsource an activity to a related service provider, and this entails a restructuring, this might involve a cross-border transfer of something of value and/or a termination or substantial renegotiation of existing arrangements. In those circumstances, the question arises of whether an arm's length compensation for the restructuring itself is due. These issues are dealt with in Chapter IX of the OECD guidelines. The BTA follow the arguments and viewpoints of the OECD on business restructuring.

According to paragraph 9.99 of the TP guidelines, in outsourcing cases, it may happen that a party voluntarily decides to undergo a restructuring and to bear the associated restructuring costs in exchange for anticipated savings. A taxpayer that is manufacturing and selling products in a high-cost jurisdiction may, for instance, decide to outsource the manufacturing activity to an associated enterprise situated in a low-cost jurisdiction. Further to the restructuring, the taxpayer will purchase from its associated enterprise the products manufactured and will continue to sell them to third party customers. The restructuring may entail restructuring costs for the taxpayer while at the same time making it possible for it to benefit from cost savings on future procurements compared to its own manufacturing costs. Independent parties implement this type of outsourcing arrangement and do not necessarily require explicit compensation from the transferee if the anticipated cost savings for the transferor are greater than its restructuring costs.[72] As regards the tax deductibility of restructuring costs (e.g. redundancy payments), the Belgian Ruling Commission generally takes the view that these costs should be borne by the entity that has taken the decision or which benefits from the restructuring.[73]

The Belgian Ruling Commission has decided that an entity can undergo a restructuring and a transfer of functions, assets and/or risks at arm's length if this alternative is more appropriate than a termination of an activity or a continuation thereof with, however, exposure to substantial business risks. In such circumstances, the restructuring (in view of outsourcing) could be positive to the entity by reducing and avoiding future losses.[74]

On the ownership of IP developed under an outsourcing arrangement, as the case may be, the BTA will also follow OECD guidance in this respect. Once final, the OECD report on TP aspects of intangibles will provide guidance. On the basis of the current draft, the identification of legal ownership will depend on the relevant registrations and contractual arrangements and the conduct of the parties. The question of legal ownership is, however, separate from the question of remuneration under the arm's length principle. The allocation of the ultimate return

72 TP guidelines, para. 9.99.
73 For example Ruling no. 2011,425, 6 December 2011.
74 Ruling no. 2011.532, 31 January 2012.

attributable to the intangible will depend on the contributions that the entities involved make to the anticipated value of the intangibles.

5.1. Case study 3 – Location savings through outsourced contract manufacturing[75]

Paragraphs 9.99 and 9.148 to 9.153 of the TP guidelines will be the basis for the Belgian tax treatment of the above scenario.

Given that the relocated activity is a highly competitive one, it is likely that the company in state A has the option realistically available to it of using either the affiliate in state B or a third party manufacturer. As a consequence, it should be possible to find comparable data to determine the conditions in which a third party would be willing at arm's length to manufacture the clothes for the enterprise. In such a situation, a contract manufacturer at arm's length would generally be attributed a small, if any, part of the location savings.[76] Therefore, the additional profit realized due to location savings should probably be allocated to the company in state A (for the major part, if not entirely). The company in state B should earn, based on the arm's length principle and the appropriate TP method, a remuneration that would be received by an independent enterprise in similar circumstances.[77]

5.2. Case study 4 – Location savings through subcontracting services[78]

It may be that there is a high demand for the type of engineering services in question and the subsidiary in state Y is the only one able to provide them to the required quality standard, so that the enterprise in state X does not have many other options realistically available to it than to use this service provider. In such an event, at least part of the additional profit realized due to location savings should probably be allocated to the subsidiary in state Y. In addition, it might be that the subsidiary in state Y had developed a valuable intangible corresponding to its technical knowhow. Such an intangible would need to be taken into account in the determination of the arm's length remuneration for the subcontracted services. In appropriate circumstances (e.g. if there were significant unique contributions such as intangibles used by both the enterprise in state X and its subsidiary in state Y), the use of a transactional profit split method might be considered.[79]

6. Withholding tax

6.1. Withholding tax on service fees

On the basis of article 228 §3 ITC withholding tax is due on payments made by a Belgian taxpayer to a non-resident which constitute income that is taxable in Bel-

75 For full discussion of the facts, please refer to the General Report.
76 TP guidelines, para. 9.151.
77 L. Batselier, "Transfer Pricing", in *Fiscale Praktijkstudies* no. 38, Mechelen, Kluwer, 2013, p. 149.
78 For full discussion of the facts, please refer to the General Report.
79 TP guidelines, para. 9.153.

gium according to Belgian domestic tax (were the recipient a Belgian taxpayer) and (a) for which Belgium has been granted the right to tax on the basis of a tax treaty or (b), in the absence of a treaty, which are not taxed in the residence country of the recipient.

As an example of payments meant under (a), reference can be made to income referred to in article 12 (royalties) of the treaties with India, Argentina, Brazil, Morocco and Tunisia and payments made by a Belgian service recipient to a service provider located in those countries for the provision of technical assistance or technical services.

The payments meant by article 228 §3 ITC will be mentioned each year in the notice to the debtors of withholding tax (*bericht aan de schuldenaars*).[80]

Payments under (b) refer to payments made by a Belgian service recipient to a non-Belgian service provider, even if the services are performed outside Belgium and the service provider does not have any link with Belgium. The mere fact that the payer of the income is a Belgian resident triggers taxation in Belgium by means of withholding tax, if the taxpayer cannot demonstrate that the income is or will actually be taxed in the country of residence of the service provider. If the recipient of the income cannot deliver a declaration confirming that the income is or will be actually subject to tax, the debtor will need to withhold the withholding tax.[81]

The rate of the withholding tax is in principle 33 per cent; the tax base is the income after deduction of a lump sum amount for expenses equaling 50 per cent of gross income. For payments under (a), a treaty can provide for a reduced rate. Under the current treaties, the reduced rate is between 5 per cent and 11 per cent.[82] This is, for instance, the case in the treaty with India, where the withholding tax rate is reduced to 10 per cent. The withholding tax in principle needs to be withheld by the debtor of the income.

6.2. Withholding tax on salaries of employees

By virtue of article 270 ITC, Belgian withholding tax is due on the salaries of employees of a non-Belgian service recipient, working in the latter's PE in Belgium (rendering services to a Belgian service provider).

If Belgian resident employees work outside Belgium in a non-Belgian PE, and are subject to tax in that country on the basis of article 15 of the OECD model convention, Belgium will provide exemption for that non-Belgian salary, but the net non-Belgian income will be taken into account to determine the tax rate applicable to the Belgian taxable income. Belgium does not provide for a credit for the non-Belgian withholding tax.

80 *Parl.Works* Chamber 2012–2013, 53.2458/001, p. 40.
81 *Ibid.*, p. 42.
82 *Ibid.*, p. 52.

7. Impact of anti-deferral regimes on outsourced structures

No anti-deferral legislation in the sense of controlled foreign company (CFC) rules exists in Belgium. However, there are a number of provisions that prevent the transfer of profits or funds to entities that are not subject to tax or are subject to a more advantageous tax regime.

Articles 54, 198(10) and 307 ITC on payments to low-taxed entities are discussed under section 2. In case of repatriation of profits, article 203 ITC will be relevant. Article 344 §2 allows the tax authorities to ignore the transfer of assets to a non-Belgian person which is not subject to tax or is subject to a more advantageous tax regime.

8. Discussion and suggestions

Currently cross-border outsourcing does not trigger many substantial discussions or litigation in Belgian tax practice. Belgian domestic tax law provides quite clear guidance on the tax deductibility of service fee payments in the hands of the service recipient. In the TP field, OECD TP guidelines are followed and applied by the BTA, triggering few discrepancies with the offshore jurisdiction. A few issues and problems that arise in a cross-border outsourcing context can, however, be identified.

A first one is the current international discussion on the agency PE in commissionaire structures, a discussion which also takes place among Belgian tax practitioners and in unilateral APA negotiations. Some clear guidance on this would be welcome in order to create certainty for business. The treaty definition should be changed (instead of the OECD commentary only) to avoid a different application by different countries. Guidance should also be provided as regards the related PE allocation issue. Is an arm's length remuneration for the commissionaire sufficient to avoid additional profit allocation to the PE and, if not, under what circumstances and conditions should additional profit be recognized? The question remains, however, of how new insights will be implemented into the existing DTTs. There is currently no guidance or experience in the Belgian field on this subject, and nor is it clear in Belgium how to deal with internal dealings for PE profit allocation purposes. This raises some discussion in practice.

Another topic relates to location savings and the attribution of additional profit realized due to location savings. Disputes may arise where a different viewpoint on location savings is taken between countries. The BTA might not accept a mark-up adjustment made by the Chinese or Indian tax authorities to factor in the lower cost base claiming location savings which accrue to the local subsidiary. This position assumes that location savings are an (intangible) asset owned by the local subsidiary. But are location savings a sufficient condition for price renegotiations or recognition of excess returns?

Given the importance of R&D activities for Belgium and in the framework of the application of the PID regime, the OECD's viewpoint on intangibles, and the

impact of BEPS on this, will be relevant for Belgium (i.e. guidelines as to what extent functions related to development, research, maintenance and protection of intangibles can be outsourced and what the impact thereof would be on the attribution of the return earned by such intangibles).

Case law on cross-border outsourcing and the above issues does not exist in Belgium. Since the number of TP audits is increasing in Belgium, more case law may be expected in the years to come. APAs play an important role, as taxpayers are looking for guidance and certainty.