

# **CFC-rules in Belgian corporate income tax**

*Scope of the new rules and interplay with other legislation*

IFA Seminar - 12 November 2019

# Agenda

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- ▶ Introduction and background
- ▶ Scope of the new rules – number of questions
- ▶ Interplay between CFC-rules and other legislation
- ▶ Q&A session

# Introduction and background



# Introduction and background

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- ▶ CFC - rules = 'Controlled Foreign Companies' rules
- ▶ Attribution and taxation of income of a low taxed CFC at the level of the controlling company
- ▶ **Double purpose**: prevent 1) *profit shifting* and 2) long term *deferral of taxation*
- ▶ ATAD allows 2 approaches:
  - ▶ **Entity approach**: taxation of entire or specific categories of (passive) income of a low taxed CFC ('mechanical' rules)
  - ▶ **Transactional approach**: taxation of income non-genuinely diverted to a low-taxed CFC whereby the majority of decision making functions are exercised by the controlling entity
- ▶ => Transactional approach implemented in Belgian corporate income tax

# Relevant provisions and entry into force

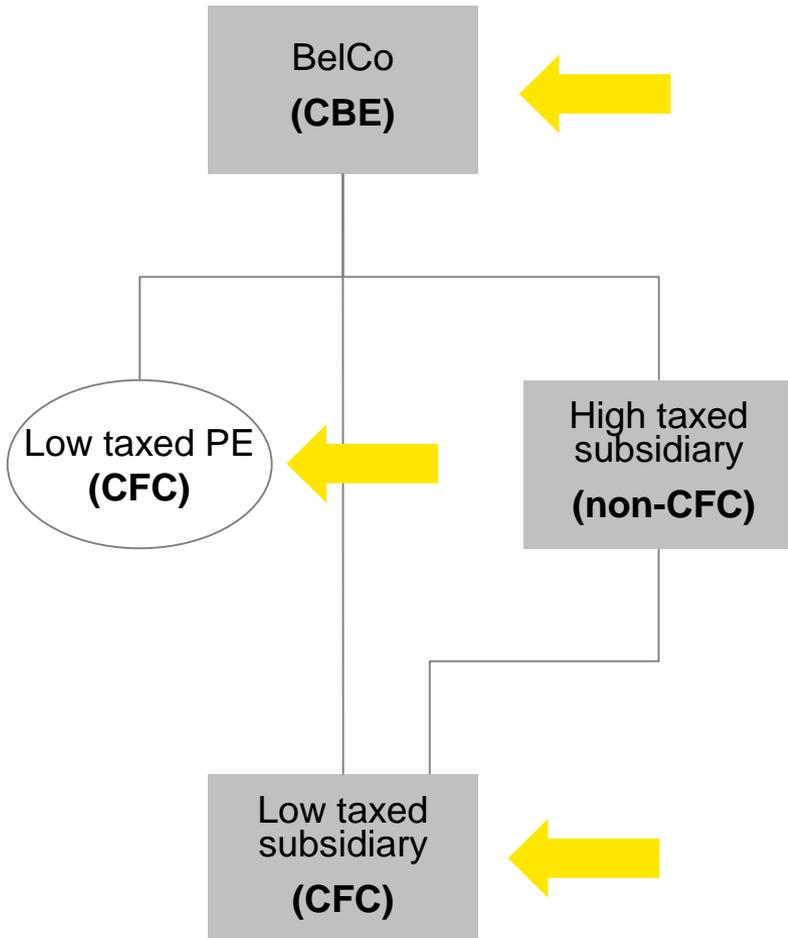
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- ▶ BEPS Action Point 3
- ▶ Articles 7 and 8 ATAD (EU Directive 2016/1164)
- ▶ Implementation ATAD - Belgian CFC rules
  - ▶ **New article 185/2 BITC92 (CFC rules)**
  - ▶ **Amendment of articles 202, §1, 4° and 5° BITC 92 and 204 BITC92 (DRD rules)**
  - ▶ **Amendment of article 307, §1/2 BITC92 (reporting obligation)**
- ▶ **Entry into force for accounting years as of 1 January 2019**

# Scope of the new rules



# Identification of a CFC



## (1) *Controlling Belgian Entity (CBE)*

- ▶ Belgian tax resident companies and legal entities subject to Belgian corporate income tax

## (2) *Controlled Foreign Company (CFC)*

- ▶ Foreign **subsidiary** of a CBE
- ▶ Foreign **branch** of a CBE
  - ▶ Included in the Law of 30 July 2018 modifying the law of 25 December 2017 despite taxation on worldwide income under Belgian CIT
- ▶ Two cumulative conditions:
  - ▶ 1° Control condition
  - ▶ 2° Low taxation condition



# Questions/remarks re. the identification of a CFC

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## (1) *Control condition*

- ▶ Two differences compared to the ATAD
  - ▶ Belgian provision includes a **top down approach only** i.e. joint control over a CFC together with an associated enterprise (e.g. with a parent or sister company) is not in scope ⇔ ATAD includes joint control with an associated enterprise
  - ▶ A participation of **at least 50%** of the share capital or entitlement to at least 50% of the CFC's profits is sufficient ⇔ ATAD requires more than 50%
- ▶ Irrelevant criterion for the attribution of undistributed profits of a CFC to the CBE which is based on the functionality (i.e. the exercise of the so-called key functions – ‘significant people functions’) of the CBE

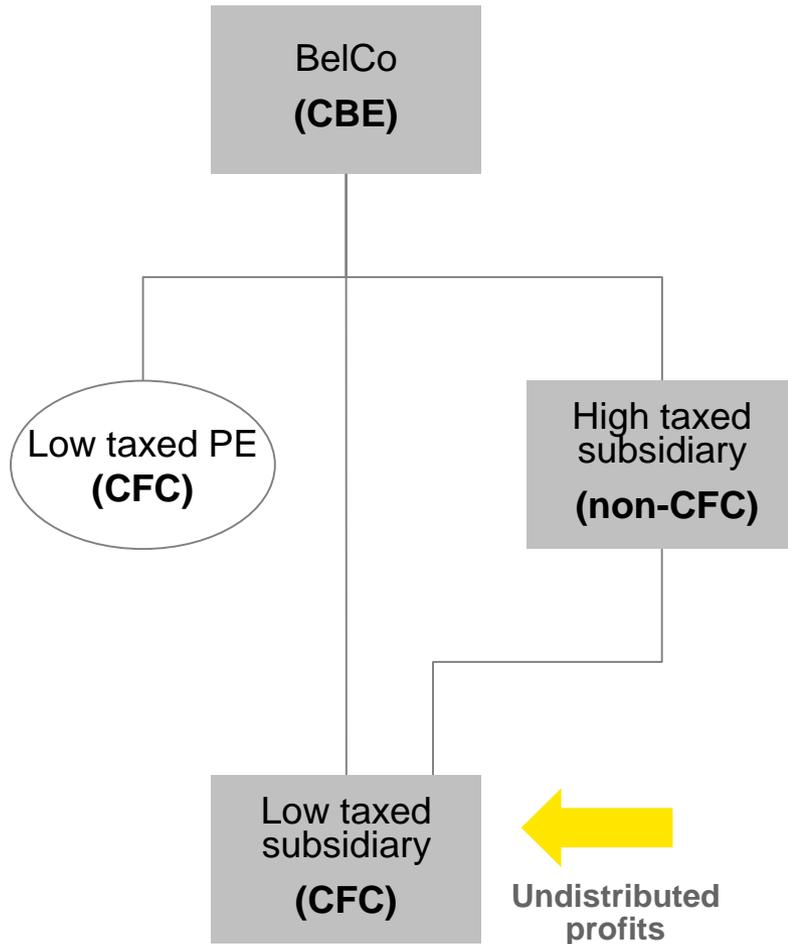
# Questions/remarks re. the identification of a CFC

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## (2) *Low taxation condition*

- ▶ Assessment in concreto at CFC level on a yearly basis without de minimis exemption ⇔ ATAD provides for the possibility to use white, grey and/or black lists
- ▶ CFC's not subject to income tax e.g. US tax transparent LLC's or Luxembourg SICAR
- ▶ More complex assessment under the 'as if' provision
  - ▶ Computation of the **hypothetical Belgian CIT** which would have been due if the CFC were to be established in Belgium and to be **compared with the actual CIT charge** in the country of establishment
  - ▶ For CFC subsidiaries a stand alone computation, for CFC branches a computation of the supplementary CIT of the branch as part of the CBE?
  - ▶ Hypothetical Belgian CIT
    - ▶ Based on BEGAAP accounting result
    - ▶ Including mandatory and optional upward and downward book-to-tax adjustments
    - ▶ Result of a branch of a CFC which is exempt in the CFC jurisdiction pursuant to a tax treaty between the CFC jurisdiction and branch jurisdiction should be disregarded (anti-blending rule => avoid that taxation at local branch level influences the outcome of the computation)

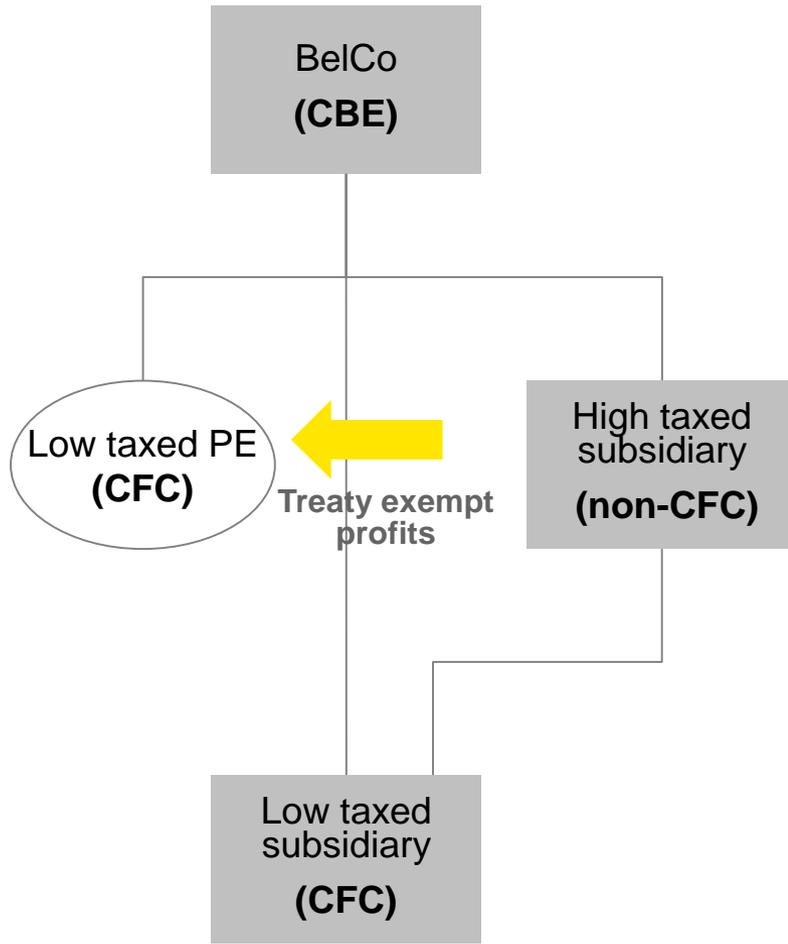
# Determination of CFC pick-up income



## (1) Scope limited to undistributed profits

- ▶ For a CFC subsidiary => “*profits realized by the CFC in a taxable period ending during the taxable period of the CBE and which are not distributed during the same taxable period to the CBE or another Belgian company*”
  - ▶ CBE with FY ending on 31/12/2019 and CFC with FY per 31/05/2019 => undistributed profit per 31/05/2019 considered for tax assessment year 2020 of the CBE
  - ▶ CFC with FY ending on 31/12/2019 and CBE with FY per 30/09/2020 => undistributed profit per 31/12/2019 considered for tax assessment year 2021 of the CBE
- ▶ ‘Undistributed profits’ = profits which are **distributable but remain undistributed according to local law rules of the CFC?**
- ▶ Mitigation through timely distribution to CBE or other Belgian company => necessary application of DRD rules

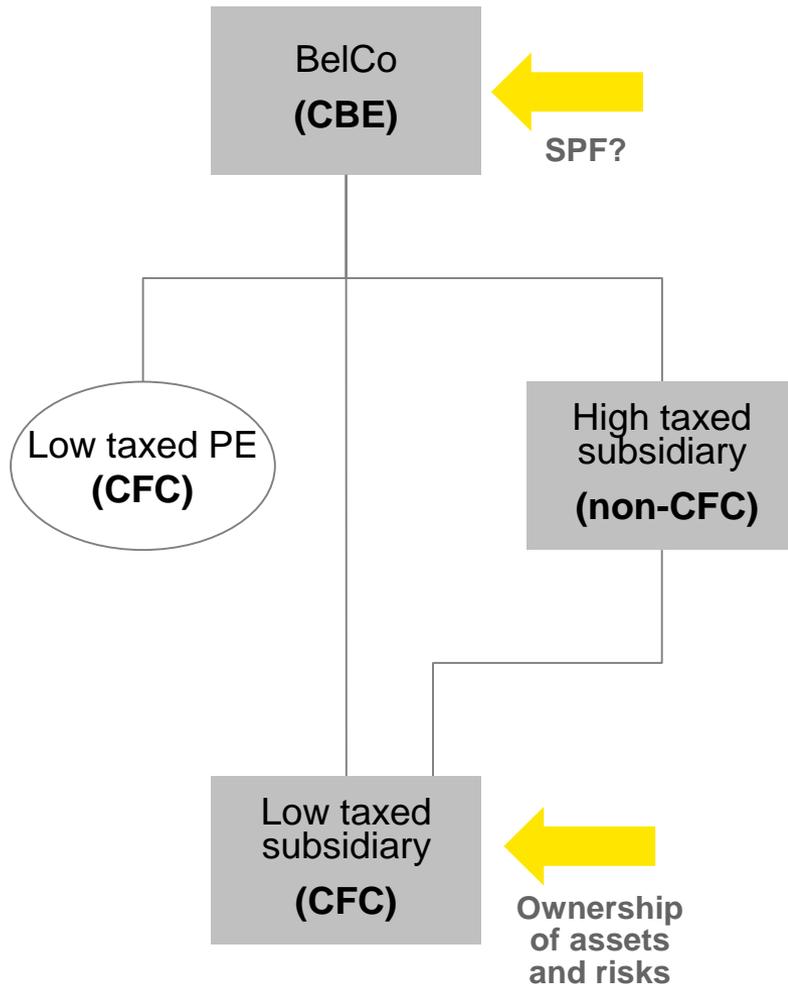
# Determination of CFC pick-up income



## (1) CFC pick-up income limited to undistributed profits

- ▶ For a CFC branch => **“profits that are exempt or benefit from a reduced taxation in Belgium by virtue of a double tax treaty”**
- ▶ Only relevant if the right to tax branch profits is allocated to the branch’s country or jurisdiction pursuant to a DTT
- ▶ How to deal with potential tax treaty override?
  - ▶ Intra-EU application - application of the ATAD prevails
  - ▶ Branch in a third country - DTT prevails and will need to be renegotiated according to the legislator

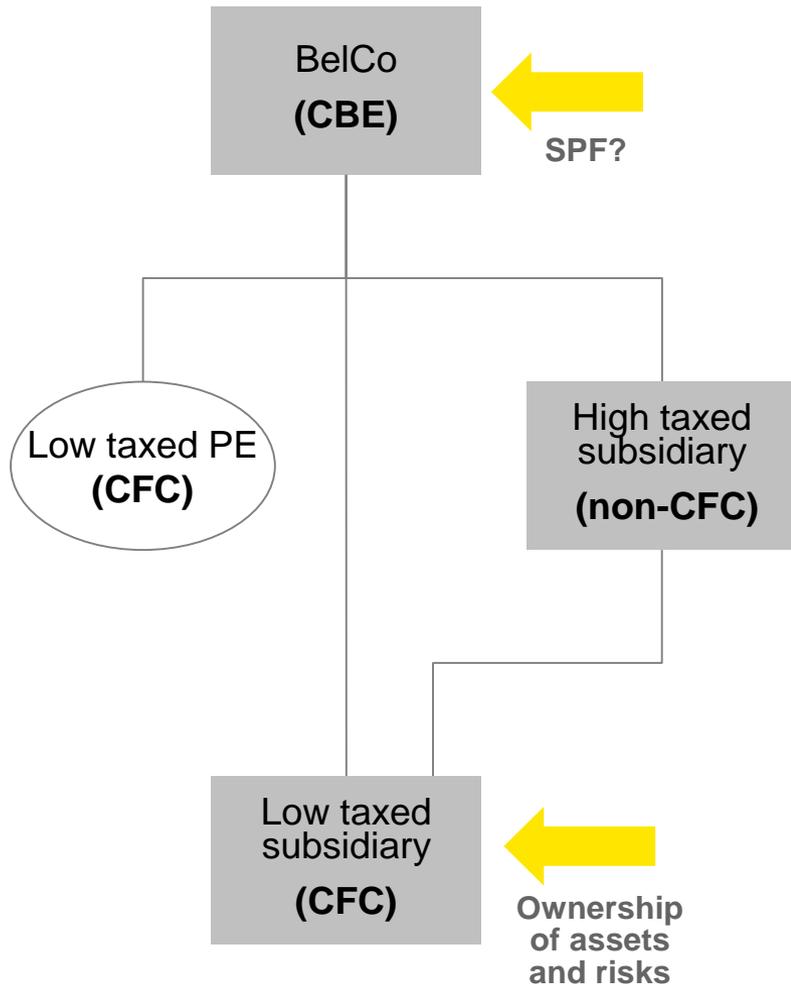
# Determination of CFC pick-up income



## (2) CFC pick-up limited to non-genuine arrangements

- ▶ Transactional approach = Pick-up of CFC profits at the level of the CBE if and to the extent that these profits result from
  - ▶ 1) *a non-genuine arrangement or series of arrangements* (objective element)
  - ▶ 2) *set up with the essential purpose of obtaining a tax advantage* (subjective element)
- ▶ **Non-genuine arrangement**
  - ▶ Mismatch between 1) the ownership of certain assets and risks undertaken by the CFC and 2) the exercise of significant people functions relating to these assets and risks by the CBE
  - ▶ Example Explanatory Memorandum: intellectual property and license income owned/earned by the CFC whilst development and update of software was done by the CBE (reference to OECD DEMPE functions)
  - ▶ Other? (Sub-)holdings with limited substance and decision making authority over the investments

# Determination of CFC pick-up income

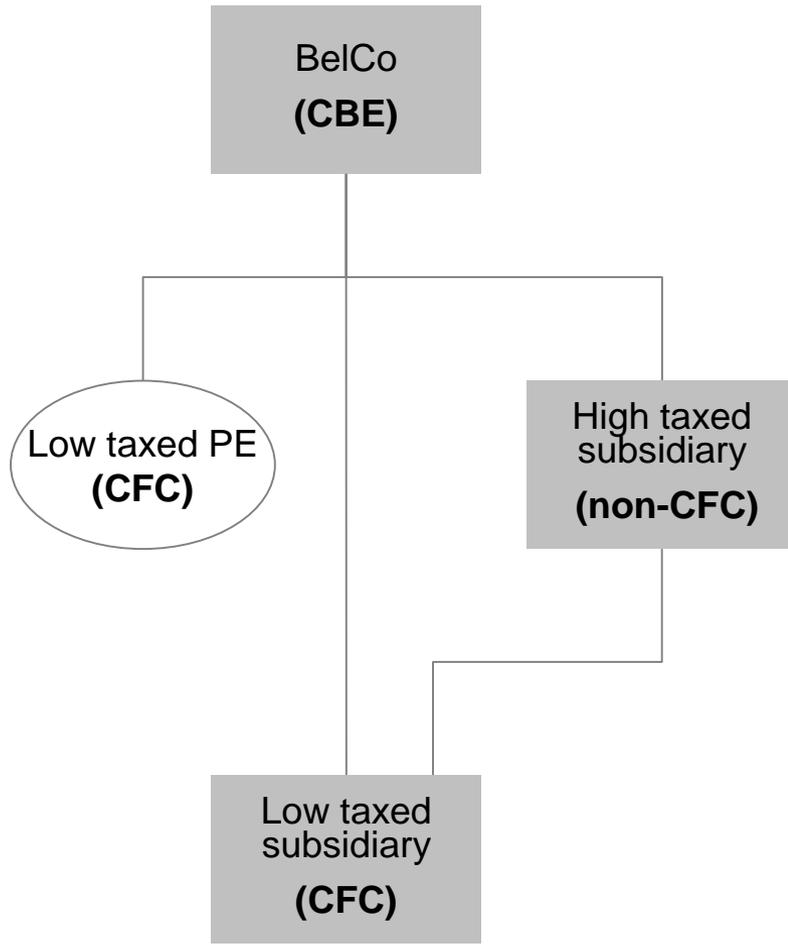


## (2) CFC pick-up limited to non-genuine arrangements (Cont'd)

### ▶ Subjective element and burden of proof

- ▶ *“Which essentially aims at obtaining this advantage”*
- ▶ Additional condition or inherent to a non-genuine arrangement?
- ▶ The wording used in Belgian legislation is a literal translation of the wording in the ATAD. The ATAD and the Explanatory Memorandum do not contain an explanation regarding the interpretation and/or the allocation of the burden of proof in this respect
- ▶ In our view to be applied in the same manner as the subjective element of article 344, §1 BITC92
  - ▶ => Tax authorities to demonstrate the objective element by all means of proof
  - ▶ => taxpayer to rebut such challenge and proof that the arrangement is justified by motives other than the avoidance of Belgian CIT
  - ▶ => If the taxpayer fails, assumption that the subjective element is met

# Determination of CFC pick-up income



## (3) Attribution of undistributed CFC profits to the CBE

- ▶ Proportionality rule: CFC profits attributed to CBE *to the extent that* they arise from a non-genuine arrangement
- ▶ Two step approach:
  - ▶ 1<sup>st</sup> step: functional and factual analysis to identify assets and risks and related SPFs
  - ▶ 2<sup>nd</sup> step: profit attributable to SPFs to be determined in accordance with OECD Transfer Pricing Guidelines
- ▶ Not a transparency rule i.e. CIT due on CFC pick-up income irrespective of its origin and nature (penalizing e.g. for entity not subject to local CIT realizing a capital gain on shares which would have been exempt if realized by Belgian holding)
- ▶ No credit for local CIT
- ▶ No rules for interplay with other foreign CFC rules

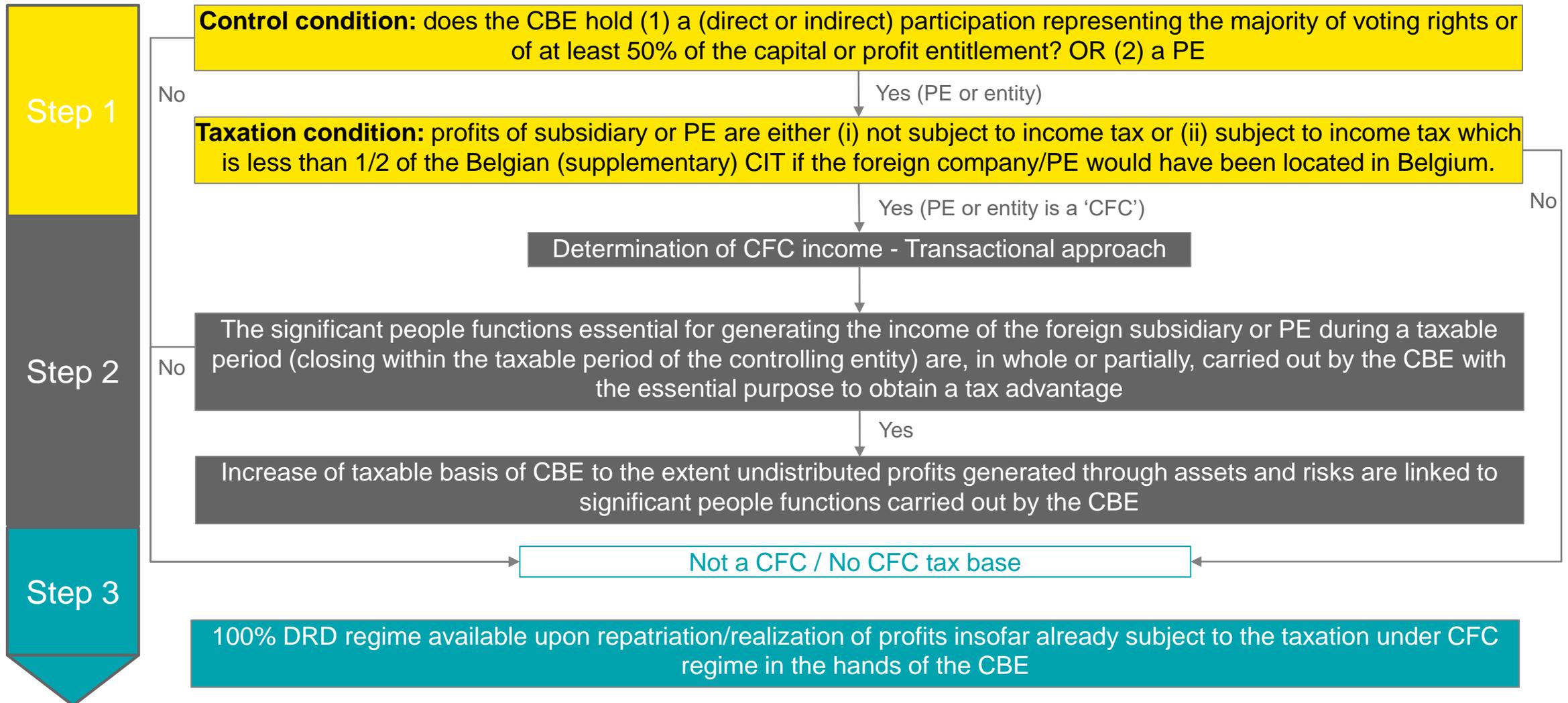
# Reporting Obligation

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- ▶ Added by the law of 30 July 2018
- ▶ Name, legal form, address and identification number of the CFC, ***of which the profits are entirely or partially taxed in the hands of the CBE***, should be reported in the yearly CIT declaration
  - ▶ => to encourage taxpayers to investigate whether the CFC legislation might be applicable and to facilitate tax audits
- ▶ Only a reporting obligation if all or part of the CFC profits are taxed in Belgium in a given year with application of the CFC-rules
- ▶ Reporting obligation should not apply if there is a CFC but no CFC profit is taxed in Belgium
- ▶ Should allow the Belgian tax authorities to identify and monitor the origin of the CFC income if and when reported

# CFC rules

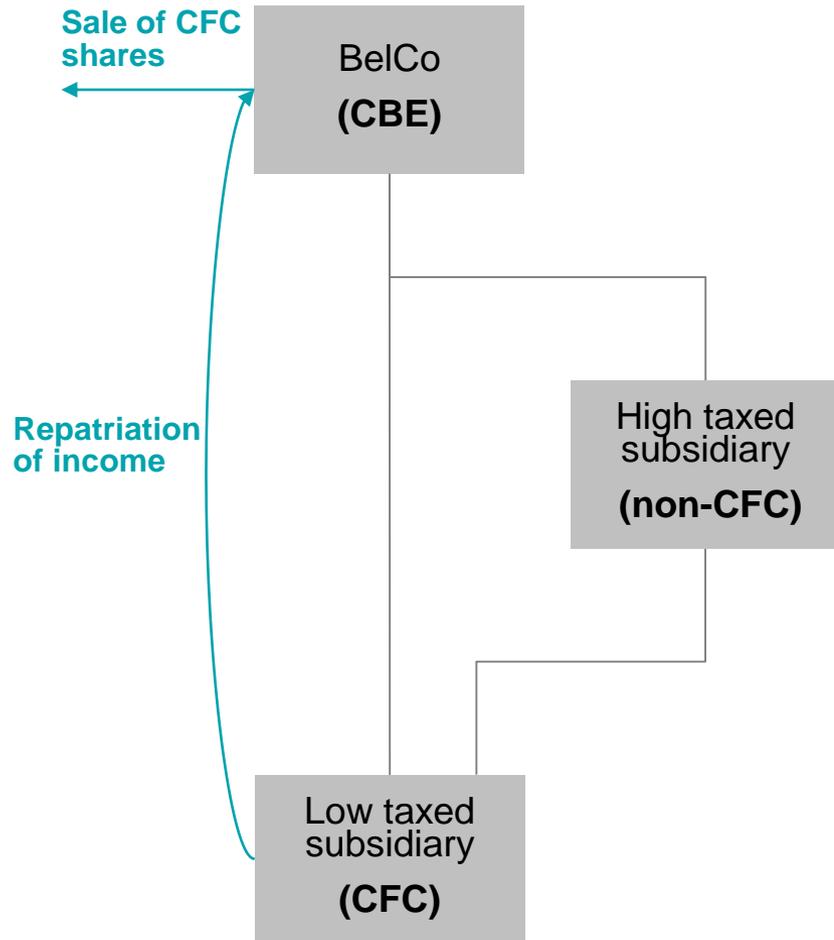
## Summarizing decision tree



# Interplay of CFC-rules with other legislation



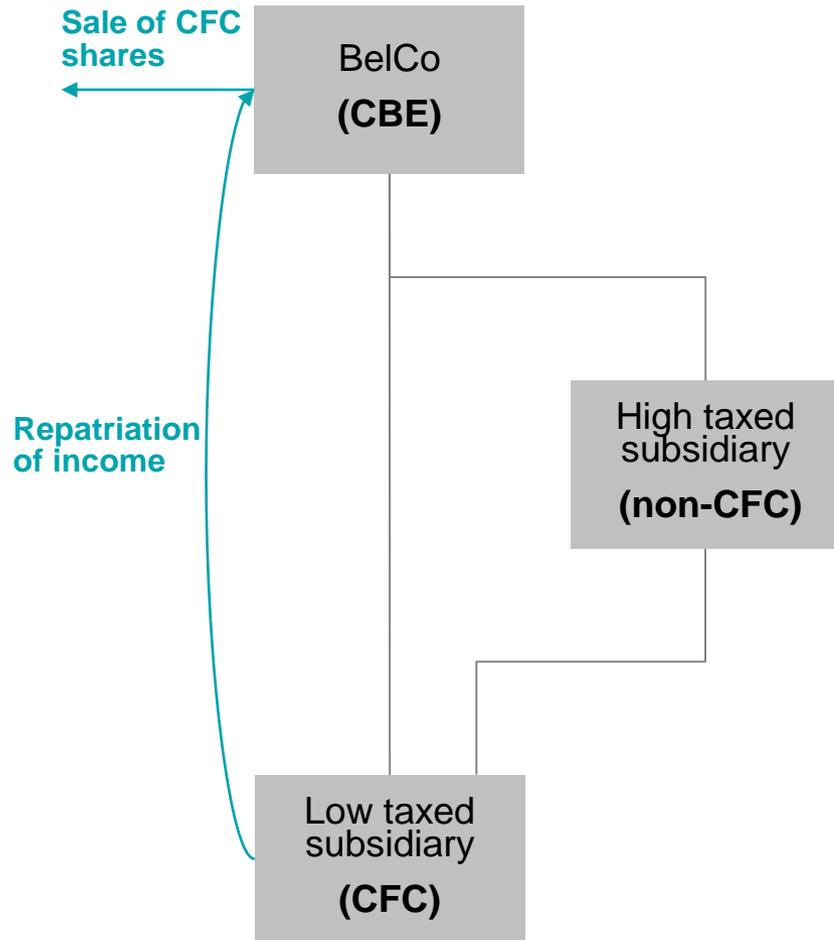
# Repatriation/realization of CFC income



## Adjusted DRD-rules

- ▶ Two adjustments:
  - ▶ **Dividend distribution by CFC:** 100% DRD regime available upon repatriation of profits subject to taxation under CFC regime in a prior tax year
  - ▶ **Capital gain on sale of CFC shares:** 100% DRD regime for capital gains realized upon the sale of a participation insofar already taxed as CFC-income, not entitled to the capital gains tax exemption (scenario of an embedded dividend) and still recorded on a liabilities account
- ▶ CBE to demonstrate that the CFC profits have been taxed as CFC pick-up income in a prior tax year in the hands of the Belgian entity
- ▶ Imputation rule: profits of the CFC that have been taxed with application of the CFC rules will be deemed to be distributed first

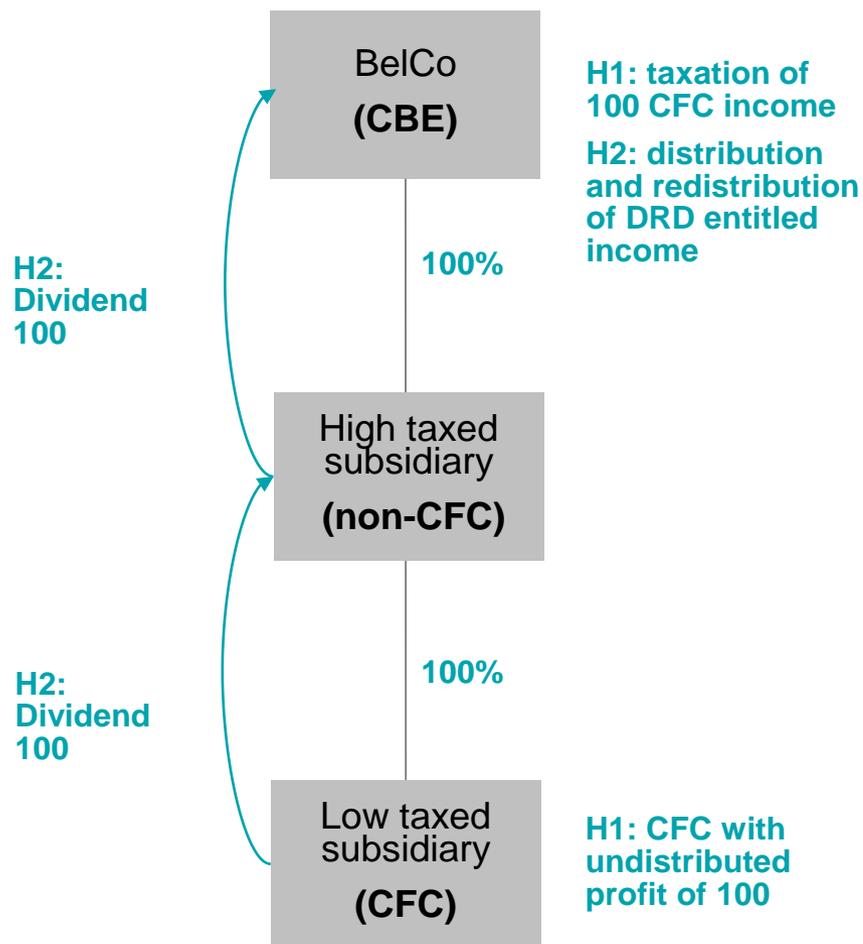
# Repatriation/realization of CFC income



## Adjusted DRD-rules (Cont'd)

- ▶ The DRD entitlement is limited to the CBE which has recognized CFC pick-up income in a prior tax assessment year
  - ▶ => New rules do not remedy economic double taxation which could arise in the hands of a non-controlling shareholder
  - ▶ => DRD entitlement does not extend to the new shareholder of the CFC which may be subject to CIT on the distribution of the embedded dividend of the CFC (if not entitled to the DRD)
- ▶ Can rules be applied in cascade i.e. including to redistributions of dividends made by CFCs which are indirectly held and capital gains on shares in a subsidiary which in its turn holds shares in a CFC with undistributed profits?
- ▶ No rules for capital gains derived from the sale of a branch (OECD Model and so do most Belgian DTT, exempt capital gains derived from the disposal of a foreign permanent establishment)

# Repatriation/realization of CFC income



## Adjusted DRD-rules (Cont'd)

- ▶ To what extent do the new CFC rules complement the DRD rules and recognize taxable income in instances where DRD entitlement could be claimed?
- ▶ DRD provisions provide for **different subject-to-tax criteria** than CFC rules
  - ▶ It cannot be excluded that CFC pick-up income needs to be recognized on undistributed profits which would be entitled to DRD if distributed
  - ▶ Example\*: DRD rules provide for EU safe harbor and nominal 15% rate whilst CFC rules requires to compare effective CIT with hypothetical Belgian CIT
  - ▶ Example\*: indirectly held CFCs whose profits are redistributed through companies referred to in article 203, §2, eight indent, 1° and 2° ITC92 (i.e. which ascertain a sufficient taxation at the intermediate holding level)

# Interplay with other CFC rules

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- ▶ Only CFC like rule included in the income tax code (applicable to companies and legal entities), is article 344, §2 BITC92
  - ▶ *“a sale, transfer or contribution of certain assets is not enforceable upon the Belgian tax authorities if it is made to a foreign taxpayer which is not subject to income tax or that benefits from a more favorable tax regime on the proceeds derived from the assets transferred than would be the case if such proceeds would be taxed in Belgium”*
- ▶ Notable differences:
  - ▶ Article 344, §2 BITC92 = a procedural provision which can be invoked by the tax authorities when challenging a transfer of assets to a low taxed jurisdiction, not part of the CIT code laying down the taxable base
  - ▶ Article 344, §2 BITC92 does not operate as a transfer pricing provision per se (no requirement that the transferor controls or owns an interest in the transferee)
  - ▶ Article 344, §2 BITC92 targets a specific transaction (i.e. the transfer of an asset) with a specific sanction (i.e. the non-enforceable character of the transfer) with a procedural measure which can only be applied post-factum by the Belgian tax authorities but does not include the proactive reporting

# Interplay with pre-existing transfer pricing rule

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- ▶ The new Belgian CFC rules are conceived as transfer pricing rules => Interplay with existing transfer pricing rules of article 185, §2, a) ITC92 (the implementation of the arm's length principle in Belgian tax legislation)?
- ▶ New CFC rules apply “***notwithstanding the application of article 185, §2, a) ITC92***”
  - ▶ In our view, one of both rules prevails over the other or excludes the other
  - ▶ Parliamentary works and advice of the Council of State, the application of the transfer pricing provision of article 185, § 2, a) ITC92 prevails
  - ▶ Burden of proof different?
- ▶ OECD BEPS 3 report: transfer pricing rules focus primarily on payments between related parties. ***CFC rules are less transactional and/or with less or no cash flows***
- ▶ The application of the existing transfer pricing rule is rather exceptional in the absence of any fee in a first instance (i.e. the pricing of which could be adjusted with the transfer pricing rule if it is not deemed to be at arm's length)

# Questions?



# Contact Details

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