Bloomberg Tax

TAX PLANNING INTERNATIONAL

EUROPEAN TAX SERVICE

International Information for International Business

DECEMBER 2017

www.bnai.com

Tax Reform in Belgium: Opportunities and Potential Threats for Large Companies

Laurent Donnay de Casteau
Osborne Clarke

Belgium's tax reform, with a phased implementation from 2018 to 2020, will, mostly, have a positive impact on large companies, with a decrease in the corporate tax rate and the introduction of tax consolidation. However, the tax reform may not bring good news for everyone.

Laurent Donnay de Casteau is Partner, Head of Tax (Belgium) at Osborne Clarke

Announced by the Belgian federal government on July 26, 2017 the details of the proposed tax reform were presented at the end of October. The bulk of the legislation is contained in an "economic recovery and strengthening of social cohesion bill" presented on December 11, 2017 to the Belgian parliament, and its approval is expected before the end of 2017. As we indicated in a previous article in September (see "Major Tax Reform in Belgium by 2020," Tax Planning International European Tax Service, Vol. 19, No. 9), this tax reform makes major changes, and takes place in an overall context of fair taxation, budget neutrality and simplification. Offsetting measures are taken to neutralize the budgetary effect of tax reductions. The implementation of the reform is phased: several measures will enter into force as of 2018, while others will become active by 2019 and 2020.

The main opportunities relevant for large companies are:

12/17 Copyright © 2017 by The Bureau of National Affairs, Inc. TPETS ISSN 1754-1646

- a decrease of the standard corporate tax rate to 25 percent;
- the introduction of tax consolidation;
- the update of the holding regime; and
- the reinforcement of tax incentives for R&D and innovation.

The main (potential) threats relevant for large companies are:
- the introduction of a minimum tax base;
- the limitation of the notional interest deduction to the increase in equity of the five preceding years; and
- the limitation of deductions, phased in two steps (with ATAD-implementation).

We detail these changes below, which are still subject to potential amendments prior to formal approval of the legislation by the Belgian parliament.

Opportunities from 2018

First Decrease of the Corporate Tax Rate

Beginning with the January 1, 2018 accounting year, the standard corporate income tax rate will be 29.58 percent, compared to 33.99 percent previously. This first reduction of the nominal rate was necessary, given that Belgium has one of the highest nominal corporate tax rates in Europe. Even if the effective tax rate can be much lower, such a high nominal rate is uncompetitive. With this first decrease, Belgium's nominal rate remains high, but this first decrease will be followed by a second one in 2020, bringing the nominal rate further in line with that of other European countries.

For small and medium enterprises (SMEs), a lower 20.4 percent rate may be applicable on earnings up to 100,000 euros, provided certain conditions are met.

Update of the Holding Regime

The dividend exemption within the parent-subsidiary regime will increase from 95 percent to 100 percent. All other conditions remain unchanged. Within the Benelux countries, Belgium will finally align itself with a full deduction on received dividends within the context of the parent-subsidiary participation exemption, provided the distributed dividends are generated by at least a 10 percent participation (or, alternatively, by a participation with an acquisition value of at least 2.5 million euros), which must be held in full property for at least one year, and which has been subject to an ordinary tax regime comparable to the Belgian one.

The Fairness tax, which was applicable to some distributions made by Belgian companies, will be abolished, as will the 0.412 percent specific tax rate on gains realized on shares by large companies.

As a result, large holdings could obtain a Belgian tax neutrality on their realized capital gains on shares (full exemption) and on their dividends (received and distributed, with full exemption of tax and withholding tax), when meeting the conditions.

A change will occur regarding realized capital gains on shares, which should not be a difficulty for large holding companies: the existing conditions of 100 percent exemption are reinforced and are aligned with the conditions applicable to dividends. A new minimum participation threshold has to be met, with a minimum shareholding of 10 percent of the share capital or acquisition value of the participation of at least 2.5 million euros, in addition to the existing conditions (shares owned in full ownership for at least one year and a "subject to taxation" qualitative condition). This alignment of capital gains conditions on dividends is a simplification, but could be bad news for some categories of companies, which should be alert to this change in due time.

First Reinforcement of the R&D/Innovation Incentives

Within the large panel of existing measures to incentivize the R&D/innovation, the payroll tax exemption for scientific personnel will be broadened. In order to benefit from this (partial) exemption, one condition relates to the educational degrees obtained by personnel. The qualifying credentials will be progressively enlarged to specific bachelor's degrees (i.e. biotech, technology, product-development, computer-oriented management). The exemption rate for bachelor's degrees will in first instance be 40 percent (and maintained at 80 percent for the already qualifying higher degrees), which produces a decrease in the cost of R&D/innovation salaries. These incentives are one reason for the presence of large R&D/innovation centers in Belgium.

Threats (Potential) Beginning in 2018

The Introduction of a Minimum Tax Base

When a company's tax profit for the year, after deductions (excepting the notional interest deduction), exceeds 1 million euros, 30 percent of this profit will be subject to effective taxation. In other words, above the 1 million euros profit level, the minimum tax base limits to 70 percent the deduction of the:

(i) notional interest deduction;

(ii) unlimited carry forward of tax losses;

(iii) unlimited carry forward of dividend deduction;

(iv) unlimited carry forward of innovation deduction; and

(v) limited carry forward of notional interest deduction.

Offsetting all the taxable profit with a carried forward deduction is thus ended, with potential changes in deferred tax valuation.

Another offsetting measure, initially targeting SMEs, could generate additional tax costs in case of insufficient payment to a director, but this aspect will be subject to further clarification when the text of bill becomes available.

Limitation of the Notional Interest Deduction to the Increase in Equity

The notional interest deduction is maintained, but as of 2018 it is restricted to the increase in equity compared to an average based on the five preceding years. Even if this represents the only change to the existing regime, this restriction (combined with the minimum tax base described above) will significantly reduce the attractiveness of Belgium for intra-group financing structures.

Another offsetting measure relates to tax qualification of capital reductions made by Belgian entities: depending on the components of the Belgian entity's equity, part of the capital reduction would be treated for tax purpose as a dividend distribution. For large companies, when the shareholder qualifies as a parent entity (EU or tax treaty country), the practical consequences can be very limited.

Limitation of Deductions

The tax treatment of several types of expenses is reviewed (i.e. provisions, prepaid expenses, effective tax on additional assessment resulting from a tax audit).

Opportunities as of 2019: Introduction of Tax Consolidation

Until now, Belgium had no tax consolidation mechanism. The consolidation model (initially announced for 2020 but anticipated to 2019 in the Bill presented to the Parliament) will be close to the Swedish model: the tax result of group entities will not be as such consolidated (each entity will file its own tax return), and will be organized though a group contribution mechanism. Unlike Sweden, this contribution will be considered as much as possible from a tax perspective only, outside the accounts.

This group contribution will be applicable only between direct parent-subsidiary entities (or establishments) or Belgian subsidiaries held by the same parent company. A participation threshold of 90 percent holding for the entire year is required, and this participation has to be held for the previous five years, to minimize tax-avoidance consolidation structuring. The consolidation can only be applicable to companies or establishments subject to the ordinary Belgian tax regime.

Such a contribution will be possible only up to the amount of the yearly tax losses suffered by a Belgian entity, and cannot exceed these losses, so there will be no use of carry forward losses. A profit-making entity will be able to deduct from its profit such contribution as would be taken into account for computing the net tax result of the tax loss-making entity. Due to the tax savings made by the profit making entity, that entity will have to pay a (tax neutral) compensation equal to the tax amount saved by the entity that used its tax losses against the group contribution. The paid amount between group entities is thus limited to the tax savings: the cash flow does not equal the group contribution.

This tax consolidation is optional. It can be set up between 2 or more entities, and it will require that those entities enter into a consolidation agreement.

Threats (Potential) as of 2019: Implementation of the ATAD-Directives

ATAD-1 and ATAD-2 would be implemented by 2019. The implementation was announced for 2020 but has been anticipated to 2019 to comply with the deadline for transposition). The deduction limitation will target the net interest charges, considering the thresholds of 3 million euros, or 30 percent EBITDA. Belgian entities within a group should be consolidated (ad hoc consolidation, separate from the tax consolidation described above). Exceptions apply, i.e. on loans granted before June 17, 2016. Tax upon exit is modified. CFC-rules and measures tackling hybrid mismatches are introduced.

Opportunities as of 2020

Second Decrease of the Corporate Tax Rate

Beginning with the January 1, 2020 accounting year, the standard corporate income tax rate will be lowered to 25 percent (8 percent below the 2017 rate) with the full abolition of the additional crisis surcharge.

Second Reinforcement of the R&D/Innovation Incentives

We already mentioned above the enlargement of the payroll tax exemption for scientific personnel. The existing exemption rate of 40 percent for years 2018–19 will be increased to 80 percent, which constitutes a harmonization of the 80 percent exemption rate for all qualifying degrees. Also note that as a consequence of the corporate tax decrease, the effective tax rate of innovation income is lowered to 3.75 percent.

Threats (Potential) as of 2020

The reform contains several other modifications, such as a review of the definition of permanent establishment under Belgian law, deductibility of car expenses, amortization rules, and the clarification of the at arm's length rate.

Conclusion

The scope of the tax reform is very broad. While we wished for more simplification, the reform contains both good and bad news, with overall results that will be positive for some large companies, but not for everyone. The extent to which benefits can be found depends on the activities and economical motivations of the structure. If not already done, we strongly recommend that companies make every effort to understand the consequences of this reform on their own activities and structure.

Laurent Donnay de Casteau, Partner, Head of Tax (Belgium) at Osborne Clarke.

 TPETS ISSN 1754-1646