Belgium in International Tax Planning
Second Revised Edition

Chapter 4

Specific anti-avoidance provisions and international tax planning

4.1. General

International tax planning strategies invariably require the use of companies in zero or low tax jurisdictions (offshore entities). Throughout the years detailed rules have been introduced in the Belgian Income Tax Code that are specifically designed to combat the use of such low tax regimes and offshore entities. These rules will be commented on below.

The methods used in this respect by the Belgian tax legislator and by the Belgian Revenue Authorities can be divided into three categories:

By applying generally applicable rules of civil and tax law, such as the traditional sham doctrine (which is a civil law concept, see below), or the general anti-abuse provision of Art. 344 § 2 of the ITC (or similar provisions in other tax codes) which obviously is a specific tax law concept. Typical examples here are: the non recognition of the existence of offshore entities in certain (extreme) cases or the re-qualification of a foreign entity as a Belgian entity based on the fact that the foreign entity may, based on all relevant facts and circumstances, be deemed resident of Belgium; the allocation of certain profits to the Belgian taxpayer on the basis of Art. 26 and 185 § 2 WIB which enshrines the general transfer pricing concept of Belgian tax law and which can be applies in transactions at a domestic level or in an international setting involving offshore jurisdictions or not.
By applying certain well designed anti-abuse provisions which are aimed very specifically at certain transactions with or structures involving offshore entities. A typical example here are the 1 to 7 thin capitalisation rule that apply only on loans obtained from low tax entities.

Applying certain “deeming” provisions, i.e. statutory provisions that will either deem certain expenses as non deductible or that will deem a certain transaction not to be “opposable” to the tax authorities. In most cases the taxpayer will have the possibility to rebut such deeming provision provided he can submit sufficient evidence that the transaction, the costs incurred or the structure set up by him meets genuine business and financial needs. Typical examples her are the deeming provision of Art. 54 ITC (non deductibility of certain payments to offshore entities), Article 344 § 2 ITC which deems certain transfer of certain well-defined assets to offshore entities as being “non opposable” to the Revenue Authorities, the re qualification of certain interest payment in dividends (Art. 18, 4° ITC).

As will be made clear in this chapter, some of these provisions are very broad and sweeping and will apply almost “instantly” unless the taxpayer can prove that the transaction(s) is (are) justifiable on the basis of genuine economic and financial purposes. In applying these type of provisions in relation to other EU member states, Belgian taw law may potentially conflict with certain fundamental rules of the EU treaty, such as the freedom of establishment (Art. 43), the freedom of services (Art. 49) and/or the free movement of capital throughout the EU (Art. 56). In the landmark case involving the application of the UK CFC rules by the UK Revenue Authorities with respect to income earned by an Irish International Financial Service Centre, a subsidiary of the UK-based Cadbury Schweppes group, the ECJ held in it decision of 12 September 2006 (C-196/04) that national legislation, such as the U.K.'s controlled foreign company (CFC) rules, are in general terms consistent with the EC Treaty, as they pursue the legitimate objective of counteracting tax avoidance. However, such rules are precluded by Articles 43 and 48 of the EC Treaty, to the extent they apply to arrangements that are not 'wholly artificial' arrangements. Relevant considerations in this determination are whether the taxpayer had a subjective intention to obtain a tax advantage by establishing itself in another Member State, whether there is an actual establishment in that Member State which carries on genuine economic activities and is an 'economic reality', and whether that establishment has a physical existence in terms of premises, staff and equipment. To the extent that certain Belgian anti- tax avoidance rules (that in specific cases may have at least the same effect as certain types of CFC rules) apply almost “instantly” as soon as a low tax jurisdiction is involved, it may come in conflict with the “not wholly artificial” test set by the ECJ in Cadbury Schweppes and the mere fact that in at least some of these provisions the taxpayer is offered the opportunity to submit evidence s to the genuine economic and financial nature and justification of the transaction may not be sufficient to meet the “not wholly artificial” test.

While there is a wide range of provisions in the Belgian tax code that specifically deal with or at least refer to foreign (or even domestic) low or zero taxed entities, there is no uniform definition of what constitutes a low taxed entity for the application of these provisions. Depending on the specific provision concerned, these rules will either refer to “zero tax regimes”, to “jurisdictions where certain types of companies are subject to a system that is not similar to the Belgian corporate income tax regime”, “tax regimes that are specifically (with respect to certain items of income) more favourable than the Belgian tax regime”, “jurisdictions where the general tax system is significantly more advantageous than in Belgium” and “jurisdictions where only certain types of holding or finance companies are treated more favourably”.

The concepts of what constitute low or no tax jurisdictions or companies are of relatively recent origin and have been introduced especially on the occasion of the introduction of the new dividend deduction system (participation exemption)

in 1991, as a result of the implementation of the EU Parent-Subsidiary Directive of July 1990 in the Belgian tax system. Before that date, in 1975, the tax authorities had already published a list of what they considered “tax havens” for the purpose of the former articles that deal with transfer pricing (Art. 24 ITC), non-deductibility of certain payments to tax haven companies (Art. 46 ITC) and non-opposability of certain transactions with tax haven companies (Art. 250 ITC). This list was part of the official commentary on the ITC and was withdrawn in 1985 for the sake of diplomacy towards the listed countries. As a result of a change of terminology introduced by the law of 1990, the tax authorities were, however, forced to give more guidance on what constitutes a tax haven of either category listed above. A new list was therefore published in 1991 in the form of an official notice published in the B.O.J. of 24 August 1991. The list was subsequently amended in 1995 and 1997 in order to correct some technical errors and, in 1997, to exclude Taiwan as a suspect country since this country no longer met the tests applied by most developed countries to qualify as tax haven.

4.2. Foreign companies: non recognition and fiscal domicile

Belgian-based taxpayers (individuals or corporate taxpayers) will often set up foreign legal entities or use existing foreign entities in low-tax jurisdictions in order to reduce their tax liability in Belgium. These companies may be used as so-called “base-companies” in which assets and income that would otherwise be taxable in Belgium are being accumulated, or they may function as “conduit companies” through which certain items of income will be channeled in order to have this income paid onwards in some form to (ultimate) beneficiaries located in third countries (high or low taxing jurisdictions). Non-EU residents may also be tempted to set-up base companies in low tax EU jurisdictions in order to avail themselves of the benefits offered by the EU treaty and the principles of free movement of goods, services, labour and capital.

The use or the setting up of low-taxed foreign entities is not prohibited by Belgian law, but if used or incorporated inappropriately these entities may be disregarded for tax purposes either on the basis of the so-called “sham doctrine” or on the basis of a mere application of international company law principles.

The sham doctrine is based on the civil law concept of “simulation” or sham transactions. Under this theory, only the real intention and purpose of the parties to a transaction will prevail and will take precedence in case the formal wording or presentation of the contract or deed deviates from the real intention to which only the parties are privy. This theory will often be applied when a taxpayer alleges that certain transactions have been entered into by the offshore entity, but is unable to prove this on the basis of reliable documents such as contracts, books and records, balance sheets, etc. (See: Tax Court of Antwerp, 5 November 2003, not yet published)

In order to disregard the existence of an offshore entity on the basis of international corporate law principles, the tax authorities should show that such a company does not exist under its governing laws (*lex societatis*) either because it was not validly incorporated or the company is no longer in good standing because it did not comply with all legal requirements thereto under the applicable foreign law. The first European Directive on company law has severely reduced the number of grounds on which a company's nullity may be ordered. The tax authorities cannot allege that a company covered by the Directive is void only for the reason that it has been created for tax avoidance purposes. In addition, the declaration of nullity of a company can only have effect for the future. Neither can the tax authorities contend that a foreign company should not be recognized on international public grounds since tax avoidance does not conflict with Belgian international public policy.

Another technique that can be used to challenge the use of non resident companies for tax purposes is to challenge the non residence status of the company, rather than its valid legal existence. The tax authorities, may indeed challenge the non-resident status of an offshore entity and treat the entity as a resident Belgian company if they can demonstrate that its principal office and actual seat of management is located in Belgium. This was successfully done in the case of a "Société Anonyme" incorporated under Luxembourg law and having its statutory seat in Luxembourg, and whereby according to the proven facts the company received its mail at a Belgian address, the factual proxy holder of the company exercised its activities habitually in Belgium, the principal activity of the company consisted in the management of a receivable on a Belgian company and the principal shareholder was a Luxembourg bank specialised in the incorporation of Luxembourg- based companies (Court of Appeals Brussels, 9 April 1963, *Bull. Bel.*, 1993, nr. 402, 2366).

4.3. Non-deductibility of certain payments to offshore entities

Art. 54 ITC disallows the deduction of interest and royalty payments for the right to use a patent, a process and other similar rights as well as the deduction of fees for services when they are paid to a non-resident or a foreign entity that is subject, in the country where it is established, to a tax treatment significantly more favourable than the Belgian regime applicable to such items of income.

This is based on the presumption that the expenses listed are not genuine and may even be simulated or excessive. The provision basically introduces a reversal of the burden of proof. The taxpayer can rebut the presumption by showing that those expenses are connected to transactions actually carried out and do not exceed the ordinary limits. To the extent this proof is demonstrated, the expenses will be allowed.

For this provision to apply there is no requirement that the paying and the receiving company are in any way linked or affiliated to each other (Court of Appeals Ghent, 30 September 2003 (FiscalNetnl. apgent20030930)

General statements supported by general publications – according to which Swiss holdings, in general, benefit in most cantons from a favourable tax regime - are not a sufficient proof in this respect (Court of Appeals Antwerp, 2 March 2004, *Fisc. Koer.*, 2004/456). The fact that a country such as Liechtenstein is on the "blacklist" of countries whose tax regime is deemed to be substantially more advantageous, is not, as such, sufficient proof either. The tax authorities must specifically prove that the company to whom the alleged non-deductible payments are made, is indeed subject to a substantially more advantageous tax regime as compared to the Belgian regime for similar types of income (Brussels, 26 January 2005, *Fisc. Koer.,* 2005/333).

If specific proof is available, the provision may, however, fully apply to certain payments made to Swiss holdings, even though Switzerland is not blacklisted (Tax Court of Antwerp, 13 December 2002, *Fiscoloog* 882 (2003), at 1). In another case, the genuine and business-like nature, as well as the arms' length character, of the payment of reinsurance premiums to an in-house reinsurance company located in Guernsey could be proven by the taxpayer and was therefore accepted by the Tax Court (Tax Court of Antwerp, 14 February 2003, *Fisconet*, AI 03/15. In contrast, in a case before the tax Court of Brussels of 21 February 2003 the Court re-affirmed that under Art. 54 ITC the burden of proof as to the genuine and arm's length nature of certain remunerations and fees to a Luxembourg company (presumably subject to a more advantageous tax regime) could not be given by the taxpayer and accordingly the deductibility of these payments was ejected by the Court (Tax Court of Brussels, 21 February 2003, *FiscalNet*, civbxl20030221-02619).

4.4. Qualification of certain interest payments as dividends

Pursuant to Art. 18, 4˚ ITC, interest remunerating "advances" made by certain persons as defined in this article (see below) are treated as a constructive or deemed dividend distribution by the debtor insofar as the total of such advances exceeds the debtor's combined paid-up capital at the end of the year and taxed reserves at the beginning of the year. This rule effectively translates into a debt / equity ratio of 1:1. The re qualification as dividend applies only to the excess amount. The remainder remains deductible interest. For these purposes, "advances" are defined as loans, whether or not represented by securities, granted by:

- an individual shareholder (regardless of the number of shares held) or his/her spouse or dependent children; or

- an individual or a legal entity which exercises, within the debtor, the functions of director (*bestuurder / administrateur*), manager (*zaakvoerder / gérant*), liquidator or a similar function.