'20 Percent for 2020': A Scenario for Belgium's Corporate Tax Reform

Posted on Oct. 19, 2016

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In this article, the author discusses the various measures that are included in Belgian Finance Minister Johan Van Overtveldt's proposal for corporate income tax reform.

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Caterpillar, a U.S. multinational corporation, recently announced its intention to close its plant in Gosselies, Belgium, where it manufactures heavy machinery. While the news was not unexpected, it still came as a shock to the 2,200 employees who will lose their jobs. In 2013, 1,400 jobs were lost in a restructuring.

Walloon Minister-President Paul Magnette said he was shocked and scandalized by the announcement, because "Caterpillar has always enjoyed massive support from the Walloon authorities, especially after the 2013 job cuts." It is estimated that -- directly and indirectly -- 6,000 to 7,000 jobs could be lost, including positions with suppliers and subcontractors. Production will be moved to manufacturing facilities in Grenoble, France, and to other manufacturing facilities outside Europe. Financial experts are pondering the link between Caterpillar's actions and the state of corporate taxation in Belgium.

Caterpillar's Notional Interest Deduction

The press was quick to point out that Caterpillar has made massive use of the notional interest deduction (NID) through its Belgian subsidiary Caterpillar Group Services SA. The NID allows a Belgian company to deduct a percentage of the company's equity, as determined by Belgian generally accepted accounting principles, from its taxable income. Over the period from 2006 to 2015, Caterpillar Group Services SA had been paying €9.857 million in corporate income tax on a total profit of €80.669 million (about 12.2 percent). The NID was some €60.5 million.

When the NID was introduced, it was touted as a means of reducing the effective corporate income tax for multinational companies that invested in Belgium and created new jobs. Caterpillar has proved that multinational companies do not link economic investments and employment issues to financial management.

The Call for Corporate Tax Reform

The Caterpillar case illustrates the need for broad corporate income tax reform in Belgium, preferably including a general reduction of the nominal business income tax rate to a level that can attract international business and generate employment.

Currently, the corporate income tax rate is a fixed rate of 33 percent with an additional crisis tax of 3 percent bringing the notional tax rate to 33.99 percent. There is a reduced rate for small companies of between 24.98 and 33.99 percent.

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However, few companies of any size pay the full corporate income tax rate due to numerous exemptions, deductions, incentives, and "niche" regimes. Profits from overseas branches in treaty countries are tax exempt. There is a 95 percent dividend received deduction and an exemption, in principle, for capital gains on qualifying shareholdings. The patent income deduction has been abolished, but its application is grandfathered for five years, until June 30, 2021, when it will be replaced by a deduction for innovation income.[1] Losses can be carried forward indefinitely and without limitation. There is the (in)famous NID. Finally, Belgian companies can take an investment deduction for investments in qualifying depreciable (tangible or intangible) assets that are newly acquired or realized. It is a confusing network of rules, particularly for multinationals based outside Belgium. Further, many of these policies have lost their attractiveness, mainly as a result of the OECD's base erosion and profit-shifting project and various EU initiatives.

Finance Minister Johan Van Overtveldt pleaded this year for a drastic reduction of the corporate income tax rate to 20 percent. He proposed an alternative system whereby companies could choose between a lower nominal corporate income tax rate of 20 percent or 22 percent with no or few deductions and the current system with its tax rate of 33.99 percent and myriad deductions and exemptions.

Van Overtveldt hoped to initiate general discussions regarding a corporate tax overhaul in the spring, but Prime Minister Charles Michel linked the proposal to the draft budget for 2017, which delayed debates until the fall. In the meantime, the finance minister has been tasked with putting together a detailed plan to reform the corporation tax. The plan must strengthen the competitive position of the Belgian market and be fair to small and medium-size enterprises.

What Are the Options?

In July the High Council of Finance published a report in which it examined different options to reform the corporate income tax in the aftermath of BEPS. The report showed that a lower corporate income tax of 25 percent or 20 percent can be financed only by axing the NID and raising the withholding tax on dividends and liquidation dividends.

The alternative regime initially proposed by Van Overtveldt, the proposal that gave businesses a choice between systems, may be attractive to SMEs, which would favour a fixed corporate income tax rate of 20 percent without any deductions or incentives. However, the finance council advised against the proposed dual regime, as the cost is hard to estimate and it would do anything but simplify the system.

The status quo is not really an option. Within the OECD, Belgium's current nominal corporate income tax rate of 33.99 percent comes in behind only the U.S. (38.92 percent) and France (34.43 percent). Rates within the European Union are dropping to compensate for BEPS, which put an end to favorable tax regimes. The U.K. wants to reduce its rate from 20 percent to 15 percent to remain competitive in the wake of its vote to leave the European Union. Luxembourg is moving from 18 percent to 15 percent. France is talking about a lower tax rate for smaller companies. The Netherlands already has a lower tax rate of 25 percent but is considering reducing that rate even further. Belgium risks getting drawn into a race to the bottom.

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The general trend in corporate income tax reform seems to involve cutting the tax rate and compensating for this by reducing available deductions and exemptions. In keeping with that trend, the finance council proposes extending the taxable basis by eliminating a number of deductions and exemptions, including the NID, and increasing the withholding tax (currently at 27 percent) on dividends and liquidation dividends, as well as the capital gains tax on shareholdings.

A Man With a Plan

Van Overtveldt is in the final stages of preparing a comprehensive corporate income tax reform plan. The reform is to be budget neutral, with any tax rate reduction primarily funded by abolishing most of the niche regimes and taking other compensatory measures within the corporate income tax system. This would have the added benefit of simplifying the corporate income tax regime.

The draft is being finalized and will most likely be modified further in discussions within the government. The following review summarizes the shape the corporate income tax reform may take.

The Planned Rate Reduction

The goal of the minister's draft plan is to gradually but significantly reduce the Belgian corporate income tax rate from 33.99 percent to 20 percent in 2019. The 3 percent crisis surcharge would also be phased out. The effective tax rate would drop to 28.56 percent in 2017, 24.24 percent in 2018, and 20 percent in 2019. These rates would apply to all corporate income tax payers, and the reduced tax rate regime for SMEs would be abolished (possibly over a transitional period of three years). However, a special regime would be available to start-ups qualifying as SMEs for the first five tax years.

Simplification and Elimination

In light of the objective to simplify the corporate income tax regime, a number of complex taxes and other tax obstacles would be axed or altered, such as:

- The fairness tax, which was introduced in 2013. This tax was imposed on large and medium-size companies that paid out dividends but did not pay any corporate income tax because of the NID or because of tax losses carried forward.[2] The future of the fairness tax was already uncertain as the Constitutional Court had asked the Court of Justice of the European Union for a preliminary ruling as to whether it is compatible with EU rules (*X v. Conseil des Ministres*, C-68/15).[3]
- The 0.4 percent capital gains tax (plus a 3 percent surcharge) capital gains tax on shareholdings realized by medium-size and large companies will be eliminated. This special tax, effective from tax year 2014, was introduced by the Program Act of December 27, 2012, and applied to otherwise tax-exempt capital gains realized by medium-size and large companies.[4]
- The dividend received deduction will be increased from 95 percent to 100 percent.
- The capital gains tax rate on shares realized within 12 months of acquisition will be lowered from 25 percent to 20 percent. Traditionally, capital gains realized by a company on a shareholding were tax exempt, but that was modified in 2012.[5] Capital gains on shareholdings that did not qualify for the dividend received deduction (that is, under the threshold of 10 percent of the share capital or with a value of €2.5 million or less) were only taxed if the company sold the shares within the first year of acquisition. Those capital gains that met the requirements were taxed at a fixed rate of 25 percent, a rate that would go down to the new tax rate of 20 percent under the simplified plan. In the final draft of the minister's reform proposal, however, the capital gains tax regime would be extended to tax

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the sale of any shares under 10 percent or €2.5 million thresholds, irrespective of whether the shareholding was sold in or after the first 12 months.

- The proposal also includes a corporate income tax exemption for start-ups during the first five tax years under certain conditions.

Compensatory Measures

To ensure that the tax rate reduction and simplification are budget neutral, the draft proposal includes a number of compensatory measures. These measures would include an increase of the withholding tax on dividends (from 27 percent to 28 percent in 2017, 29 percent in 2018, and 30 percent in 2019) and a broadening of the basis for the calculation of the corporate income tax. Other compensatory measures include the following:

- the NID regime would be abolished effective 2017, but any NID carried forward from before tax year 2013 could still be carried forward;
- the carryforward of tax losses, dividend received deductions, and NID would be limited to €750,000 plus 40 percent of the excess profit per tax year as of 2017;
- the deduction of interest expenses would be limited in accordance with the proposed anti-tax-avoidance directive,[6] while loans contracted before a date to be specified would be grandfathered;
- the investment deduction would be phased out gradually, although the research and development tax credit would be maintained;
- the depreciation rules for tax purposes would be amended, and the declining balance depreciation method would be abandoned;
- the deduction of provisions for risks and charges would be limited;
- the general rule for disallowing business expenses would be amended substantially, for example:
    - penalties relating to direct or indirect taxes will be disallowed;
    - donations by companies would be disallowed;
    - the business expenses for entertainment and restaurant costs would be capped at 5 percent of the company's gross income; and
    - the cost of company cars would be disallowed even further, a measure that would include taking into account actual carbon dioxide emissions calculated per car rather than per category of cars, among other company car-related changes
- the minimum taxable basis for calculating the taxable income of a company that fails to file an income tax return would be raised to €40,000 from €19,000; and
- companies will be allowed to pay tax at a lower rate on tax exempt reserves.

Targeting Evasive Maneuvers

The minister is also considering a diverted profits tax along the lines of the similar tax introduced in the U.K. This would tax profits deemed to be artificially diverted from Belgium. For example, this evasion could occur when a Belgian company has Belgian sales made by a non-Belgian related company or permanent establishment or when a Belgian company has a significant transaction with a related company. The targeted transactions are typically undertaken so that any income ends up in a related company that is subject to a low tax rate.

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Notably, the U.K. diverted profits tax is not considered to be a corporation or income tax, so tax relief under double tax treaties would be not available. Nonetheless, a deduction is allowed against the diverted profit tax for any corporation tax paid on the diverted profits.

The minister's proposal also contains a number of measures to discourage individuals from conducting business activities via a management company. In particular, owners of such companies would have to pay themselves a minimum remuneration of €40,000, which would be liable to social security and personal income tax.

Rejected Measure

An earlier draft reform proposal included an extension of the capital gains tax on substantial shareholdings. Belgium does not, in principle, tax capital gains unless they fall outside the "normal management of a private estate consisting of securities, tangible assets or real property." Capital gains on the sale of shares are taxable under certain conditions, that is, if they result from the sale of a "substantial shareholding" in a Belgian company to an entity outside the European Economic Area are taxed at a rate of 16.5 percent, even if the sale is made "in the course of the normal management." A shareholding in a Belgian company is deemed "substantial" when an individual vendor and his close relatives hold or have held a direct or indirect participation of more than 25 percent at any time during the five years before the sale. Because the conditions are so wide, the sale of the shares of a substantial shareholding in a Belgian company was rarely liable to capital gains tax.

After the business world protested that this provision would effectively make all sales of substantial shareholdings liable to capital gains tax for individual shareholders, the measure was abandoned. Instead, the capital gains tax for companies of 25 percent (reduced to 20 percent) would be extended to the sale of all shareholdings under the threshold of 10 percent or €2.5 million as set out above.

What's Next

The proposed plan has been submitted to the coalition parties in the federal government as part of the upcoming budget negotiations. It is uncertain when, and even if, an agreement will be reached on the reform of Belgium's corporate income tax regime. What is certain is that this would be one of the larger tax reforms of this century.

FOOTNOTES

[1] *See* Quaghebeur, "Government Replaces Patent Box With Innovation Box," *Tax Notes Int'l*, Aug. 22, 2016, p. 658.

[2] *See* Quaghebeur, "New Tax Measures Rushed Through Parliament," *Tax Notes Int'l*, July 29, 2013, p. 417.

[3] *See* Quaghebeur, "Constitutional Court Turns to Tax Matters," *Tax Notes Int'l*, Feb. 16, 2015, p. 571.

[4] *See* Werner Heyvaert, "New Law Introduces Tax on Capital Gains From Shares," *Tax Notes Int'l*, Jan. 14, 2013, p. 141.

[5] *See* Quaghebeur, "The Belgian Budget Process and Its Tax Implications," *Worldwide Tax Daily*, Dec. 14, 2011.

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[6] Council Directive (EU) 2016/1164 of July 12, 2016, laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193 (July 19, 2016), 1-14.

END OF FOOTNOTES

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