Belgian Court of Audit Criticizes Tax Regime for Foreign Executives

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In a report presented to the Belgian Parliament on 25 February, the Belgian Court of Audit questions the legality and effectiveness of Belgium's special tax regime for foreign executives.

The Court of Audit is a collateral body of the Parliament whose members are elected by the House of Representatives to exert an external control on the budgetary, accounting, and financial operations of the Belgian federal state, the Dutch and French communities, the Flemish and Walloon regions, public service institutions, and the provinces. It has wide autonomy to perform its duties, which include examining and validating the accounts of the general administration and all accounting officers answerable to the public Treasury. It also monitors budgetary expenditures and ensures that there is no transfer of expenditures between budgetary items.

More important for tax practitioners, the Court oversees operations relating to the assessment and collection of state revenue, including the collection of taxes. The reports it addresses to the federal Parliament are always a source of information about the way the Ministry of Finance operates.

During 2001, the Court of Audit examined the laws and regulations governing the special tax regime applicable to non- Belgian executives, as well as the way the relevant services of the tax department operate. Its final report was presented to the federal Parliament on 25 February.

The Tax Regime

Belgium's beneficial tax regime for foreign executives is based on an administrative note, issued by tax authorities in 1983, that replaced a slightly different regime that was held to be illegal by the Brussels Court of Appeal.

The basis of the regime is that the qualifying executive is deemed to be a nonresident in Belgium, although he or she is living and working in Belgium. Nonresidence status must be established through the submission of a special file to the Belgian tax administration establishing that the center of the applicant's economic interests has been maintained outside of Belgium. That is essentially a factual test, and factors that the tax administration considers to be indicative of nonresidence include the following:

- the executive's spouse and/or children reside abroad;
- the family home is outside of Belgium;
- the executive's children are being educated abroad;
- he or she has one or more foreign savings accounts and/or holds life insurance policies outside of Belgium; and
- he or she is affiliated with a foreign social security system.

The qualifying executive is entitled to two important tax concessions: a number of tax-free allowances and a tax exemption for any foreign-source income.

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Tax-Exempt Allowances

There are two categories of tax-free allowances. Onetime allowances cover nonrepetitive expenses that the executive incurs as a result of his or her assignment to Belgium (moving costs, the loss incurred on the sale of property before coming to Belgium, the cost of furnishing a new house in Belgium, and so forth) and are, in principle, not subject to any cap.

For ongoing expenses, the executive is entitled to an annual allowance. That allowance is capped at €11,250 per year (or €29,750 for employees working in a coordination center or research lab). However, in practice, the administration insists that the allowances be calculated based on a so-called home base salary so that the actual level of the total allowances often is well below the maximum. The most common tax-free allowances are:

- cost-of-living allowance;
- housing allowance;
- tax equalization allowance;
- travel allowance to the home country;
- allowance for school fees; and
- tax exemption for foreign-source income (foreign travel exclusion).

Because the executive is deemed to be a nonresident, he or she is taxed in Belgium only on income related to activities carried out in Belgium. In particular, any income that the executive receives for work outside Belgium will not be taxable in Belgium. If the executive spends about 40 percent of his or her time traveling outside of Belgium for business purposes, then 40 percent of his or her total earnings will be tax-exempt in Belgium.

The Report

Some of the findings of the Court of Audit make quite interesting reading. A comparison shows that to provide a net income of €75,000, the gross cost for the employer of an expatriate executive with a 40 percent travel allowance is €148,453, compared to €224,068 for an executive without a travel allowance. In other words, a salary split between Belgium and another country allows the employer to keep the gross salary cost under €200,000.

Currently, about 40,000 individuals are subject to Belgian income tax as nonresidents, and about half of those are foreign executives. In 1999, 17,683 expatriate executives were recognized as nonresidents, and the administration gets more and more applications every year.

An examination of approximately 200 tax files shows that on average, the expatriate receives about half of his or her salary tax- free. Extrapolating those findings indicates that the total gross salary cost of those expatriates is about €4,500 million, of which €386 million is tax-exempt by way of tax-free allowances and €1,900 million is tax-exempt foreign source income. The Court of Audit estimates that the tax regime costs about €1,140 million in uncollected income taxes.

Not surprisingly, the Court of Audit questions the legality of a special tax regime introduced by way of an administrative note. The administrative note does not respect the boundaries between the executive and legislative powers, and it is in breach of several provisions of the Income Tax Code, the report said. That has been pointed out regularly in publications on the subject, but the Belgian

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courts have rarely questioned the validity of the administrative note. However, the Antwerp Court of Appeal recently referred a question to the Court of Arbitration about a Belgian executive who claimed discrimination because he was not afforded the tax exemption for the school fees of his children.

The Court of Audit also questions the effectiveness of the tax regime. It points out that the tax administration has no permanent monitoring system in place to show to what extent the regime helps to sustain growth or maintain foreign investment in Belgium.

A comparison with similar tax regimes in Austria, Denmark, Finland, France, Luxembourg, the Netherlands, Sweden, and the United Kingdom shows that the Belgian system is an outsider in Europe. Where other countries grant either a uniform reduced tax rate or a tax exemption for certain allowances, Belgium qualifies the expatriate as a nonresident and provides a full tax exemption for any foreign- source income.

The Court says that is an incentive for executives to travel outside of Belgium, which is inconsistent with the idea behind the tax regime -- namely, attracting executives to work with foreign investments in Belgium. Furthermore, the Belgian tax regime is the only one that does not set an effective cap on the potential tax benefits. In some extreme cases, executives are almost totally exempt from tax without any time limit.

The report also says that Belgian tax authorities' oversight of the application of the regime is not very extensive and that little information is exchanged with foreign tax authorities despite the international nature of the tax regime. It is difficult to verify that documents establishing that the expatriate has maintained residence in his or her country of origin are correct and current. The Court found that gaps in the laws and regulations, and in the organization of the tax administration, make it impossible to ascertain conclusively that an expatriate's stay in Belgium is temporary -- and that fact is at the core of the favorable tax regime.

Moreover, the lack of information exchanged with foreign tax authorities means that they often are not aware that they might have authority to tax the foreign-source income under a double taxation treaty with Belgium, and the limited number of effective audits gives taxpayers the impression that they are not controlled, the Court says. Finally, the ease with which they can claim the foreign travel exclusion is an ideal breeding ground for fraud, it says.

The Recommendations

The Court of Audit has issued a number of recommendations aimed at fighting possible abuses and excesses in the short term. It says tax advantages should be capped and subject to time limits and that the percentage of the travel exclusion should be limited. The verification of tax returns, and of individual applications, should be more organized, and the exchange of information should be intensified, the Court says.

Reacting to the report, Minister of Finance Didier Reynders pointed out that the general reform of the tax administration, the modernization of the Ministry of Finance, and the new system of tax rulings should optimize the tax regime for foreign executives. He said he is reluctant to propose

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concrete structural measures to increase the timing and frequency of the audits, or to increase the exchange of information, unless that works both ways.

Reynders said small economies must make their tax regimes competitive and attractive for foreign companies. He even said the incentives provided by the administrative note of 1983 should be strengthened by reducing the salary cost for expatriates who stay in Belgium for longer periods of time.

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