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Belgium Clarifies Issues Regarding Repatriation of Profits in Treaty With Hong Kong

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In a March 31 administrative note, the Belgian Ministry of Finance has clarified some issues in the Belgium-Hong Kong double tax treaty that are relevant for the repatriation of profits to Belgium. (For prior coverage, see *Tax Notes Int'l*, Jan. 19, 2004, p. 227, *2004 WTD 9-14*, or *Doc 2004-665* [PDF]; for the treaty, see *2003 WTD 240-20* or *Doc 2003-26395* [PDF].)

Profits Realized by a Hong Kong Branch of a Belgian Company

While Hong Kong uses the credit method to eliminate double taxation, Belgium uses a modification of the exemption with progression method. The treaty provides that Belgium will exempt parts of income that are subject to tax both in Belgium and in Hong Kong, but that it may -- in calculating the tax on the remaining income -- apply the tax rate that would have been applicable if the income had not been exempted. For Belgian companies, that means that Belgium will exempt the profits that have been taxed in Hong Kong.

However, under the applicable Inland Revenue Ordinance, Hong Kong levies its profits tax for the territorial principle, meaning that the assessable profits of a corporate entity include only the trade profits it realizes in Hong Kong that arise in, or are derived from, Hong Kong.

Article 7 of the protocol to the treaty states explicitly that elements of income that are considered to be nontaxable or tax-exempt in Hong Kong shall not be considered to be taxed, and do not qualify for exemption in Belgium. In its administrative note, the Belgian Ministry of Finance confirmed that it will exempt all profits realized by a permanent establishment -- even those that are not taxed under the territorial principle -- as long as the branch has paid some income tax in Hong Kong. The administrative note refers to the protocol, which exempts:

- dividends paid in connection with a holding that is effectively connected to a PE situated in Hong Kong;
- interest paid in connection with a debt claim that is effectively connected to such a PE; and
- royalties paid in connection with a right or property that is effectively connected to such a PE.

Hong Kong Dividends and the Belgian Participation Exemption

The administrative note also confirms that the dividends of a Hong Kong subsidiary qualify for the Belgian holding regime. That is remarkable, as one of the conditions for the participation exemption is that the subsidiary must be subject to a corporate income tax that is equivalent to the Belgian corporate income tax and must not be located in a country where the ordinary tax regime is "substantially more advantageous" than in Belgium.

Neither the law nor the administration's commentaries on the income tax law indicate when a tax regime is substantially more advantageous. However, a royal decree dated February 13, 2003, lists countries that are considered to have substantially more advantageous corporate income tax

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regimes. (For prior coverage, see *Tax Notes Int'l*, Mar. 10, 2003, p. 934, *2003 WTD 43-12*, or *Doc 2003-5700* [PDF].) Hong Kong, which has a 17.5 percent tax rate and is lower than the Belgian corporate tax rate, is not on that list, which sets the threshold at 15 percent.

However, because a Hong Kong subsidiary pays the 17.5 percent profits tax only on its assessable profits, the tax burden can be very low when it has substantial offshore profits. The administrative note confirmed that the dividends of a Hong Kong subsidiary are not excluded from the Belgian holding regime. That rule is justified, in part, by the commentary on article 4 of the OECD model income tax treaty. That commentary states that residents of countries adopting a territorial tax principle cannot be excluded from the scope of the treaty. Moreover, Belgian tax authorities maintain that the application of the territorial principle leads to a result that is similar to the exemption method used by Belgium in its double tax treaties.

Also excluded from the participation exemption are dividends received from a subsidiary whose income (other than dividends) is derived from a country other than its country of fiscal residence, if that income is subject, in the country of fiscal residence of the distributing company, to a separate tax regime that deviates from the ordinary tax regime. The administrative note confirmed that the territorial principle is the ordinary tax regime in Hong Kong. It is, therefore, not a separate tax regime that deviates from the ordinary tax regime.

Using the Belgium-Hong Kong Conduit

The administrative note makes the treaty an interesting conduit to repatriate profits from the Far East to Belgium, as a Belgian company can repatriate profits without any major withholding tax in Belgium or Hong Kong.

The offshore profits that its Hong Kong branch or subsidiary realizes are not subject to any profits tax in Hong Kong and do not incur any withholding tax when they are paid out from Hong Kong. Indeed, Hong Kong does not withhold tax on dividends or interest, and the withholding tax on royalties is only 5.25 percent, which the treaty reduces to 5 percent. Also, profits realized via a Hong Kong branch do not attract any further tax in Belgium.

Dividends received from a Hong Kong subsidiary qualify for a participation exemption of 95 percent if the Belgian company holds a participation of at least 10 percent of the subsidiary's capital, or a participation with an acquisition value of at least €1.2 million. Only 5 percent of the dividend is subject to corporate income tax at 33.99 percent. However, the holding company can offset many expenses against that taxable dividend, particularly its interest expenses.

Capital gains realized by a Belgian company on the sale of a shareholding are tax-exempt. The condition that the subsidiary must pay tax applies, but not the minimum participation requirement.

Finally, the EC parent-subsidiary directive (2003/123/EC) prevents Belgium from levying withholding tax on any dividends paid out to a parent company that holds at least 20 percent of the share capital (or voting rights) of the company paying the dividend for an uninterrupted period of at least 12 months. That shareholding requirement will be gradually reduced to 10 percent by January 1, 2009. For dividends paid to a non-EU parent company, one must rely on Belgium's extensive treaty network, which reduces the tax rate to 15 percent, 10 percent, or even 5 percent.

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Repatriation of Profits From Europe Via Hong Kong

Belgium rarely includes a limitation-on-benefits provision in its tax treaties, the only exceptions being its treaties with the United States and, to a lesser degree, with Switzerland and the United Kingdom. There is no limitation-on-benefits provision in its treaty with Hong Kong, so non-Hong Kong investors have access to other EU jurisdictions at minimal tax rates through a Belgian holding company. The treaty also makes a Belgium-Hong Kong holding company structure an attractive vehicle for extracting dividends from the European Union with minimal withholding tax costs.

No withholding tax is due on dividends paid to the Belgian holding company if it holds at least 20 percent of the share capital or voting rights of the subsidiary. Dividends received by the Belgian holding company can pass through without paying any corporate income tax. And the treaty with Hong Kong now provides for a zero withholding tax on dividends paid out.

The Belgium-Hong Kong treaty is a useful tool for repatriating profits between Europe and Hong Kong. Belgium has a competitive advantage, as the Hong Kong Special Administrative Region has no other comprehensive double tax treaties yet. However, Hong Kong recently started treaty discussions with Italy and the Netherlands. Its treaty discussions with France and Denmark are proving a bit more difficult, because those countries insist on the application of the 2004 version of the OECD model income tax treaty regarding the exchange of information, and Hong Kong is not prepared to go that far.

In its treaty with Belgium, Hong Kong did not want to empower authorities to proactively request information from the other country's authorities. The text of the 1998 OECD model income tax treaty was used so that the exchange of information is limited to the taxes covered by the treaty.

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