Belgium Implements EU Savings Tax Directive

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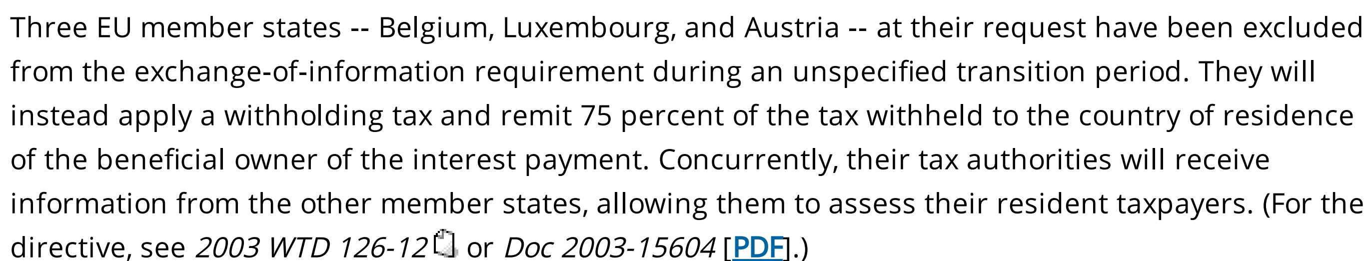
At its meeting on June 6 and 7, the EU Council of Economic and Finance Ministers confirmed that all EU member states have transposed the EU savings tax directive (2003/48/EC) into their domestic laws.[1] The resulting exchange-of-information system became effective in the European Union on July 1. Belgium transposed the directive in its law of May 17, 2004,[2] and the legislation entered into force there on July 1. However, much remains to be done.

The EU Savings Tax Directive

The savings tax directive[3] establishes an automatic exchange-of-information system between member states to ensure that EU residents effectively pay income tax on savings income in the form of interest payments. Under the system, the debtor or paying agent must provide information to the competent authority of his state of residence, identifying the beneficial owner of the interest income. That information is then shared with the competent authority of the beneficial owner's state of residence. The directive does not revise the basic rules of interest taxation: An individual who receives interest income as a beneficial owner will continue to be subject to income tax in accordance with the laws of his state of residence.



Three EU member states -- Belgium, Luxembourg, and Austria -- at their request have been excluded from the exchange-of-information requirement during an unspecified transition period. They will instead apply a withholding tax and remit 75 percent of the tax withheld to the country of residence of the beneficial owner of the interest payment. Concurrently, their tax authorities will receive information from the other member states, allowing them to assess their resident taxpayers. (For the directive, see *2003 WTD 126-12* or *Doc 2003-15604* [PDF].)

To prevent capital flight to certain tax jurisdictions that offer alternatives for EU resident taxpayers, the council decided to make the directive dependent on the implementation of similar measures in Switzerland, Andorra, Liechtenstein, Monaco, San Marino, the Channel Islands, the Isle of Man, and the dependent or associated territories in the Caribbean. Those tax jurisdictions have since entered into agreements to that effect with the EU.

ECOFIN on June 7 acknowledged that all the member states and the 10 dependent or associated territories[4] have confirmed their readiness to apply the necessary savings tax measures, effective July 1, subject to confirmation from the other countries and territories involved that they will apply the same measures. The exchange-of-information system will therefore become effective in the European Union on July 1.

Belgian Domestic Legislation

Belgium introduced legislation in May 2004 to transpose the EU savings tax directive. However, because of its special position regarding the exchange of information during the transition period, Belgium had to set up a withholding tax system for Belgian paying agents. It also adopted legislation to fully implement the exchange-of-information system after the transition period expires.

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Because some Belgian residents are likely to be beneficiaries of interest payments in Luxembourg and Austria (the two other EU member states that will withhold tax in lieu of the exchange of information), Belgium had to introduce a system to either avoid that withholding or to credit or recover the tax.

EU Withholding Tax and Revenue Sharing

Belgium refers to the EU withholding tax as a "state-of-residence withholding tax" to help distinguish it from the domestic withholding tax that Belgium levies on interest. Indeed, the EU savings tax directive does not preclude Belgium from levying other types of withholding tax in accordance with its national laws or tax treaties (article 16). Belgium's domestic withholding tax rate is 15 percent.

The EU withholding tax is not included in the Belgian Income Tax Code. Although the law of May 17, 2004, addresses the domestic rules for withholding tax on interest, the EU withholding tax must remain separate from the domestic withholding tax. In other words, the domestic withholding tax on interest and the EU withholding tax do not cancel each other out and can be levied concurrently. Furthermore, the scope of Belgium's income tax treaties is limited to those taxes in the Belgian Income Tax Code, so a beneficiary cannot invoke a tax treaty to obtain an exemption or reduction of the EU withholding tax.

The EU withholding tax is levied at a rate of 15 percent for the first three years, 20 percent for the next three years, and 35 percent for the three subsequent years.

Beneficial Owner

The Belgian paying agent will retain the EU withholding tax if interest is paid or credited to a beneficial owner resident in another EU member state.

However, Belgium will not levy the EU withholding tax if the beneficial owner presents a voluntary disclosure certificate from the competent authority of his state of residence. The certificate must identify the beneficial owner (name, address, and tax or other identification number, or, alternatively, his date and place of birth), the paying agent, and the beneficial owner's account number or the identification of the security. In that situation, Belgium does not allow the beneficial owner to ask the paying agent to report information to the beneficial owner's state of residence.

Identification

In a Royal Decree of March 26, 2005,[5] the Belgian government established rules for identifying the beneficial owner. The paying agent must determine the beneficial owner's identity on the basis of his name, fiscal identification number or place and date of birth, and place of residence according to his permanent address. Those elements must be verified in a passport or other official identity card, or by way of any other documentary proof of identity presented by the beneficial owner. The text does not specify, but the financial sector assumes that this must be a document established by a public authority. The paying agent must make copies of the identification documents presented and keep them for five years.

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The paying agent generally will determine the beneficial owner's residence on the basis of the address provided in the above-mentioned documents. However, there are two exceptions. If the beneficial owner presents a passport or official identity card issued by one member state, but declares to be resident in a third country, he can establish residence by means of a tax-residence certificate issued by the competent authority of the third country in which he claims to be resident. The second exception relates to officials of international organizations and expatriate executives. They are deemed to have maintained their tax residence outside Belgium, though most have an address only in Belgium.

Initially, the Royal Decree stated that if the beneficial owner has a permanent address in Belgium but an overseas fiscal residence,[6] his country of nationality will be deemed to be his place of residence.

While the first exception can be found in the savings tax directive, the second is a Belgian invention. The government justified the second exception with a reference to Article 1 of the directive, which explains the aim of the directive as "to enable savings income in the form of interest payments made in one Member State to beneficial owners who are individuals resident for tax purposes in another Member State to be made subject to effective taxation in accordance with the laws of the latter Member State, and to ensure that the tasks necessary for the implementation of this Directive are carried out by paying agents established within their territory, irrespective of the place of establishment."

Luxembourg has taken the opposite approach in implementing the savings tax directive; it maintains that the permanent address is the tax residence, and there are no exceptions if the individual has maintained his tax residence outside Luxembourg.

A second category of beneficial owners is composed of taxpayers who benefit from the special tax regime for foreign executives temporarily assigned to Belgium. They are deemed not to be resident in Belgium and are subject to Belgian income tax only on the earnings they receive for their work in Belgium. That is, they are not subject to tax in Belgium on investment income. It is unclear how the paying agents will apply the directive to that category of beneficial owners, because they will not present an overseas tax residence.

In a last-minute change, the government changed the place-of-residence provision and stated that a beneficial owner who has a permanent address in Belgium but is deemed to be a nonresident taxpayer for withholding tax purposes on his investment income must prove his overseas domicile by any means.[7]

Basis for Computation of the EU Withholding Tax

The basis for the EU withholding tax is the gross interest, before the deduction of any domestic withholding tax. The paying agent will levy the withholding tax on the amount of interest paid or credited, or on income derived from interest payments, either directly or through an entity referred to in Article 4(2) of the directive, that are distributed by UCITS (Undertakings for Collective Investment in Transferable Securities) and similar entities or undertakings.

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For interest paid to or credited to an account held by an entity that has not opted to be treated as a UCITS but that receives interest for the benefit of the beneficial owner, the payment will be considered an interest payment by the entity and the EU withholding tax will be levied on the amount of interest attributable to each of the members of the entity.

Alternatively, for interest accrued or capitalized on the sale, refund, or redemption of the debt claim generating the interest, or of shares or units in relevant UCITS or similar undertakings or entities,[8] the EU withholding tax will be in the form of an equivalent levy to be borne by the recipient on the full amount of the proceeds of the sale, redemption, or refund.

Notably, Belgium has not opted to require paying agents to annualize the interest paid out by UCITS and to treat that annualized interest as an interest payment even if no sale, redemption, or refund takes place during that period.

Grandfathered Bonds

During the transitional period, so-called grandfathered bonds[9] are not considered to be debt claims, so no EU withholding tax will be retained. If the transitional period continues after December 31, 2010, the grandfathered bonds will remain exempt if they contain gross-up and early redemption clauses and if an Austrian or Luxembourg paying agent pays interest to, or secures the payment of interest for the immediate benefit of, a beneficial owner resident in another member state.

If a further issue of an aforementioned negotiable debt security issued by a government or a related entity acting as a public authority was made after March 1, 2002, the entire issue of that security (including the original issue before March 1, 2002) will be considered a debt claim subject to the EU withholding tax. If another issuer makes the further issue, only the further issue will be subject to the EU withholding tax.

Assessment and Collection

For the practical application of the EU withholding, the law of May 17, 2004, refers to the section in the Income Tax Code that deals with the assessment and collection of the income tax and, more specifically, the domestic withholding tax. Those provisions determine the form of the tax return to be filed by the paying agent, his obligations, the obligations of third parties, the powers of investigation and means of proof available to tax authorities, mutual assistance, the assessment procedure, delays in assessing the tax, appeals against the tax, and the collection of the tax.

In particular, the interest is deemed to have been attributed or made payable -- and the EU withholding tax will become due -- on the last day of the quarter during which the interest has been paid or credited to an account.

Revenue Sharing

As explained earlier, the Belgian paying agent must remit the EU withholding tax to the Belgian tax authorities, which in turn will remit 75 percent to the beneficial owner's state of residence. The

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competent authority there must then prevent double taxation by granting a credit for the full amount withheld by Belgium, or by way of a tax refund.

Transitional Period

Belgium probably will not wait until the end of the transition period, and may switch to the exchange-of-information system after six years; Finance Minister Didier Reynders has already indicated that he does not want to apply the (final) 35 percent rate.[10] In any event, the procedure for the exchange of information will enter into force -- and the rules related to the EU withholding tax and revenue sharing will be abolished -- at a date to be set by royal decree, or on January 1 of the first tax year following either:

- the date of entry into force of an agreement between the European Union, following a unanimous decision by the European Council and Switzerland, Liechtenstein, San Marino, Monaco, and Andorra, providing for the exchange of information upon request, as defined in the OECD Model Agreement on Exchange of Information on Tax Matters released on April 18, 2002, regarding interest payments made by paying agents established within their respective territories to beneficial owners resident within the European Union, in addition to the simultaneous application by those same countries of a withholding tax on those payments at the rate defined for the corresponding periods in article 11(1) of the directive; or
- the date on which the council unanimously agrees that the U.S. is committed to the exchange of information upon request, as defined in the OECD model agreement, regarding interest payments made by paying agents established in the United States to beneficial owners resident in the European Union.

Procedure for the Exchange of Information

Despite the EU withholding tax, Belgium has introduced a procedure for the automatic exchange of information into its Income Tax Code, along with the provisions related to mutual assistance in the collection of taxes and exchange of information between EU member states. That will allow Belgium to switch to the exchange-of-information procedure at the end of the transition period and also to use the information it receives from the tax authorities of other member states during that period.

Under the procedure, when the beneficial owner is resident in another EU member state, the Belgian paying agent will transmit to Belgian tax authorities the information (which will be established later by royal decree). That competent authority will share the information with the competent authority of the state of residence of the beneficial owner. The exchange of information will be automatic and will take place at least once a year (Article 338 *bis*, Section 1 of the Income Tax Code). The actual procedure still must be established by royal decree.

For practical reasons, that provision also states that the government will determine in a royal decree the meaning of the terms "beneficial owner," "payment of interest," and "paying agent," as well as how the beneficial owner can be identified. The royal decree normally would simply copy the text of the law of May 17, 2004, which will be cancelled at the end of the transition period.

Belgian Residents

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When a Belgian resident taxpayer receives interest in Luxembourg, Austria, or a third country or territory[11] that levies the EU withholding tax, he can ask Belgian tax authorities to issue a voluntary disclosure certificate identifying him,[12] the paying agent, and his account number or the security on which the interest was paid. That certificate must be delivered within two months and will be valid for three years. Upon presentation of the certificate, the overseas paying agent will not levy the EU withholding tax.

However, if the overseas paying agent has levied the EU withholding tax, the state of residence of the paying agent will remit 75 percent of the tax collected to Belgium. The Belgian taxpayer can credit the entire EU withholding tax against his individual income tax liability. Any excess will be refunded.

Comments

Although ECOFIN has acknowledged that the 5 third (non-EU) countries and the 10 dependent or associated territories are ready to apply measures that will allow effective taxation of savings income, the situation is not entirely clear as far as Belgium is concerned.

Belgium has signed specific agreements with the Netherlands (relating to Aruba and the Netherlands Antilles) and with Guernsey, Jersey, the Isle of Man, Anguilla, the British Virgin Islands, Montserrat, and the Turks and Caicos Islands. The first four of those agreements have been ratified by Parliament and are awaiting publication in the official gazette.

A law of June 21, 2005,[13] has already extended the application of the law of May 17, 2004, subject to reciprocity, to the payment of interest by a Belgian paying agent to a beneficial owner residing in one of the Dutch dependencies, the Channel Islands, the Isle of Man, Anguilla, the British Virgin Islands, Montserrat, or the Turks and Caicos Islands, as if the beneficial owner was a resident of an EU member state. (An exception is made for payments to a beneficial owner residing in Anguilla or the Turks and Caicos Islands, as long as those tax jurisdictions do not levy any direct tax on those interest payments.)

The law of May 17, 2004, also has been extended (subject to reciprocity) to the payment of interest from one of the above-mentioned territories to a Belgian resident, as if the paying agent was established in the European Union.

Belgium's banking sector says it is ready to implement the law. It faced certain practical problems in cases in which the withholding obligations are not the same for the EU withholding tax and the domestic withholding tax, particularly regarding dividends paid out by certain open-ended UCITS (namely the corporate *Societes d'Investissement Capital Variable*, or SICAVS). Moreover, the interest accrued or capitalized on the sale, refund, or redemption of the debt claim generating the interest, or of shares or units in closed-ended UCITS, are not subject to tax in Belgium. They are, in principle, tax-exempt capital gains.

Belgian banks want the government to provide additional clarification by way of royal decrees. The Royal Decree of March 26, 2005, stated that the finance minister would provide detailed information about the use of the tax identification number in other member states. Moreover, many member states have not yet notified the competent authority that can deliver tax-residence certificates (the certificates that allow the paying agent to refrain from withholding the tax). Without clear rules, the

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Belgian Federation of Banks has decided that reverse convertibles would fall under the EU Savings Tax Directive, while real estate certificates would not.

In the meantime, the Belgian government expects the EU withholding tax to net €50 million in 2006 for the Belgian treasury. Most overseas savings held by Belgian residents are invested with Luxembourg banks. In practice, the liability to Belgian income tax is the tax withheld at source by a Belgian bank. If tax has been withheld at source, the taxpayer must not declare the interest received in his tax return, and the withholding tax is the final tax. It is only if no domestic tax has been withheld at source that the taxpayer must declare the interest income in his tax return.

The government believes that as long as the rate of the EU withholding tax does not exceed 15 percent, many taxpayers will prefer to pay the EU withholding tax rather than paying the same rate in Belgium.

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FOOTNOTES

[1] Press Communiqué IP/124/05

[2] Belgian State Gazette, May 27, 2004, p. 41.328

[3] Council Directive 2003/48/EC of June 3, 2003, on Taxation of Savings Income in the Form of Interest Payments, O.J., 2003, L 157, 38.

[4] Guernsey, Jersey, the Isle of Man, Aruba, the Netherlands Antilles, Anguilla, the British Virgin Islands, the Cayman Islands, Montserrat, and the Turks and Caicos Islands.

[5] *Belgian State Gazette*, April 19, 2005, p. 17.712.

[6] That is, in one of the EU member states, third country, or territory.

[7] Royal Decree of June 27, 2005, *Belgian State Gazette*, June 29, 2005, p. 30.067

[8] These are the undertakings and entities, such as UCITS authorized in accordance with Directive 85/611/EEC, entities which qualify for the option under Article 4(3) of the directive, or undertakings for collective investment established outside the territory referred to in Article 7, that invest directly or indirectly, via other undertakings for collective investment or entities referred to below, more than 40 per cent of their assets in debt claims.

[9] These are domestic and international bonds and other negotiable debt securities which have been first issued before 1 March 2001 or for which the original issuing prospectuses have been approved before that date by the competent authorities within the meaning of Council Directive 80/390/EEC (7) or by the responsible authorities in third countries.

[10] See Presentation of the Bill by the Finance Minister, Doc. Parl., Chambre, 2003-2004, 923/001, p. 12

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[11] This will be the case for Switzerland and Liechtenstein, Guernsey, Jersey, the Isle of Man, the British Virgin Islands, and the Turks and Caicos Islands.

[12] That is, his name, address, and tax or other identification number or, alternatively, his date and place of birth.

[13] Law of June 21, 2005, *Belgian State Gazette*, 24 June 2005, p. 29.080. A Royal Decree of June 27, 2005 (*Belgian State Gazette*, 29 June 2005, p. 30.066), confirms that the law enters into force on July 1.

END OF FOOTNOTES

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