Capital Gains on Shareholdings: Developments in Belgium

Posted on Apr. 19, 2006

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One of Belgium's major selling points for many years was the absence of a capital gains tax for individuals. It does not have a wealth tax either. Therefore, Belgium was very attractive for wealthy individuals. Belgium's reputation as a harbor for tax exiles has been seriously dented in recent years, but things are looking better.

Capital Gains in Belgium

One of the basic principles of Belgian income tax is that an individual is not taxed on capital gains realized on his private assets consisting of securities, tangible assets, or real property if those gains are realized on transactions that are within the limits of the "normal management of a private estate."[1] A sale of shares in a privately owned company usually constitutes normal management, so resulting capital gains generally are tax-free.

Normal Management of a Private Estate

There has always been an assumption among tax advisers in Belgium that a capital gain relating to an individual's private assets is tax-exempt unless it obviously results from speculation. The Belgian courts defined the notion of normal management as a conservative, risk-averse, and nonsophisticated approach to the ownership of a private estate.[2] The general understanding was that capital gains on a private estate are subject to income tax only if they were of a speculative nature. Then they are liable to income tax at a flat rate of 33 percent.[3]

The traditional belief was that speculation existed if an individual purchased and sold assets repeatedly and at a fast pace, borrowing to do so, using sums that are important for his private estate, and with the help of pseudoprofessional means (for example, a Reuters terminal). If tax authorities could not prove that an individual taxpayer had been speculating, the capital gain was tax-exempt.

Consequently, single transactions, in particular, could never be deemed to fall outside the normal management of a private estate. It thus became common practice for individual shareholders to sell their majority shareholding in a company to an entirely owned holding company, either against shares to be issued by the holding company or against a payable due by the holding company. That allowed the individual shareholder to "freeze" his capital gains; that is, to record a capital gain tax-free in view of a possible takeover in the future.

In 1998 the Belgian tax authorities worked out a different reading of what constitutes normal management to tax capital gains resulting from those one-shot transactions with entirely controlled companies. In Belgium, those capital gains were labeled as "internal capital gains." The tax authorities took the position that a transaction did not need to be speculative to fall outside the normal management of a private estate. They held that setting up a holding company to hold a participation did not constitute normal management.

That position was contested before the courts on several accounts. The provision on which it was based (article 90, 1° ITC) cannot be given a wide interpretation. Moreover, when article 90, 1° ITC was adopted in 1962, the Senate Committee on Finance had explained that normal management was the behavior of a *bonus paterfamilias*, as opposed to working and speculation. A *bonus paterfamilias* does not speculate.

A number of cases have been brought before the courts; some have followed the position taken by the tax authorities with varying degrees of inspiration.

The tax authorities seem to have reexamined their position and have come up with a practical solution. The finance minister confirmed that position in reply to a question by a member of Parliament (Sept. 27, 2005). It was also the position taken by the Belgian Ruling Committee in four similar cases dated December 22, 2005.

In practice, a private individual can safely assign his participation to an entirely owned holding company against shares to be issued by the holding company if he subsequently maintains a status quo and refrains from:

- reducing the share capital of the holding to replace it by a receivable against the company;
- reducing the share capital of the subsidiary;
- paying out higher dividends from the subsidiary to the holding company; and
- paying out higher management fees or director's fees unless the holding company actually takes over activities from the subsidiary (for example, accounting tasks).

The subsidiary can, however, reduce its share capital or pay out a higher dividend if the funds released are used for new investments or to finance other companies of the group or other affiliated companies. These funds may not be distributed to the individual shareholders. Higher dividends may also be used to pay back a loan or a current account of a shareholder who leaves the company. The reimbursement must be spread over a sufficiently long period of time. In reply to a question in Parliament on March 28, the finance minister has now confirmed that this position would be taken for pending files (that is, capital gains realized before the end of 2005).

All decisions (some 20 to date) concern the assignment of a shareholding against shares to be issued by the holding company. There are no decisions about a sale of shares in cash, except by way of a secondary agreement. There does not appear to be an objective reason for the period of three years, but it coincides with the statutory assessment period of three years. After three tax years, an assessment is time-barred.

Substantial Shareholdings

Capital gains resulting from the sale[4] of a "substantial shareholding" in a Belgian company to a foreign entity are taxed at a rate of 16.5 percent even if the sale is "in the course of the normal management."[5] A shareholding in a Belgian company is deemed to be 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. Even the sale of a single share may trigger the 16.5 percent tax if that share was part of a substantial shareholding during the previous five years. In any event, the capital gain is only taxed when it is actually realized.

A specific antiavoidance clause has been tagged on to that provision; even if the basic requirements above are met and the shares in the company are sold to a Belgian entity, the tax still becomes due if the purchaser transfers the shares to a foreign entity within 12 months after the initial sale.[6]

The tax liability does not solely apply to Belgian vendors selling shares to a foreign entity, but also applies to foreign (individual) vendors.[7] They can, however, usually rely on the provisions of a double taxation treaty if they are not resident in Belgium. Nevertheless, the double tax treaties with Canada and Mexico do not prevent Belgium from taxing Canadian or Mexican resident individuals on capital gains they realize on substantial shareholdings in Belgian companies.

Because capital gain is only taxable if the shareholding is assigned to a foreign company, institution, or association, the European Court of Justice condemned the provision.[8] (For prior coverage, see *Tax Notes Int'l*, July 5, 2004, p. 8.)

Nearly two years later, Belgium still has not adapted its legislation. In a June 9, 2005, decision however, the recently established Ruling Committee has acknowledged the case law of the ECJ, but only for transfers of shares within the European Union. The decision concerned a Spanish shareholder who intended to transfer his shareholding to a Dutch company against shares to be issued by that company.

The effect of the ECJ's decision is limited to the European Union, and there is little chance that Belgium will adapt its legislation to exempt from capital gains tax any transfers of the shares of non-EU companies. One can anticipate that for those companies, the purchaser will continue the practice of acquiring family-owned shares via a Belgian special purpose vehicle incorporated for that purpose. The Belgian tax authorities have not attacked those avoidance techniques yet. Neither would it appear that they can use the general antiavoidance rule of article 344, 1° ITC 1992 against that construction, as the law specifically permits it. Moreover, in a recent decision the Belgian Supreme Court has seriously limited the application of that statutory antiavoidance rule. (For prior coverage, see *Tax Notes Int'l*, Jan. 16, 2006, p. 141.)

FOOTNOTES

[1] Article 90, I°, Income Tax Code (ITC) 1992.

[2] Antwerp, Nov. 18, 1997, *Fisc. Act.*, 1998/2,4; Antwerp, Feb. 2, 1993, *F.J.F.,* nr. 93/186; Liège, Dec. 19, 1991, *Bull. Bel.,* nr. 723,121, *Fiskoloog* 1993, nr. 421, 11.

[3] Article 171, I°, (a) ITC 1992.

[4] Article 90, 9°, ITC 1992.

[5] Article 171, 4°, (e) ITC 1992.

[6] Article 94, ITC 1992.

[7] Article 228, section 2, 9°, (h) ITC 1992.

[8] Case C-268/03, June 8, 2004, *De Baeck v. Belgian State, O.J.,* C 228, Sept. 11, 2004, p. 18, *Rec.* 2004, p. I-5961.

END OF FOOTNOTES