Foreign Tax Credit Rules Unconstitutional, Belgian Court Holds

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Belgium's Constitutional Court on January 29 held that Belgium's foreign tax credit rules are unconstitutional because the requirement to add an FTC to a company's taxable profits even if only part of the credit can be used discriminates against loss-making companies (Case 14/2014).[1]

The Rules

When a Belgian company receives interest from a foreign-source investment and declares the interest received, it is entitled to set off a limited FTC against its Belgian income tax liability[2] if it can prove that tax has been withheld at source (this applies to all foreign-source investment income except dividends) and if the capital is used for the taxpayer's business activity in Belgium. This FTC is, however, subject to limitations.

In practice, the FTC is added to the company's profit as a disallowed expense and is subsequently set off against its company tax liability. If the company tax liability is less than the FTC because the company does not have sufficient taxable profits, the balance of the credit can neither be paid back[3] nor carried forward as a tax credit or a disallowed expense.

Moreover, the Belgian Tax Administration (BTA) requires the company to add the full FTC to its profit[4] even if only part of the credit can be effectively credited against the income tax, thereby reducing the other tax assets that can be carried forward (that is, losses, the so-called notional interest deduction (risk capital deduction), and so on).

The Case

In the case at issue, Belgian company Nyrstar Belgium SA had given a loan to its Australian subsidiary. The subsidiary withheld tax on the interest payment at the rate of 10 percent in accordance with article 11 of the 1977 Australia-Belgium income tax treaty.

Under article 24 of the treaty, Belgium has to grant an FTC for that interest income, as provided by Belgian law, provided that the tax credit is not less than the rate of the tax withheld in Australia.

Nyrstar Belgium claimed the credit but could not use it effectively because it did not have taxable profits for the tax years in question (2009 and 2010). However, the FTC was still added to the company's taxable profits for those years and the BTA would not allow the credit to be carried forward.

The Referral

The case was brought before the Antwerp Court of First Instance, which asked the Constitutional Court for a preliminary ruling on whether the FTC regime is discriminatory.

The first potential cause of discrimination arises because taxpayers who have made a profit and pay income tax can deduct the FTC while taxpayers who are in a loss position cannot, even though both have to add the FTC to their taxable profit to calculate the tax. While the profit-making company can

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credit the foreign tax and effectively avoid double taxation, the loss-making company can neither credit nor carry forward the FTC, and thereby loses it.

Also potentially discriminatory is the fact that because loss-making companies cannot credit the FTC but have to add it to their taxable profits, the tax losses and other deductions they can carry forward are reduced and they must pay more tax later.

The Decision

The court noted that the case stems from a provision of the Income Tax Code that denies the taxpayer a reimbursement and the BTA's interpretation that the tax code also denies the carryforward of the FTC to a later tax year. The court therefore examined whether Nyrstar Belgium's profitability was relevant in view of the objectives of the tax treaty and the FTC provisions.

It said articles 10 and 11 of the constitution do not include a general prohibition of double taxation. The tax for a specific tax year is assessed on the income of that taxable period and Parliament can decide which deductions can derogate from that principle, the court said. However, because the FTC is not a tax deduction, per se, it is not relevant in determining the net taxable amount and thus cannot be treated the same as, for example, losses, which can be carried forward, the court held.

It said Parliament has wide discretionary powers to take account of the nature and characteristics of each withholding tax and tax credit in order to determine the limits of the deduction of a tax credit. By not allowing a reimbursement or carryforward of the FTC, Parliament could reasonably assume that the FTC was used for the compensation of a foreign tax.

The court therefore accepted the taxpayer's argument that the BTA's position that the FTC must be added to a company's taxable profits discriminates against loss-making companies.

Referring to the parliamentary documentation at the time the rule denying a reimbursement was introduced, the court held that the obligation to add the FTC to a company's taxable profits is an exception, and that income for which the FTC cannot be credited does not have to be added to a company's taxable base. This was confirmed in a practice note issued by the BTA, the court added.

It therefore held that the provision in article 37 of the tax code that requires a company to add the FTC to its taxable base is not compatible with the constitution to the extent that the FTC has not been credited against the tax due.

Conclusion

This decision confirms that taxpayers are required to add the FTC to their taxable profits only to the extent that they can set off the tax credit against the income tax due. The decision allows other taxpayers to claim back excess company income tax paid on amounts for which the FTC was not credited. Claims can be made until 2018.

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FOOTNOTES

[1] The decision is available in Dutch at http://www.const-court.be/public/n/2014/2014-014n.pdf and in French at http://www.const-court.be/public/f/2014/2014-014f.pdf.

[2] Article 285, paragraph 1, Income Tax Code, 1992.

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[3] Article 292 Income Tax Code, 1992.

[4] Article 37, paragraph 3, Income Tax Code, 1992.

END OF FOOTNOTES

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