

News Analysis: Changes to the Belgium-U.K. Tax Treaty

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The 2009 protocol to the 1987 income tax treaty between Belgium and the United Kingdom entered into force on December 24, amending a number of provisions that will affect individual and corporate taxpayers. (Prior coverage.)

Before a treaty or protocol can enter into force, Belgium's minister of finance and his counterpart in the other country must exchange ratification documents. In Belgium, however, ratification is not quite as simple as in the U.K. because the Belgian Parliament must first vote to adopt the treaty or protocol.

As reported in a previous article, Belgium's power to negotiate income tax treaties came to a standstill in 2010 when it became clear that all its tax treaties are mixed treaties (under which both the federal and regional governments are competent), meaning that the treaties require ratification not only by the federal Parliament but also by the Flemish parliament, the Walloon parliament, and the parliament for the Brussels-Capital Region, as well as the two parliaments for the French-speaking and German-speaking communities.

The procedure to ratify the protocol to the Belgium-U.K. treaty has now been finalized and the act ratifying the protocol, as well as the protocol itself, were published in the official gazette on December 28. The new provisions generally apply from January 1.

What Changed?

The protocol amends treaty provisions dealing with dividends, interest, royalties, employment income, directors' fees, and pensions. Some of the major changes are outlined below.

Dividends

The U.K. does not withhold tax on dividends paid out, but Belgium does. The Belgian domestic rate is 25 percent, and under the 1987 treaty, that rate can be limited to 10 percent (or 5 percent in some cases). That means that if a dividend is paid to a British company or individual, Belgium may still withhold tax at the rate of 10 percent. However, it must always exempt dividends paid to a British pension fund (provided that the dividends are not derived from the carrying on of a business by the pension scheme directly or through an associated enterprise) and dividends paid to a U.K. parent company that has held 10 percent of the shares of the Belgian subsidiary for an uninterrupted period of at least 12 months.

This dividend withholding tax exemption is similar to the exemption under the EU parent-subsidiary directive, which Belgium has adopted and extended to all treaty partners, regardless of EU membership. However, the exemption provided in the parent-subsidiary directive is limited to certain types of companies.

In some situations, dividends paid by investment vehicles out of income derived from real property may be subject to a maximum dividend withholding tax rate of 15 percent.

Dividends paid to a Belgian resident by a U.K. tax-transparent entity will be subject to tax in Belgium unless the Belgian resident taxpayer has paid income tax in the U.K. on the income out of which the dividends were paid (see below).

Interest

The protocol also has a new article on interest that reduces or eliminates withholding tax on interest in many cases.

Belgium's domestic tax rate on interest increased from 21 percent to 25 percent on January 1. Under the 1987 treaty, Belgium could withhold tax at a maximum rate of 15 percent on interest paid to a British company or individual. Under the protocol, Belgium may still withhold 10 percent, but not on interest paid between Belgian and U.K. enterprises.

Moreover, Belgium now must exempt interest paid to a British pension fund, to the other contracting state, to one of its political subdivisions or local authorities or a public entity, as well as interest paid between enterprises, regardless of whether they belong to the same group. That is an improvement on the exemption under the EU interest and royalty directive, which requires a 10 percent participation between the payer and the payee.

The provisions on dividends, interest, and royalties have also been updated with an antiabuse provision to prevent abusive tax practices and treaty shopping.

Employment Income

The previous rules for employment income have been reversed for employees working aboard a ship, aircraft, or road or railway vehicle operating in international traffic. In the past, those employees were subject to tax in the country where the management of their employer is located. Now they will be taxed in their home country.

Directors' Fees

Belgian resident directors of a British company pay tax in the U.K. if they work in the U.K. This regime has been clarified to ensure that it also applies to directors of a company that does not have a board of directors.

Pensions

The protocol completely changes the pension rules for taxpayers who receive their pension for the first time after January 1, 2014; they will pay tax only in the country from where their pensions are paid. Pensioners who retired before 2013 will continue to pay tax in the country where they live.

Pensioners who retire in Belgium now will pay U.K. income tax on the pension they receive from the U.K. (including their U.K. state pension). U.K. government pensions will continue to be taxable in the U.K. as before.

Pensioners who return to the U.K. from Belgium will not be eligible for the advantageous combination of the exemption in Belgium on their lump sum pension and the U.K. extra statutory concession (ESC A10), which together exempt them from tax on their pensions. As of 2014, pensioners are advised to do careful retirement planning.

Elimination of Double Taxation

Under the terms of the 1987 treaty, Belgium must exempt income (other than dividends, interest, or royalties) derived by a resident of Belgium regardless of whether that income has been taxed in the United Kingdom. The protocol introduces a "subject to tax" clause, under which Belgium must exempt the income only if it is taxed in the United Kingdom in accordance with the provisions of the income tax treaty. The term "taxed" for this purpose is defined as meaning that the income is subjected to the tax regime that is normally applicable under U.K. tax law.

The protocol also states that Belgium must exempt dividend income derived by a resident of Belgium from a participation in an entity that has its place of effective management in the U.K. and that has not been taxed as such in the U.K., provided that the Belgian resident has been taxed in the U.K. in proportion to his participation in the U.K. entity.

This eliminates the risk of double taxation of hybrid entities (such as limited liability partnerships) that are transparent in the United Kingdom; each partner is personally subject to tax on his share of the partnership income. In Belgium the partnership is treated as a company and the Belgian partners would have been subject to tax on the profit distribution they received from the LLP.

Municipal Taxes

Belgium reserves the right to levy municipal taxes on income earned in the U.K. by a Belgian resident taxpayer, even if the U.K.-source income must be exempted from Belgian federal income tax. A partner of an international partnership (such as a law firm) will normally see his income split between the different countries where the partnership has offices.

The U.K.-source income is taxable in the U.K. but must be exempt in Belgium. Belgium cannot levy federal tax on the partner's non-Belgian income (the exemption with progression rule), but it can determine the tax rate (on the Belgian income) as the rate that would theoretically apply to the partner's worldwide income (that is, the standard Belgian corporate tax rate on theoretical income represented by a factor of 100). The U.K. income remains exempt from federal income tax but Belgium will calculate the municipal tax (typically between 6 and 9 percent) on the theoretical tax on the U.K. income.

The protocol also revises the treaty to update provisions allowing for the exchange of information between tax administrations.

When Is Income Affected?

In Belgium, the tax year coincides with the calendar year. The protocol therefore will apply to income earned in tax year 2013 (year of assessment 2014) for individuals and for companies whose accounting year is 2013. If tax is to be withheld at source, the new rules will apply to income that is payable or that is credited on a bank account after January 1.

In the U.K., the tax year runs from April 6 to April 5. The old rules will continue through April 5, 2013, and the protocol will apply to income earned in tax year 2013-2014. For corporation tax, that will be for any financial year beginning on or after April 1.

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