1. Background and ratio *absentiae legis*

1. Belgium does not have a generally applicable controlled foreign company (CFC) regime\(^3\). In 1986, the Belgian Minister of Finance stated explicitly that he did not intend to introduce CFC legislation in Belgium due to the complexity of such a change\(^4\). Ever since, the subject has come up on a regular basis, for example during the debate about the context of the corporate income tax reform of 2002\(^5\).

2. In 2009 the issue was raised again by the Parliamentary Commission on Tax Fraud, which recommended in its report of May 2009 the introduction of CFC legislation in Belgium\(^6\). However, the Minister of Finance indicated in July 2011 and in January 2012, in answer to two parliamentary questions on the subject, that such legislation would not be introduced for several reasons, which will be clarified below\(^7\).

3. First of all, reference was made again to the complexity that the introduction of such legislation would entail, especially with a view to ensuring the efficiency and effectiveness of the rules.

4. Secondly, EU law was taken into consideration, more in particular the freedom of establishment. It cannot be denied that CFC rules make it more

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difficult to incorporate a subsidiary in another EU Member State. According to the case law of the Court of Justice of the European Union (CJEU), for example in the *ICI*\(^8\) and *Cadbury Schweppes*\(^9\) cases, a national measure restricting the right of establishment is only justified where it specifically relates to wholly artificial arrangements, which do not reflect economic reality, aimed at circumventing the application of the legislation of the Member State concerned. When the controlled company has the necessary “substance”, the application of CFC rules cannot be justified\(^10\).

Even though CFC rules may apply to artificial arrangements and tax fraud, they also apply in situations where the controlled company is established in another Member State for sound business reasons. It therefore appears that CFC legislation may be deemed as being in breach of EU law, depending on the scope of application of such legislation\(^11\).

5. Thirdly, it was stressed that, as a matter of policy, the Belgian government considers CFC legislation to be incompatible with the OECD Model Tax Convention (OECD MTC). In this respect, Belgium has made observations to the official OECD commentary on the OECD MTC. Belgium states explicitly that it considers the application of CFC legislation to be contrary to the provisions of Article 5, paragraph 7, Article 7, paragraph 1 and Article 10, paragraph 5. Belgium considers this to be “especially the case where a contracting state taxes one of its residents on income derived by a foreign entity by using a fiction attributing to that resident, in proportion to his participation in the capital of the foreign entity, the income derived by that entity. By doing so, that State increases the tax base of its resident by including in it income which has not been derived by that resident but by a foreign entity which is not taxable in that state in accordance with the Convention. That contracting state thus disregards the legal personality of the foreign entity and therefore acts contrary to the

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Constitution”\textsuperscript{12}. Hence, Belgium clearly dissociates itself from the general OECD approach, which states that CFC legislation is in accordance with Articles 5, 7 and 10 of the OECD MTC\textsuperscript{13}. Furthermore, it should be noted that the courts of three countries (France, the UK and Finland) have considered the compatibility of their domestic CFC rules with tax treaties\textsuperscript{14}. Although these courts have expressed different views on the subject, it can be assumed that the Belgian courts would follow the French interpretation, as on many occasions our case law has proven to be in line with French case law\textsuperscript{15}. According to the French Council of State in the Schneider case, the French CFC regulation is in violation of double tax treaties that have an article similar to Article 7 OECD MTC\textsuperscript{16}.

6. Finally, the Minister of Finance indicated that there was no need to introduce CFC legislation, as the Belgian Income Tax Code (“ITC”) already contains an article with a (more or less) similar goal, namely Article 344 (2) ITC. Although this article cannot be defined as a CFC rule in the strict sense of the word, there are nevertheless many similarities between the characteristics of the article and that of a CFC rule\textsuperscript{17}. Article 344 (2) ITC will be further elaborated on below.

7. In May 2013, two draft bills were introduced, one in the Senate and one in the House of Representatives, to combat international tax fraud and tax havens by introducing CFC regulation in Belgium\textsuperscript{18}. These draft bills are still pending in Parliament.

8. Recently, in connection with Base Erosion and Profit Shifting (BEPS), the CFC regulations of the OECD countries came under scrutiny again. The OECD report concerning the action plan on base erosion and profit shifting

\textsuperscript{12} Com.OECD Model, Article 1 §27.4; Article 7 (old) §66; Article 7 (new) §79, Article 10 §68.1.

\textsuperscript{13} L. DE BROE, De vervagende grens tussen belastingontduiking en belastingvermijding, T.F.R. 2010, vol. 375, (125) 129.


\textsuperscript{15} L. DE BROE, De vervagende grens tussen belastingontduiking en belastingvermijding, T.F.R. 2010, vol. 375, (125) 129.


\textsuperscript{17} P. VANHAUTE, Belgium in International Tax Planning, IBFD Publications, 2008, 152.

of 19 July 2013 listed “Strengthening CFC rules” as one of the issues to be addressed. The report states the following: “One area in which the OECD has not done significant work in the past is CFC rules. One of the sources of BEPS concerns is the possibility of creating affiliated non-resident taxpayers and routing income of a resident enterprise through the non-resident affiliate. CFC and other antideferral rules have been introduced in many countries to address this issue. However, the CFC rules of many countries do not always counter BEPS in a comprehensive manner. While CFC rules in principle lead to inclusions in the residence country of the ultimate parent, they also have positive spillover effects in source countries because taxpayers have no (or much less of an) incentive to shift profits into a third, low-tax jurisdiction.” In September 2015 the OECD intends to finalize its recommendations regarding the design of domestic rules to strengthen CFC rules. It remains to be seen what consequences this will have for Belgium. In response to a recent parliamentary question, the Minister of Finance indicated that Belgium fully endorses the BEPS action plan.19 Nevertheless, it should be kept in mind that, as already indicated by the High Council of Finances in 2001, the introduction of CFC rules in Belgium would entail a complete reorientation of its international tax policy.20

9. Although Belgium does not have general CFC legislation, the Belgian tax regime nevertheless contains a number of general and specific provisions to counter tax planning techniques intending to shift taxable income to foreign low-tax jurisdictions, in addition to the general anti-abuse provision of Article 344 (1) ITC.

10. First of all, the Belgian tax regime has a specific anti-avoidance provision concerning the disregarding of asset transfers to low-tax jurisdictions (Article 344 (2) ITC). Secondly, Belgium has thin capitalization rules (Articles 18, 4° ITC and 198, 11° ITC). Thirdly, Article 54 ITC provides for a disallowance of the deduction of certain payments to residents of tax havens or to beneficiaries of foreign preferential tax regimes. Furthermore, anti-avoidance provisions relating to the participation exemption are laid

20 Report High Council of Finances, De hervorming van de vennootschapsbelasting: het kader, de inzet en de mogelijke scenario’s, April 2001, 115.
down in Articles 202 and 203 ITC. In addition, the Belgian income tax code contains three articles related to Transfer Pricing adjustments (Articles 26, 207 and 185 (2) ITC). Article 344 (2) ITC and the thin capitalization rules will be discussed below, as they bear the most similarities with a CFC regime²¹.

2. The “paper tiger” – disregarding asset transfers

2.1. Text of the article

11. Article 344 (2) ITC states the following: “The sale, transfer or contribution of shares, bonds, debt claims or other debt instruments, patents, manufacturing processes, manufacturing or trademarks, or any other similar rights, or money in cash to a taxpayer as defined in Article 227 [i.e. non-resident taxpayers] that, pursuant to the legislation of the country where they are established, are not subject to income tax or are subject in respect of the income derived from the transferred goods and rights, to a tax regime that is considerably more favourable than that applicable to similar income in Belgium, cannot be invoked against the Administration of Direct Taxes, unless the taxpayer proves either that the transaction meets legitimate financial or economic needs, or that he received for the transaction a real consideration producing income effectively subject in Belgium to a tax burden that can be considered normal in comparison to the one that would have been borne if the transaction had not taken place”.

12. This provision was introduced in 1954 and was substantially amended in 1973 and 1992. The purpose of Article 344 (2) ITC is to provide the Belgian tax authorities with a means to attack an international tax strategy when income generating assets are transferred to a non-resident taxpayer as a


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result of which the income can no longer be taxed in the hands of the
transferor, while the income is subject to a low taxation abroad. 22

2.2. Preconditions for application
13. Pursuant to Article 344 (2) ITC the tax authorities can disregard a sale,
transfer or contribution of certain assets (shares, bonds, debt claims or
other debt instruments, patents, manufacturing processes, manufacturing
or trademarks or money in cash) to a low-taxed non-resident person.
14. To be considered as “low-tax” it is required that in the country of
establishment the non-resident recipient is either not subject to income tax
or, with respect to the income produced by the transferred qualifying
assets, subject to a tax regime that is substantially more beneficial than the
tax regime that would apply to the income in Belgium. This “low-tax” test is
similar to that of Article 54 ITC, 23 which deals with the non-deductibility of
certain payments 24.
15. The condition that the non-resident recipient should not be subject to
income tax can relate to countries that do not levy any income tax, but also
to countries that do levy income tax but where the recipient as such is not
subject to income tax. It should be noted that taxpayers who are in
principle subject to taxation, but who do not effectively pay tax (as a result
of certain deductions, tax losses carried forward, exemptions, etc.) are not
targeted 25.
16. Furthermore, the “low-tax” test will be met when the income generated
by the transferred assets is subject to a substantially more beneficial regime

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23 Com.IB, n° 344/2.
24 Article 54 ITC reads as follows: “Interest, manufactured dividends, royalties for the right to use a patent, manufacturing processes and other similar rights or the remuneration for activities and services do not constitute deductible business expenses when they are paid, either directly or indirectly, to a taxpayer referred to in article 227 ITC or to a foreign establishment that, according to the laws of the country where they are established are not subject to income tax or are, with respect to the aforementioned types of income, subject to a tax regime that is substantially more beneficial in comparison with the tax regime applied to that type of income in Belgium, unless the taxpayer demonstrates, by means of any legally accepted means of evidence, that the payments are made with respect to genuine and sincere operations and do not exceed the normal limits.”

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abroad in comparison with the tax regime applied to that specific type of income in Belgium. There are no detailed guidelines indicating when income should be considered as subject to a “substantially more beneficial tax regime”. Taking into account the SIAT case of the CJEU, it is highly likely that Article 344 (2) ITC falls foul of EU law. In the SIAT case, the CJEU ruled that Article 54 ITC violated the EU freedom of services, due to the absence of clear rules to determine when income has to be considered as being taxed substantially more beneficially than in Belgium. By just referring to the level of taxation, the anti-abuse provision of Article 54 ITC does not provide sufficient guarantees that only wholly artificial arrangements fall within its scope. As indicated above, the wording of Article 54 ITC is similar to that of Article 344 (2) ITC. Hence, it can be assumed that the CJEU would apply the same reasoning when assessing whether Article 344 (2) ITC is compliant with EU law.

2.3. Applied concept of control
17. For the application of Article 344 (2) ITC it is not required that the Belgian entity controls or owns a certain interest in the non-resident taxpayer. The article also applies to non-shareholders of a foreign company. Hence, the scope of the Belgian provision is even broader than traditional CFC legislation.

2.4. Characteristics of involved subjects
18. The transferor should be an individual or a company resident in Belgium for income tax purposes or a non-resident owning income producing assets situated in Belgium. The transferee should be “a taxpayer as defined in Article 227 ITC”. This article defines and lists all categories of non-resident taxpayers, such as individuals, corporate entities, partnerships and

26 CJEU 5 July 2012, C-318/10, in curia.europa.eu.
associations (with or without legal personality), foreign governmental agencies and non-profit organizations.

2.5. Criterion to determine taxable amount

19. A question that remains unanswered to date is what amount of income should be attributed to the transferor and be taxed accordingly. There are several possible answers to this question: (a) the income produced by the assets before their transfer, (b) the income produced by the assets after their transfer, (c) the income produced by the assets that may have been required as a replacement of the assets initially transferred or (d) any income realized by the foreign entity after transfer of the assets. The predominant view seems to be that only the actual income produced by the assets initially transferred should be attributable to the transferor. Although this approach is in accordance with the text of the provision, it raises some intriguing questions, such as: What income should be taken into account when the initial assets are sold or disposed of and replaced by other assets that do not generate any income or generate income of a different nature and amount? How should the provision be applied in case of a transfer of money in cash, as this does not generate any income?

20. Due to these many unresolved questions and due to the fact that hardly any official guidance is available, the tax authorities seem to be reluctant to apply Article 344 (2) ITC in practice. If possible, they rather apply other anti-abuse provisions that do not disregard the transfer as such, but on the basis of which the arm’s length consideration for the transfer or for the subsequent payments (e.g. royalties, interest) is challenged. This is why the provision was aptly described as “a paper tiger” in Belgian legal doctrine. In the context of the ever-returning discussions concerning the introduction of a CFC regime in Belgium, Belgian legal scholars suggested starting with an examination of how Article 344 (2) ITC can be made more

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efficient, before considering whether to introduce new and even more complex CFC legislation.

2.6. **Criterion of attribution of taxable income**

21. Article 344 (2) ITC triggers a legal fiction as a result of which the assets transferred in violation of the provision are deemed not to have left the Belgian transferor’s estate, and therefore the assets and income remain attributed to and taxable in the hands of the transferor. Such direct attribution of the income to the transferor shows a strong similarity with CFC legislation based on a transactional approach.

2.7. **Avoidance of double taxation**

22. Pursuant to Article 344 (2) ITC the assets and income remain taxable in the hands of the transferor, which may lead to double taxation if the income is taxed abroad as well. It should be noted that the latter article does not provide relief for such double taxation.

2.8. **Right to prove the absence of avoidance purpose**

23. The Belgian transferor can avoid the application of Article 344 (2) ITC if he demonstrates (a) that the transfer is justified by legitimate financial or economic needs or (b) that he has received for the transfer an actual consideration generating income effectively subject in Belgium to a tax burden that is normal compared to the tax burden which would have applied if the transaction had not taken place. This ‘escape clause’ constitutes an alternative (and not a cumulative) burden of proof for the taxpayer: it is sufficient to demonstrate that one of the conditions is met.

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24. In case of doubt, a taxpayer can request an advance decision with the Belgian Ruling Commission to obtain confirmation that Article 344 (2) ITC is not applicable to a planned transaction.

2.9. Compliance with domestic constitutional principles

25. Article 344 (2) ITC is generally considered as being in accordance with the Belgian domestic constitutional principles, and more in particular with the principle of equality and non-discrimination and the principle of legality.

26. The principle of equality and non-discrimination is laid down in Articles 10 and 11 of the Belgian Constitution. This principle contains a double requirement: categories of persons in comparable situations should be treated equally and categories of persons in non-comparable situations should be treated differently. When assessing whether laws are compliant with the equality principle as laid down in the Constitution, the following criteria are taken into account: the objective character of the distinction, the adequate character of the measure in relation to the objective of the measure, and the existence of a reasonable relationship between the means employed and the intended objective of the measure.

When applying the aforementioned criteria, it can be concluded that Article 344 (2) ITC seems to be in accordance with the equality principle, as the differences in treatment are based on objective criteria and the proportionality test is met.

27. The famous adage "no taxation without representation" is enshrined in the Belgian Constitution. Article 170 of the Belgian Constitution states that no tax for the benefit of the State may be levied except by way of a law. It results from the legality principle that a fiscal debt can only be generated by law and not by a unilateral decision of the tax authorities, by a circular letter or by an administrative interpretation by the revenue authorities. Hence, nothing is taxable unless there is a statutory provision.

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40 So far only one ruling decision has been issued with regard to this provision: Ruling n° 800.456, 31 March 2009, www.monkey.be.
43 B. PEETERS, Het fiscaal legaliteitsbeginsel in de Belgische Grondwet: verstrakking of erosie?, in: B. PEETERS and J. VELAERS, (Eds.) De grondwet in groothoekperspectief. Liber
When testing Article 344 (2) ITC against the legality principle, the ‘escape clause’ should be addressed. The second part of the escape clause (actual consideration) seems sufficiently precise to be in accordance with the legality principle. With regard to the first part (legitimate financial or economic needs) of this clause, it should be noted that the Council of State expressed the concern that such vague terminology grants broad discretionary powers to the tax authorities, and hence, violates the principle of legality. However, according to legal doctrine on the matter, the legality principle is applied less strictly as a result of social and economic changes. Such evolution cannot be considered as a violation of the text of Article 170 of the Constitution. Furthermore, the legal uncertainty caused by the use of vague terminology, can be moderated by making use of the ruling procedure.

2.10. Compliance with the OECD MTC and EU law

28. As indicated above, although Article 344 (2) ITC is not a CFC rule, there are a number of similarities as to the purpose and the effect of both rules. As Belgium has made an explicit observation on the OECD Commentary indicating that it believes CFC legislation to be inconsistent with certain articles of the OECD MTC, it can be expected that, taking into account the principles of good governance, Belgium will respect its own observation and will refrain from applying a domestic provision with identical effects to a CFC rule in a tax treaty context. This can be assumed for the treaties signed after the observation was made, but also for the treaties concluded at an earlier point in time. In other words, as a matter of principle, Belgium should never apply Article 344 (2) ITC to transactions involving residents of states with which a tax treaty was concluded.

29. As regards the compatibility with EU law, we refer to the SIAT case as discussed in paragraph 0. Furthermore, it should be noted that, given its

46 L. DE BROE, International tax planning and prevention of abuse, IBFD Publications, 2008, 637. Making abstraction of the Belgian observation, a detailed technical analysis of whether Article 344 (2) ITC is consistent with the Belgian tax treaties can be found on pages 638-644 of the aforementioned publication.

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very broad wording, Article 344 (2) ITC is equally applicable in situations that cannot be considered as “wholly artificial” within the meaning of the CJEU case law referred to above. Therefore, it seems highly unlikely that the article can be considered as being in accordance with the freedom of establishment. When there is no controlling participation, the matter will be governed by the free movement of capital. Given the particularities of the measure, it can be expected that Article 344 (2) ITC also constitutes a breach of the free movement of capital that cannot be justified.

Apart from this, it should be borne in mind that Belgium has concluded tax treaties with all EU-member states. As Belgium should not apply Article 344 (2) ITC under its tax treaties, as discussed in paragraph 0, the article will hence never be applicable in an EU context. As Article 344 (2) ITC dates from before 31 December 1993 (last amended in 1992), there is no reason to examine whether the provision is in accordance with the free movement of capital in relation to third countries.

3. The thin capitalization provisions

3.1. 1:1 debt equity ratio - Interest paid to certain shareholders and directors

3.1.1. Scope of the Article

30. Pursuant to Article 18, 4° ITC interest earned on certain tainted debts (regardless of whether they are represented by securities) is treated as a deemed dividend distribution if and to the extent one of the following thresholds is exceeded: (a) the interest rate exceeds the market interest rate (Article 55 ITC) or (b) the total amount of the tainted loans exceeds

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49 Article 64 of the Treaty on the Functioning of the European Union (TFEU). It should be noted that the provision has been amended by a Royal Decree on 20 December 1996. However, this Decree only confirmed the existing measure and, rather than introducing a new discrimination in 1996, the Decree reduced the scope of the existing one. This leads to the conclusion that the 1996 amendment does not make the free movement of capital towards third States applicable. In this respect, see L. DE BROE, International tax planning and prevention of abuse, IBFD Publications, 2008, 956.
50 The requalification as dividend only applies to the excess amount. The remainder is considered as deductible interest.
the debtor’s combined paid-up capital at the end of the year increased with
the taxed reserves at the beginning of the year (resulting in a 1:1 debt
equity ratio)\textsuperscript{51}.

31. Tainted debts are considered to be (a) loans granted by individual
shareholders or by directors, managers, liquidators and persons exercising
similar functions within the company (b) loans granted by the spouse or the
dependent children of these persons (c) loans granted by non-resident
companies or (resident and non-resident) non-profit associations, provided
that such companies or associations perform functions of directors,
managers, liquidators and the like in the Belgian borrowing company.
Publicly issued bonds and similar debt instruments are excluded from the
list of tainted debt.

32. Hence, loans granted by Belgian companies do not fall within the scope
of this provision. Furthermore, the provision does not affect shareholder
loans made by non-resident companies/shareholders. The application of the
provision to non-resident companies can easily be circumvented altogether
because there is normally no need to appoint a (foreign) creditor as
director/manager of a Belgian company (nor even if he is a shareholder)\textsuperscript{52}.

33. The provision was introduced in 1992\textsuperscript{53}, and aims in part at avoiding
thin capitalization and in part at preventing a company from eroding its tax
base through the payment of excessive interest\textsuperscript{54}. As indicated in paragraph
0, the provision is of little relevance for cross-border operations and the
object of this study and will therefore only be touched upon briefly.

\subsection*{3.1.2. Compliance with the OECD MTC and EU law}

34. Article 18, 4° ITC is not in accordance with the arm’s length
requirement laid down in Article 9 (1) OECD MTC, given the application of
the low 1:1 debt/equity ratio that applies invariably to all Belgian
companies, regardless of the industry they operate in, their status or

\textsuperscript{51} The taxpayer has no right to rebut the application of the 1:1 ratio.
\textsuperscript{52} L. DE BROE, \textit{International tax planning and prevention of abuse}, IBFD Publications, 2008,
122-123.
particularities. The fact that the taxpayer has no right to rebut the application of the 1:1 ratio is an aggravating factor in this respect.\(^{55}\)

As to the question whether the Belgian domestic recharacterization of the excessive interest as a dividend also results in a qualification as a dividend for purposes of Article 10 OECD MTC, it should be noted that the Minister of Finance holds the view that any income treated as a dividend for the purposes of Belgian domestic law is to be characterized as a dividend under Belgian tax treaties.\(^{56}\) However, Article 10 (3) OECD MTC requires to this end that the income receives the same tax treatment as dividends and that the income is derived from other corporate rights in a company. As interest does not meet the last requirement (a debt claim does not qualify as a corporate right), recharacterized excessive interest should be considered as interest within the meaning of Article 11 OECD MTC. Nevertheless, such a conclusion is only valid to the extent the Belgian treaties follow the OECD MTC, as Belgium traditionally recorded a reservation on Article 10 (3) OECD MTC to ensure that interest taxed as dividend under Belgian domestic law falls within the scope of Article 10 OECD MTC. Hence, the question whether the recharacterized interest is considered as “interest” or “dividend” for treaty purposes, and each tax treaty should be considered individually.\(^{57}\)

Furthermore, the Minister of Finance stated that Article 18, 4° ITC does not violate Article 24 (4) and (5) of the OECD MTC.\(^{58}\) However, in many cases where the 1:1 ratio is applied, the application of Article 18, 4° ITC will constitute an infringement of Article 9 OECD MTC and Article 18, 4° ITC will be set aside by Article 24 (4) OECD MTC as it has a discriminatory nature (since it only applies to interest paid to non-residents).\(^{59}\) There is no consensus in Belgian legal doctrine on whether Article 18, 4° ITC violates Article 24 (5) ITC.\(^{60}\)


\(^{57}\) L. DE BROE, International tax planning and prevention of abuse, IBFD Publications, 2008, 528-535. The author distinguishes four groups of treaties and examines the applicability of Article 10 and 11 OECD MTC for each group in detail.


\(^{60}\) G. LOWAGIE and S. DINGENEN, Onderkapitalisatie van vennootschappen in W. MAECKELBERGH (ed.) Fiscaal Praktijkboek Directe Belastingen 1997-98, Diegem, ©Copyright Seast – All rights reserved
35. As regards the compatibility with EU law, it should be noted that in the *Lammers & Van Cleeoff* case\(^{61}\), the CJEU ruled that Article 18, 4° ITC represents an unjustified restriction of the freedom of establishment. The CJEU observed that interest paid by a Belgian resident company to a director company was treated differently depending on whether that company had its seat in Belgium. Consequently, companies managed by a director company non-resident in Belgium are subject to less advantageous tax treatment than companies managed by a company resident in Belgium. The CJEU noted that a restriction of the freedom of establishment could only be justified on grounds related to the prevention of abuse if it prevents the creation of wholly artificial arrangements that do not reflect economic reality and which are aimed mainly at tax avoidance. Since the provision goes beyond targeting non-arm’s length transactions, Article 18, 4° ITC was found to be incompatible with the EU freedom of establishment and, therefore, should not be applicable in the case of an EU (and EEA) corporate lender. However, Article 18, 4° ITC remains applicable within an EU/EEA context when it concerns individuals\(^{62}\).

### 3.2. 5:1 debt equity ratio – Interest paid to lenders enjoying preferential tax regime

#### 3.2.1. Text of the article

36. In 1996 a second thin capitalization rule was introduced in Article 198 (1) 11° ITC\(^{63}\). Pursuant to this Article, a 7:1 debt equity ratio applied if the creditor was exempt or taxed at a reduced rate in respect of the interest paid on the debt. Interest in excess of this ratio was considered as a non-

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\(^{61}\) CJEU 17 January 2008, C-105/07, in curia.europa.eu. See also: C. SANÒ, *Legal presumptions in national tax systems (Italy and Belgium) and in EU law*, PhD thesis. University of Antwerp – University Bologna, 2013, 392, sub. 3.2.2.2. (to be published).

\(^{62}\) For individuals, the national rule applies without distinction, i.e. without differentiating between residents and non-residents. For an analysis on whether such rule is compliant with EU law and with the Belgian constitutional principle of legality, we refer to: D. DE GROOT, *Het Belgische artikel 18, 4° WIB na twee recente arresten van het Europees Hof van Justitie*, TFR 2008, vol. 340, (439) 443-444 and L. DE BROE, *International tax planning and prevention of abuse*, IBFD Publications, 2008, 941-942.

deductible business expense. This rule was not applicable to intra-group loans.

37. In view of the announced reduction of the so-called “notional interest deduction” in 2012, it was feared that companies would set up thin capitalization constructions involving intra-group companies to reduce their taxable profit in Belgium. This is why Article 198 (1) 11° ITC was modified by the Law of 29 March 2012, introducing a 5:1 debt equity ratio and expanding the scope of the provision to intra-group loans.

38. Article 198 (1), 11° ITC now states that “notwithstanding the application of Article 54 and 55 ITC, interests from loans are not considered as tax deductible business expenses if and to the extent the total amount of such loans, other than publicly traded bonds or similar securities, exceeds five times the debtor’s combined paid-up capital at the end of the year increased with the taxed reserves at the beginning of the year when the beneficial owner of the interest (a) is not subject to income tax, or is subject to a substantially more beneficial tax regime for this type of income than would be the case in Belgium or (b) is part of the same group of companies as the debtor.” Article 198 (3) and (4) provide for certain exemptions to this rule.

66 The ruling commission confirmed that, when the total of taxed reserves results in a negative amount, the amount is considered as being equal to zero. Decision n° 2012.462, 18 December 2012, www.monkey.be. See K. WILLOQUÉ, Thin cap: negatieve belaste reserves tellen niet mee, Fiscoloog 2013, vol. 1352, 5.
67 It should be noted that Article 198 (3) ITC provides for an exemption to this rule for financial companies engaged in leasing of movable assets, real estate and factoring to the extent that the loans are effectively used for those activities and for companies carrying out a project under public-private cooperation obtained from the government through a tender. Furthermore, in Article 198 (4) ITC the rules are relaxed for group companies who, on the basis of an agreement, manage the daily cash pool of the group. For such companies, the interest paid on loans is equal to the positive difference between the interest paid on loans granted by group companies minus the interest received on loans granted to group companies (netting). The following types of interest received are not taken into account for a cash pooling company: (a) interest paid by financial institutions and factoring companies that are part of the group and are established in an EEA country and (b) interest paid by group companies not subject to Belgian corporate income tax or a similar foreign tax or established in a country where the common tax regime is substantially more beneficial than the Belgian common tax regime.


**3.2.2. Preconditions for application**

39. Article 198 (1), 11° ITC is applicable if and to the extent that the 5:1 debt equity ratio is exceeded and the beneficial owner of the interest meets the low tax test or is part of the same group of companies as the debtor.

40. The low tax test implies that either the beneficial owner is not subject to income tax, or subject to a substantially more beneficial regime for this type of income than would be the case in Belgium. Hence, the latter test is a test at income level and not at country level. In other words, the loan from a foreign company that, as an entity, is subject to normal corporate income tax, can still be considered as tainted if the interest itself is taxed substantially more favourably than in Belgium. It has not yet been clarified when a tax regime should be considered as “substantially more favourable than in Belgium” in the context of Article 198 (1), 11° ITC. It is uncertain whether the clarifications in the framework of the so-called “dividend received deduction” could be applied *mutatis mutandis*. This would imply that the tax regime applicable on the interest can be considered as “substantially more favourable” if (a) the nominal tariff on the interest income is lower than 15% or (b) the tariff actually applied on the interest income is lower than 15%. The tariff applicable on interest in the Member States of the EEA would then be considered not to be substantially more favourable than in Belgium. Strangely enough, the law provides this explicitly in the case of netting for cash pool companies.

**3.2.3. Applied concept of control**

41. As indicated above in paragraph 0 and 0, the 5:1 debt equity ratio applies among others when the beneficial owner of the loan is part of the same group as the Belgian debtor.

For the definition of a qualifying group, Article 198 (3) refers to affiliated enterprises in their entirety within the meaning of Article 11 of the Belgian

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69 This is the Belgian implementation of the parent subsidiary directive.


71 See footnote 67.
Companies Code ("BCC")\textsuperscript{72}. The concept of control as referred to in Article 11 BCC, is defined in Article 5 (1) BCC as the legal or factual competence to have a decisive influence on the appointment of the majority of the directors of another enterprise or on the orientation of its management.

Legal control is presumed to be irrefutable in the following circumstances:
- when the control stems from the ownership of the majority of the voting rights of the shares of a company;
- when a partner has the right to appoint or make redundant the majority of the directors;
- when a partner enjoys the competence to control the company in accordance with the articles of association or specific agreements concluded with the company;
- when a partner has the majority of the voting rights of the shares, based on an agreement with other partners; and
- in the case of joint control\textsuperscript{73}.

When the control follows from factors other than those mentioned above, the control has a factual character. In this respect, the partner is required to be able to influence decisively the orientation of the management of the company or the composition of the board of directors. There is a rebuttable presumption of factual control when a partner has exercised voting rights at the last two general meetings of shareholders that represent the majority of the voting rights connected to the shareholding represented at these general meetings of shareholders\textsuperscript{74}.

Furthermore, it should be noted that the concept of control includes direct as well as indirect control\textsuperscript{75}.

**3.2.4. Criterion to determine taxable amount**

42. When Article 198 (1), 11° ITC is applicable, this results in non-deductibility of the interest related to loans exceeding the 5:1 threshold.

\textsuperscript{72} Article 11 BCC states that the term ‘companies affiliated with another company’ is defined as (a) companies controlled by the latter company (b) companies controlling the latter company (c) companies the latter company forms a consortium with and (d) other companies that, to the knowledge of its management, are under control of the companies mentioned above.

\textsuperscript{73} Article 5 (2) BCC.

\textsuperscript{74} Article 5 (3) BCC.

\textsuperscript{75} Article 7 (1), 1° BCC.
3.2.5. Right to prove the absence of avoidance purpose

43. Under Article 198 ITC the taxpayer has no right to rebut the application of the 5:1 ratio. Hence, there is no possibility for the taxpayer to prove that, in his specific case, although the 5:1 ratio is exceeded, its debt level and the interest expenses still meet the arm’s length requirement.

3.2.6. Compliance with domestic constitutional principles

44. On 5 October 2012 the vzw/asbl "Liga van belastingplichtigen/Ligue des contribuables" filed a request for annulment of the new thin capitalization provision, stating that the amendments to this provision constituted a violation of the equality and non-discrimination principle as laid down in the Belgian Constitution (see supra paragraph 0). On 9 July 2013 the Constitutional Court ruled that the 2012 amendments to the Belgian thin capitalization rule are not incompatible with the equality and non-discrimination principle and rejected the request for annulment.\(^76\)

3.2.7. Compliance with the OECD MTC and EU law

45. Similar to what is stated above under paragraph 0 with regard to Article 18, 4° ITC, also Article 198 (1), 11° ITC cannot be considered in accordance with the arm’s length requirement laid down in Article 9 (1) OECD MTC, given the application of the 5:1 debt equity ratio that applies invariably and irrefutably to all Belgian companies, regardless of the industry they operate in, their status or particularities.\(^77\)

With regard to Article 24 (4) and (5) of the OECD MTC it should be noted that the provision applies irrespective of the residence of the beneficiary and the borrower. Hence, Article 198 (1), 11° ITC cannot be said to be incompatible with the aforementioned Article of the OECD MTC.

46. As regards the compatibility with EU law, reference can be made again to the SIAT case.\(^78\) Similar to Article 54 ITC, the conditions for deduction

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\(^76\) Constitutional Court, n° 104/2013, 9 July 2013, B.S. 16 September 2013. For a detailed analysis of the decision in English, see R. OFFERMANS, Constitutional Court: 2012 changes to thin capitalization compatible with Belgian Constitution in IBFD Country Analyses – Belgium – Corporate Taxation, www.ibfd.org.

\(^77\) N. BAMMENS, Het nieuwe onderkapitalisatieregime van artikel 198, §1, 11° WIB, TFR 2012, vol. 430, (914) 920.

\(^78\) See paragraph 16.
under Article 198 (1), 11° ITC are stricter than the general deductibility conditions laid down in Article 49 ITC. Moreover, where in the case of Article 54 ITC the taxpayer can deliver counterproof, this is not even possible in the framework of Article 198 (1), 11° ITC79. Furthermore, there is considerable uncertainty about when a regime can be considered as “substantially more favourable”. Given the above, it can be assumed that the CJEU will consider the second thin cap rule to fall foul of EU law.

With regard to netting for cash pool companies, the law provides that the commonly applicable tax rules in the EEA Member States cannot be considered as substantially more beneficial than Belgium. The question arises whether the exclusion from the netting of interest from a third country that is not an artificial construction, but which has a substantially more beneficial tax regime, could be considered as contrary to the freedom of capital80.

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79 C. SANÒ, o.c., 436, sub 3.3.1.2.2.