BJA Legal & Tax Committee

Position Paper on Belgian Corporate Income Tax Reform

25 July 2016

1. Introduction: setting the scene

On the occasion of the 2016 budget control, the Belgian federal government agreed on 9 April 2016 on the principle of a corporate income tax ("***CIT"***) reform. According to the budget control notifications, the Finance Minister is requested to propose, by 30 September 2016, alternatives to reform the CIT regime, allowing to address the challenges facing the country's competitive position.

Having an attractive CIT system - for both SMEs and MNEs - is one of the fundamental cornerstones of a strong business and investment climate, which particularly allows open economy countries such as Belgium to maintain employment and economic growth.

The Belgian CIT system has always been characterised by a high nominal tax rate (currently 33.99%). This high nominal rate is only relative, as the effective tax rate - depending on the company's profile - can potentially be reduced by making use of a number of important tax incentives, which have traditionally allowed the Belgian CIT regime to positively distinguish itself from the CIT regimes of countries with which Belgium competes for direct investment. However, this conclusion no longer holds, considering that some Belgian tax incentives are losing their attractiveness and that competitor countries continue actively promoting their tax climate. In times where actions against 'aggressive tax planning' are flourishing (*cf*. the OECD's BEPS project and related EU initiatives such as state aid investigations and a proposal for Anti Tax Avoidance Directive), MNEs actively question the location of their economic activities and it can be expected that Belgium will face challenges to retain and/or attract regional headquarters of MNEs and economic investments in the future if the Belgian CIT system is not reformed efficiently.

Recent changes to the Belgian holding company tax regime (introduction of 0.412% tax on capital gains on shares, introduction of 5:1 thin cap rule on inter-company loans, introduction of fairness tax) and the absence of a 100% participation exemption for dividend income (only 95% dividend-received-deduction) have rendered Belgium less attractive as a regional headquarter / holding location compared to other EU Member States (e.g. Ireland, Luxembourg, the Netherlands and the UK).

In addition to the recent corporate tax changes the impact of the Sixth State Reform on the Expatriate Tax Regime may further reduce Belgium's competitiveness for hosting headquarters. This Sixth State Reform will furthermore significantly increase the administrative costs of payroll and tax compliance for expatriates.

This position paper outlines how the BJA Legal & Tax Committee believes – following a consultation with its members, i.e. Japanese MNEs investing in Belgium – the Belgian CIT regime should ideally evolve in order to deal with these challenges and in order to remain competitive for retaining and attracting regional headquarters of (Japanese) MNEs in Belgium.

These CIT reform measures should furthermore be adopted within a broader framework of increasing legal certainty and predictability, so as to ensure that corporate taxpayers can accurately plan their activities, employment and investment strategies in the long term.

Finally, these CIT reform measures should simplify the CIT regime in view of reducing the CIT compliance cost of companies doing business in Belgium.

2. BJA vision on Belgian corporate tax reform

In order to strengthen the competitiveness of Belgium for retaining and attracting foreign direct investment, the BJA Legal & Tax Committee believes that the strategic focus of the CIT reform should be on realising a significant tax rate reduction in combination with (continued) support of innovation, investment & employment and with a simplification of the CIT regime.

2.1. A competitive corporate income tax rate is a prerequisite

In Belgium, corporate profits are subject to tax at a *nominal* rate of 33.99%, which significantly exceeds the statutory rates in the Netherlands (25%), Ireland (12.5%), the UK (20%), Luxembourg (29.22%) and Switzerland (7.83%, to be increased with cantonal and municipal taxes). As regards the UK it should furthermore be noted that a further reduction to 17% is foreseen for 2020 and that in the context of Brexit a further reduction to 15% has been announced. As regards Luxembourg it should be noted that a Luxembourg corporate tax reform has been announced reducing the statutory CIT rate to 27.88% in 2017 and to 26.01% in 2018.

In order to improve the competitiveness of the Belgian CIT regime, the statutory corporate income tax rate should be reduced significantly. In order to send a powerful message to Japanese and other foreign investors the Belgian statutory CIT rate should be reduced to maximum 20% by 2020.

The assessment of the net budgetary impact of such a considerable reduction of the corporate income tax rate may be a complex exercise. Guidance may be found with other European countries that have transitioned from a relatively high corporate tax rate in the recent past. The UK could be a good example since it successfully combined a gradual but substantial reduction of its corporate tax rate with the introduction of additional measures to improve investment climate (such as patent box regime, participation exemption, relaxation of CFC rules, etc.).

The broadening of the corporate tax base following the implementation of BEPS and EU measures will compensate for any negative revenue effects of such a statutory rate reduction.
The measures that have been (or are being) proposed by the OECD and the EU (such as transfer pricing (documentation) rules allowing the Belgian tax administration to accurately enforce the arm's length standard, an interest deductibility limitation, anti-hybrid rules, CFC rules, an exit tax, anti-avoidance rules in Belgian domestic tax law and double tax treaties, etc.) are intended to significantly increase global tax revenues. The Belgian government budget will obviously considerably benefit should Belgium implement (some of) these measures. This will create room for, e.g., a tax rate reduction to compensate for any loss of competitiveness.

2.2. Taxation of income from shareholdings

The taxation of dividend income and capital gains on shares are important drivers for holding company location decisions, which is generally considered to bring about positive externalities (e.g., triggering the location of headquarter functions and decision centres at the same location, even more so in these current times of ever increasing demand for economic substance).

To improve the investment climate and to retain and/or attract holding (and hence headquarter) companies and decision centres, Belgium should *(i)* move from a 95% to a 100% dividend-received-deduction regime, *(ii)* abolish the 0.412% taxation of capital gains realised by MNEs on shares; and, *(iii)* abolish the fairness tax. We believe that the abolition of such measures will have a negligible impact on the state budget, whilst having a significant return on investment in terms of stimulating direct and indirect employment.

These existing measures create an unfavorable perception of unnecessary complexity, making Belgium less attractive compared to countries typically competing for the location of holding company and regional headquarters such as the UK, the Netherlands, Luxembourg, Ireland and Switzerland. The introduction of a full participation exemption and the abolition of the fairness tax would definitely make Belgium more competitive in retaining and attracting holding companies and linked thereto, decision centres.

2.3. Existing tax incentives should be maintained

Specific tax incentives should remain in place, if only from a reputational point of view as a reliable and stable investment location. In addition, these incentives are key for a number of sectors and investors that make a considerable contribution to the local economy. They contribute to the country's overall image as investment friendly location.

2.3.1. Notional Interest Deduction

The Notional Interest Deduction ("NID") has seen its impact (even for quite a few of the finance and treasury companies) on the effective tax rate greatly reduced because of the low interest rate on the ten year government bonds. Enhancing the measure to restore its positive impact on the effective corporate tax rate should not be a priority considering the substantial headline rate reduction requested. At the same time and given its BEPS and state-aid proof character, keeping the measure is strongly recommended so as not to (further) jeopardize the country's reputation as a stable and reliable investment climate and to accommodate the gradually decreasing but still significant number of Belgian treasury centres (to whom the Notional Interest Deduction regime was offered as an attractive regime after abolition of the coordination centre regime, and which historically generated significant parallel investments into broader investment and decision centres in Belgium).

As regards NID it should furthermore be noted that Italy recently introduced a notional interest deduction regime and that also Switzerland foresees introduction of a notional interest deduction regime at the discretion of individual cantons within the context of the Swiss Corporate Tax Reform.

Given the introduction of NID regimes by competitor countries it would not be wise to abolish the Belgian NID regime.

2.3.2. R&D Tax Incentives and Patent Income Deduction

The Patent Income Deduction ("PID") will be adjusted to be in line with the "Modified Nexus Approach" as agreed by the OECD and European Commission. This clear legal framework of acceptable specific tax incentives should be implemented to the fullest extent possible within the allowed scope.

To retain, and even improve, the attractiveness of the PID regime, Belgium should make maximum use of the available options under the Modified Nexus Approach, such as *(i)* extending the qualifying IP rights to a

broader scope of IP assets; *(ii)* extending the qualifying IP income to capital gains on qualifying rights as well as compensation for damages; *(iii)* having the benefits of the regime kick-in at the moment of application of the IP right; *(iv)* increasing the percentage of the exemption from 80% to 90% or ideally 100%; *(v)* providing for a carry-forward mechanism; *(vi)* not providing for a recapture mechanism of historic R&D expenditure before the benefit of the regime kicks in; *(vii)* ensuring R&D expenditure incurred in foreign branches is regarded as qualifying expenditure; and, *(viii)* grandfathering the application of the old PID regime until the final date of 30 June 2021.

2.3.3. Expatriate tax regime

In addition to a competitive CIT regime, the Belgian expatriate tax regime is very important to retain and attract regional headquarters, centres of excellence and decision centres. Without expatriate tax regime the cost of key functions employed within (regional) headquarters, centres of excellence (e.g. R&D centres) and decision centres would no longer be competitive in Belgium.

The continuation of the existing expatriate tax regime in its current form will therefore be essential to have a competitive labor cost for (regional) headquarters, centres of excellence and decision centres.

2.4. Implementation of BEPS and EU initiatives

The BJA welcomes the work done by the EU and OECD in the area of taxation but believes that Belgium should adopt a '*wait and see*' attitude to see how other countries' CIT legislation changes as a result of the BEPS project and related EU developments; and, that Belgium should in any case not (unilaterally) introduce measures that are not 'minimum standards' in the BEPS project or mandatory under EU law.

More specifically as regards the proposal for an Anti Tax Avoidance Directive ("ATAD"), the BJA believes that Belgium should implement all the optional derogations regarding the limitation of deductibility of interest expenses.

3. Conclusion

The BJA and the Japanese companies doing business in Belgium welcome the contemplated CIT reform. It will be essential that such CIT reform will reinforce the competitiveness of Belgium for keeping and attracting regional headquarters and investments of multinational enterprises.

The BJA would also like to express that it appreciates the measures already taken by the government to reduce the wage gap with our neighboring countries and that the BJA would like the Belgian government to continue improving the competitiveness of labor costs in Belgium.

The BJA welcomes the opportunity to work together with the government for the better of the country and would like to have a meeting with the Minister of Finance to discuss the priorities of Japanese companies doing business in Belgium in greater detail.

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