COUNTRY DIGEST

News Analysis: New Developments For Belgium's Dividends Received Deduction

The Antwerp Court of Appeal recently rejected a Belgian company's claim that the participation exemption (the Belgian dividends received deduction) conflicts with the EU parent-subsidiary directive. Meanwhile, the Belgian government has introduced a bill in Parliament that would further ease restrictions of the participation exemption.

The EU Parent-Subsidiary Directive

The EU parent-subsidiary directive[1] was adopted over 20 years ago to set up a common system of taxation for dividends (and other profit distributions) paid by a subsidiary in one member state to its parent company in another member state. The directive ensures the fiscal neutrality of such payments.

In particular, the member state of the subsidiary must refrain from withholding tax as long as its parent company holds a participation of 10 percent, and the member state of the parent company must take measures to eliminate double taxation. Double taxation can be eliminated by granting the parent company either a tax exemption for the distributed profit, or a tax credit for the corporation tax paid by the subsidiary (and any lower-tier subsidiary) on those profits. Nevertheless, the member state of the parent company may disallow a fixed amount of the management costs relating to the participation, with a maximum of 5 percent of the dividends.

Belgium implemented the parent-subsidiary directive by adapting its participation exemption regime[2] to comply with the directive. If the parent company holds a participation that is at least 10 percent of the subsidiary's nominal share capital, dividends are eligible for a 95 percent exemption. The participation exemption is also granted for shareholdings that are less than 10 percent but have an acquisition value of €2.5 million or more.

Moreover, the shareholding must be held in full ownership for a period of one year without interruption, and it must be recorded as a fixed financial asset in the company's financial statements.

Recent Developments

Belgium changed its rules in 2005 following a complaint by the European Commission that the Belgian participation exemption was incompatible with the parent-subsidiary directive. Belgium subsequently allowed the deduction of dividends received from EU subsidiaries from disallowed expenses.

At the end of 2009, Belgium changed its legislation again to comply with the European Court of Justice decision in *Belgium v. Cobelfret NV*. The court found that the method imposed to compute the tax liability of the parent company did not always give the parent company the full benefit of the participation exemption. (For the decision, see *Doc 2009-3117* or *2009 WTD 28-17*.)

That is why, effective from 2010, Belgium lifted the law's restriction on setting off dividends received from subsidiaries in EU member states against some disallowed expenses. The changes also allowed any excess dividends received from those subsidiaries that could not be deducted to be carried forward. (For prior coverage, see *Doc 2010-1200* or *2010 WTD 13-5*.)

[1]Council Directive 90/435/EEC on the common system of taxation applicable in the case of parent companies and subsidiaries of different member states, as amended by Directive 2003/123/EC of Dec. 22, 2003, [2004]. OJ L 7/41.

[2]The name given in Belgium is deduction for *revenus définitivement taxés* (definitively taxed income). It is also designated as the dividends received deduction because the parent company can deduct the 95 percent of the dividends received from a subsidiary that falls outside one of a set of specific antiavoidance exclusions. In practice, this means that the subsidiary must meet a ''subject-to-tax'' condition.

(Footnote continued in next column.)

Bill 53/1208

The requirement that the shareholding must be recorded as a fixed financial asset in the company's financial statements has been challenged by the European Commission. (For the commission's request, see *Doc 2009-25698* or *2009 WTD 223-20*.)

On February 11 the government submitted Bill 53/1208 to Parliament to abolish that requirement. The bill would also extend the benefit of the full participation exemption to dividends from subsidiaries in member states of the European Economic Area instead of just EU member states. In practice, this means subsidiaries in Iceland, Liechtenstein, and Norway.

Belgian parent companies would be entitled to set off the participation exemption for dividends originating in those countries against some disallowed expenses, and excess of the dividends received deduction could then be carried forward. Moreover, if a subsidiary in one of these countries is merged into a Belgian parent company, the merger must be neutral and the parent company would be entitled to a 100 percent deduction for the liquidation bonus received in the merger.

The 95 Percent Limitation

The only remaining restriction on the Belgian deduction of dividends received is the 95 percent rule. That was challenged by a Belgian parent company that had received dividends in 2002 from a U.K. subsidiary. In 2002 the rule was still that dividends could not be set off against certain nondeductible expenses. The company complied with that rule and limited its deduction of dividends.

When the law was changed in 2005, the company raised an appeal. Both the tax authorities and the Antwerp Court of First Instance rejected the appeal on the ground that a taxpayer is bound by the tax return that it filed, which was based on, and in accordance with, the law applicable at the time it was filed.

The Court of Appeal on January 18 held that the taxpayer can appeal against an assessment that was based on a tax return it has filed if it can prove that it had made a mistake in the application of domestic or EU legislation. The court granted the company's claim and reduced the tax assessment because the setoff of dividends against disallowed expenses was granted in 2005. The taxpayer received the additional deduction resulting from the setoff of dividends against disallowed expenses.

However, the taxpayer raised another argument: that the 95 percent limitation of the participation exemption was incompatible with article 4, paragraph 2 of the parent-subsidiary directive. That provision allows each member state:

> to retain the option of providing that any charges relating to the holding and any losses resulting from the distribution of the profits of the subsidiary may not be deducted from the taxable profits of the parent company. Where the management costs relating to the holding in such a case are fixed as a flat rate, the fixed amount may not exceed 5% of the profits distributed by the subsidiary.

The company argued that the Belgian participation exemption appears to comply with the directive but that the Belgian Income Tax Code does not indicate that ''any charges relating to the holding, and any losses resulting from the distribution of the profits of the subsidiary, may not be deducted from the taxable profits of the parent company.'' The code simply limits the deduction of 95 percent irrespective of whether the company has any such charges or losses, the company said.

The court referred to the history of the participation exemption and the discussions in Parliament on successive bills. Citing the parliamentary minutes, the court noted that Belgium has always limited the participation exemption to 95 percent (and, for a period from 1988 to 1991, to 90 percent) because of the costs related to the management and administration of the holding. Thus, it is not just a 95 percent limitation. Therefore, the limitation is not contrary to the parent-subsidiary directive, the court said. ◆

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