

THE INTRODUCTION OF THE CONCEPT OF "NOTIONAL INTEREST DEDUCTION" INTO BELGIAN TAX LAW

1. Introduction of notional interest deduction confirmed

On 4 March 2005, The Belgian Government reached an agreement on the concept as regards the introduction of a notional interest tax deduction for risk capital into Belgian tax law.

The proposal introducing this innovative measure would amend Belgian tax law so that Belgian tax resident companies and Belgian branches of non-resident companies can claim a tax deduction for their cost of capital by allowing them to deduct a notional interest at a rate calculated on the aggregate amount of their equity including retained earnings.

The Belgian Government stressed in particular that a strict timetable would be followed. Belgian Parliament should pass the Bill before its summer recess, i.e. in principle by 30 June 2005. The entry into force is foreseen as from **assessment year 2007** (i.e. financial year endings as per 31 December 2006 or later).

2. The "alternative" for the Belgian Coordination Centers

By introducing the measure, the government is seeking **equal treatment** between equity and debt financing, which would give companies an incentive to finance their investments through equity and therefore to strengthen their capital structure.

In addition, this innovative measure should be a solution for Belgian Coordination Centres whose royal decree elapses as of 31 December 2005.

Belgian Coordination Centers have, for many years, been a successful way of attracting multinationals to centralize in Belgium shared functions (including finance) on a pan-European basis. However, due to developments within the EU tax scene, the Belgian Coordination Centre regime is destined to disappear at the latest by 31 December 2010.

The notional interest deduction would be compliant with EU "state aid" rules, as it will be accessible to all Belgian tax resident companies and Belgian branches of non-resident companies.

3. Main features of the notional interest deduction regime

Under the proposed new rules, Belgian corporate income taxpayers will be allowed to claim tax-wise a notional interest deduction reflecting the economic cost of using capital, equal to the cost of long-term, risk-free financing.

Reference is made to 10-year Belgian government bonds, which, as things currently stand, would amount to approximately **3.7%**. The interest rate as per 31 December 2005 would be used as reference for the first three years. After the initial three-year period, the interest reference rate would be established for a new period of three years.

Small and medium-sized companies would be allowed to raise the interest reference rate by 0.5%. However, these companies would have to make the choice between the current system of the investment reserve and the notional interest deduction. They would not be allowed to apply both incentives.

As for determining the basis on which the interest is calculated, certain adjustments need to be made (the most important one aims at avoiding double use and abuse).

In terms of eligible entities and allowed activities, no restrictions will be imposed.

The tax benefit resulting from the notional interest deduction could be carried forward for seven years, if there is insufficient tax capacity in the year of deduction. However, in order to benefit from the notional interest deduction, the amount of the granted notional interest deduction should remain within the company for at least three years.

No (advance) ruling would be required for its application.

The Belgian Government also announced that the 0.5% registration duty on capital contributions would be abolished as of 1 January 2006. As per today this registration duty is still due upon incorporation of the company and in case of an increase of the company's share capital.

4. Opportunities for MNE

Just as Belgian Coordination Centers have proved to be a success for a fair number of US-based multinationals as well as a growing number of European and Asian groups over the past decades, this measure will undoubtedly raise **Belgium's profile** on the international tax scene.

- The measure will provide a smooth transition for existing Belgian Coordination Centers whose rulings lapse within the next few years. This will avoid migrating finance operations from their current centre of excellence and central location in Europe, in Brussels.
- The measure will attract new group financing vehicles as it allows for an EU-proof, financing structure, whereby equity is injected into a 'common' Belgian company by a group (EU intermediary) holding company so as to leverage other operating companies.
- The measure will also be attractive for new, equity-maximized investments into Europe in general.

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