

Pricing Knowledge Network

Focusing on the impact of major intercompany pricing issues

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PKN Alert Belgium - New draft legislation on Belgian thin cap rules has been published and potential changes have been announced

A Transfer Pricing
Publication

Current rules

Belgian tax law currently does not have a general thin capitalisation ("thin cap") rule. A specific thin cap rule exists for interest payments or attributions to (real) beneficiaries taxed at low rates on that interest. This is referred to as the "7/1 debt-equity ratio" (art. 198, 11° of the Belgian Income Tax Code).

Another specific 1/1 thin cap rule for payments to specific persons (e.g. directors of the company) currently exists (art. 18, 4° of the Belgian Income Tax Code).

New rule

According to the draft Act, the 7/1 rule will be replaced by a new rule that introduces a (general) 5/1 debt-equity ratio.



For the purposes of the thin cap rule, equity is defined as the sum of the taxed reserves at the beginning of the taxable period and the paid-up capital at the end of the taxable period.

For the purposes of the thin cap rule, debt is defined as:

- all loans under which the beneficial owner is not subject to income taxation or, with regard to the interest income, is subject to a tax regime that is substantially more advantageous than the Belgian tax regime;
- all intra-group loans (where "group" should be interpreted in accordance with article 11 of the Belgian Companies Code).

Bonds and other publicly issued securities are excluded, and so are loans granted by financial institutions.

Interest payments or attributions in excess of the 5/1 ratio are not tax deductible. The new thin cap rule is generally not applicable to loans contracted by leasing companies or factoring companies within the financial sector insofar as the borrowed funds are actually used for leasing and factoring activities.

An anti-abuse rule is introduced stating that, where the loans are guaranteed by a third party or where the loans are funded by a third party that partly or wholly bears the loan-related risk, the third party is deemed to be the beneficial owner of the interest if the guarantee or the funding has tax avoidance as its main purpose.

Potential changes to the proposed new thin cap rule

Currently, no exception to this thin cap rule has been included for finance companies or companies that perform (zero balancing) cash pool activities.

Shortly after the publication of the draft legislation, it was announced that, after discussion with certain stakeholders, the Belgian government had decided to revisit these rules in order to determine whether they should be adjusted to accommodate finance activities in Belgium. The reason for this was that, strictly interpreted, the wording of the initial draft legislation would – unintentionally – have caused many intercompany finance activities to fall within the thin cap scope. The announced amendment would aim to remedy this.

New draft legislation is expected mid-2012.

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